DIALOGUE

Lawrence L. Grypp, CLU®, ChFC®, is president of the University of Cincinnati's Goering Center for Family and Private Business and Co-founder of the Center for Executive Transitions.

Larry.Grypp@wcinput.com

Michael A. Hirschfeld, Esq., is a partner in Graydon Head & Ritchey, LLP, with over 37 years practicing law and counseling family and closely held businesses.

Michael.Hirschfeld@wcinput.com

Family Business Dynamics

An Interview with Larry Grypp and Michael Hirschfeld, Esq.

By Stephen D. Tarr, MSM, CLU®, ChFC®, CASL®, CAP®

Learn about the intricacies of communication within a family business.

So that we have a level playing field for our advisors, how do you define a family business?

Larry: There are many ways to define family businesses. At the Goering Center we choose to use the definition developed by Harvard Business School. That is, where two or more related individuals own, lead or make the major decisions for a company. Now, that could be everything from a mother and her son on through to Ford Motor or Walmart.

We hear a lot about the significance of family businesses on our GNP. What's the real impact?

L: There are about 5.5 million family firms in the United States, and they're 83 percent of the work force, Steve, but more importantly, they represent 78 percent of the new jobs in our country. It's dramatic. Many of the Fortune 500 companies, about 35 percent of them, are family owned, too. It's a significant contribution—and growing—in our economy.

Do we have any idea as to where this growth is coming from?

Michael: As Larry indicated, about 78 percent of new jobs are developed by family businesses. An interesting statistic is that within the last five years there's been a 37 percent increase in women-owned family businesses, and experts are talking about roughly a $10 trillion wealth transfer in family businesses in the next decade. This represents a lot of activity and a lot of growth opportunities for advisors.

What is the survival rate of a family business?

L: Often the question is, "How do family businesses endure?" Are they there generation to generation? John Ward, who was a professor at Loyola University in Chicago, did a landmark study of this and indicated that about 30 percent of family businesses made it to the second generation. And then approximately 10 to 12 percent made it to the third generation, and only 4 percent to the fourth generation. Now, that doesn't mean that they were failures. They could have been merged in with another company or liquidated, sold to a competitor—but those are the fundamental facts of how family businesses go, generationally.

From your research, have you determined some best practices for family businesses to help them endure?

L: If we looked at the family businesses that endured into the third generation and prospered, there are some themes. One is around communications within the business, but also communication among the business family. There are best practices concerning having a family constitution as it applies to the business; also a family charter. And then having a family council—particularly when you're in the second or third generation and the shares get disbursed among various families, it becomes even more important. Then there's the concept of plans: strategic plans, annual business plans, contingency plans, a retirement plan and, of course, an estate plan for the principals. Those are the most common characteristics.

Tell us more about how these businesses are going to be transitioning over a period of time.

M: Experts are saying there'll be roughly $10 trillion worth of wealth transfer in the next decade, and I think most family businesses don't plan—about three-fourths fail to transition properly. The real key is not necessarily the normal things we think about having: an estate plan and a funded buy-sell agreement. Maximizing wealth isn't the ultimate answer. What's going to happen to that wealth, and what's going to happen to the people who receive it? Those businesses that follow some of the best practices Larry talked about, that put into place processes and procedures to deal with those issues, are most likely to be able to succeed. The No. 1 issue that most family business owners have identified—that's the most critical concern and the most immediate concern—is resolving conflicts among family members in the business. So having an effective system to be able to deal with that and a culture that allows for those kinds of issues to be addressed is critical.

So, what you're saying is, it's not about the quantitative; it really has to do with understanding the different roles.

M: If you look at the statistics, 85 percent of business and wealth transfers fail because of inadequately prepared heirs or a breakdown in communication and trust within the family. Less than 50 percent of the failures are because we didn't work out all the tax planning and estate planning. It's that you have to adequately prepare the next generation to be able to take over, and there hasn't been adequate communication within the family.

L: Documents and the plans need to be done. They're important.

