



The Perfect Storm

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In the recent motion picture, “The Perfect Storm,” swordfisherman Captain Billy Tyne and his crew perish off the coast of Massachusetts, in one of history’s most devastating autumn storms. The terrifying and destructive storm was created by a series of forces that combined to overwhelm the captain and his crew. Of course, Captain Tyne could have avoided death in the depths of the ocean if he had plotted a course clear of this storm—a storm he knew was fast approaching.

Similarly, families-in-business face forces capable of destroying the family and the business, if the family does not have the necessary early warning alert information and as a consequence fails to plot their own course through the storm. But what are these forces that commonly capsize family businesses?

Four Key Questions

Based on my experience with hundreds of family businesses, the forces creating conflict are rooted in failure to respond to four key questions:

In future generations, will the business be owned collectively by the extended family for the benefit of all future shareholders, or will the business be owned only by those family members who are actively employed in the business?

When the senior generation retires from active employment in the business, will they continue to own the business and receive ongoing financial benefits, or will they sell the business to the next generation?

When an employed minority shareholder decides to leave the company, will his or her stock be redeemed will discounted values be used?

Will the compensation package, including salaries and bonuses, for shareholders employed in the business be equal for all owners, or be based on an individual’s market contribution for the position held?

Discussing the Undiscussables

Families often avoid discussing these four questions to avoid conflict. Similar to Captain Tyne, who decided to ignore the weather report, families often ignore the issues and sail headstrong into turbulent waters. The problem is that none of these questions have “right” answers.

A storm occurs when there is disagreement within the family or when there is confusion over interpretations of future direction concerning these key questions. For example, many successful family businesses have survived for multiple generations using the assets of the corporation to provide financial benefit to all shareholders in the extended family. Similarly, many family businesses have been successful in “trimming the family tree” and consolidating ownership in the next generation for only those employed in the business.

Smooth Passages

The approach taken to ownership transfers, retirement income, buy/sell agreements and compensation combine to create conflicts that often destroy families and their businesses. In my judgment, there are two primary ways to avoid the storm and to have a smooth passage through the transition of generations in a family-owned business.

The first solution works best in mid-sized to large profitable family businesses which can generate S-distributions or dividends that provide significant income for the shareholders, equal to or better than returns in the stock market. In this circumstance, clear boundaries are defined between the benefits of ownership and the benefits of employment. Owners, independent of their employment in the family business, can derive adequate financial benefit from their stock ownership. Four elements need to be in place for success:

- A strong outside Board of Directors with clearly defined rules and regulations for governing the business
- A clearly-defined dividend policy
- A clearly-defined method for selling stock back to the corporation or to other shareholders
- A professionally developed compensation plan

If the business is not large enough to meet these four key elements, then the second alternative is to “trim the family tree” and consolidate ownership into the hands of those actively employed in the business. In this approach, the boundaries between ownership and management do not have to be so clearly defined. In most small to mid-sized family businesses, this option is often more realistic than the first, but requires:

- Financial resources for the re-capitalization of the corporation, preferably from outside sources.
- Buy/sell agreements within the new ownership group that clearly define the exit strategy options for shareholders

Business Assessment

Business assessment tools developed by Dean Fowler Associates provide an excellent method to uncover the key questions that your family needs to discuss. The assessment process covers twelve independent factors critical to family business success. The questionnaires for the assessment tools allow all of the stakeholders in your business to provide their own perspective on a range of questions related to the four key issues identified in this article.

In all circumstances, make sure to discuss the four key questions outlined at the beginning of this article. Make sure you have a well-integrated plan for ownership, retirement, management succession and compensation. If you do, you will have a smooth passage—and avoid “The Perfect Storm.”

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