“If you look at the statistics, 85 percent of business and wealth transfers fail because of inadequately prepared heirs or a breakdown in communication and trust within the family.”

However, the issues that have been identified through the current research are trust, communication and having leaders ready to take over the family business.

You talk about communication and communicating effectively. Let’s dig in deeper.

M: The real key is communication, both within the family unit as well as outside the family unit. Are you communicating clearly to the rest of the business stakeholders? That includes being clear, direct, open and consistent in the communications you have. If you ask most business owners, they’ll typically say, “Well, my employees, my family, know what I want to have done.” If you ask the family and the employees, they’ll say, “We don’t have a clue.” So having a process in place to be communicating clearly is very critical.

L: For example, at the Goering Center, we’re a nonprofit organization affiliated with a major university. And the biggest thing that we do for our members through our education, training and connecting program is bring them into a safe environment where they can communicate with each other. And we bring topics to the table that enable the communication that Mike’s talking about. It’s critical for your advisors out there—not just in their silo specialty—to do the good work, but also to encourage that communication occurs with the other professionals, with the family members and with the extended family.

M: These are not easy conversations to have. They’re much easier when you’re talking about them as hypotheticals as opposed to when you’re actually faced with a situation and emotions and family members who may not be involved in the business who you now have to deal with.

I know you talk about this idea of family council meetings, which I think is quite interesting.

M: Because you will have both active and passive members within the family, some of the owners have nothing to do with the daily operations of the business. You’ll also have the in-laws and the outlaws, those who are direct family members and those who are sitting on the outside, usually finding something to harp about. Have a communication process where you use a family council gathering principally to educate—it’s not intended to be a business decision-making session. Use it as a forum to pass along information about your particular business, the industry in general, good business practices and how you’re tying in those. Pass along family values; family history. You’re telling the story of why this business is important, why you do what you do with it, to have the next generation learn directly from the people who have enough passion about it. It’s really important to make sure that those values get passed along—[that family members] have acceptance and alignment and understanding of why things are done the way they are.

L: Mike is talking about communication of the information, the culture, the tradition to family. Then you have the governance structure, and that can be very different but include overlapping with some of the same people doing the communication and being communicated to. That’s where great advisors—be they from the financial services and insurance industry, accountant, attorney [or] a bank trust officer—can enable those discussions.

M: It’s also a great opportunity to recognize various roles. In a family business you’re wearing many hats. And getting people to understand the various rights and responsibilities of each of those roles is really important. You know, good managers know how to do things right, whereas good leaders know how to do the right things. And again, the family council can be an important way to help pass along some of those critical leadership principles.

How do you get a family to create those guiding principles and actually live by them?

M: It can be a fascinating process, and I've seen it done lots of ways. When we're talking about guiding principles, these are meant to be more of the "30,000-feet" kind of general principles. For example, only one of us will speak at a time. We will not talk over each other when we are having a gathering. You can also lay out some things: What are the expectations for one of the family members who wants to come into the business? Do you need a college degree before you're able to enter? Do we allow every kid to have a summer job while they're in high school? Or do we require you, before you're able to take more of a permanent position within the company or a position of responsibility, to go out and have experience elsewhere for three to five years? Do we have a rule that says you don't report to any family member? Having those discussions makes it a lot easier when Cousin Larry says, "My kid's ready to graduate from college next month, and I know you've got a job for us, don't you?" Having those kinds of conversations about general protocol and rules is very useful.

I can understand that. I love my brother dearly, but if our family got in a room together, I'm not sure we'd all see eye to eye.

L: We have one member of the Goering Center, on the issue of family employment, the member company is run by three brothers who are third generation, and they agreed to have a family charter and communicated to their children that none of their children would be employed. They were not going to hire family members any longer. But it's fair for those children to know that they will not be going through college with the expectation that they have an opportunity in the family business. On the other hand, we had one of our members—a nice business, 1,100, 1,200 employees—say to family members, "If you want to be in management in this company, then you need to graduate with either an engineering degree or a business degree. Then you need to go out and work for at least one other company for five years and get a promotion during that five years." They didn't want people just biding time for five years and not learning and contributing out in society. Having those guidelines set up really enables good conversations and then [the ability] to carry out the business itself.

That's an excellent point. I know that this also involves trust—what should the family leader focus on?

M: In my mind, trust has really three components: a reliability that you do what you say you will do, a real sincerity that you mean what you say and that you will accomplish what you say.

L: I heard it expressed one time during my corporate years—the leader's primary roles are to set and execute a strategy and to develop leaders for the future. I don't think that's any different for a Fortune 100 company than it is in a family business. So that leader of that family business, whatever generation he or she is in, needs to have that strategy articulated, communicated, measured, and then also to be developing the next generation of leaders, be they family members or not.

M: That's a great point, because we all know that leadership development takes generations. This isn't going to happen overnight, and just because someone happens to be an heir or blood doesn't mean they've immediately inherited the right skill set to be able to do everything. Having those opportunities, building those values early on and later on continuing to build competency as they grow into their role is very critical.

What are some other areas that you observe that cause a family business to self-destruct?

L: The common one that we see through our education program is this differing of priorities of family members, of what they expect of the business and what they expect of different family members. I think when those become hidden and defused you have a degradation of the entire enterprise and the relationships within the family.

M: I would agree completely with that—expectation setting and whether people are aligned in that regard. And it goes further throughout the family unit—are in-laws, children and others on the outside aligned as well?

How do you think we can get the advisor to be more sensitive and more helpful in terms of family businesses?

M: I think part of it is to be able to work with organizations like the Goering Center. Most wisdom comes from making mistakes and having spent time in organizations and having seen wonderful tax planning, estate planning, insurance planning not work properly is a very frustrating experience. So trying to figure out the real levers that make things work is critical—getting educated, understanding more about these kinds of emotional intelligence issues, interaction and helping you optimize the possibility of success by thinking about some of these softer issues in the process. And sensitize the ownership, the family members, to these issues so they are able to cope with them and develop a strategy as to how they're going to proceed.

L: I think it goes back to fundamentals that you would teach in the CLU® courses: to be exceptionally sound and knowledgeable in your own sector or profession, that you would be a good team player with the other professionals, and then as much as you can, get these families to talk about the soft issues that Mike's been talking about.

What do you do, Larry, if this client just doesn't want to listen?

L: I think patience is important; educating the client is a dynamic, holistic process. There are no easy answers. Set their expectations early on, help them think through the strengths they have and then hopefully recognize where there may be weaknesses. Shooting for small wins is critical. You can build on those small wins. Frankly, the most successful results come from peers. That is when you get people together in a room talking about common issues—and there are lots of them—and things they have done that have worked or not worked; those are usually the most successful activities. I think if advisors could get peer groups, industry groups where they can foster these conversations bringing people into a more intimate environment (10 to 12 individuals) where they can have that dialogue guided by a professional—that could be invaluable. The Goering Center does that. There are others like YPO, EO, many local Chambers of Commerce with noncompetitive peers who are able to get together on a regular basis and be very transparent and hold each other accountable.

Tell us how you think advisors can tap into resources like the Goering Center around the country?

L: There are approximately 45 or 50 university-based family business centers in North America. I would go to those local universities, mainly if affiliated with a college of business as it is at the University of Cincinnati. We happen to be fortunate; we've been able to become the largest family business center in North America. We have about 350 businesses that are members, and they make the magic happen, helping each other and educating each other.

Any additional advice you might have for the advisor?

M: I guess the most important advice, I would say, is that clients don't really care what you know until they know that you care. So really understanding the client, developing a relationship, getting behind the issues—provide that kind of value-added advice to them.

L: This may seem a little unusual for your insurance industry advisors, but when people call in to us, which they do regularly, over half the time it has to do with family conflict. So I would advise the advisors to get two or three psychologists, family business psychologists who can help their clients if they run into a family business conflict, because that will be a valued referral.