

Helping family businesses navigate between the family and the business.

The CPA as Family Adviser

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Family-owned businesses represent the heart of America. As important as they are, however, special challenges, conflicts and problems—mostly related to managing the complex boundaries between the family and the business—constantly threaten them. CPAs often are the closest, most trusted

and typically the first professional advisers who discover such problems. They have the opportunity—and the challenge—of helping family businesses overcome the dangers they face. CPAs can help not only with huge problems that threaten to tear the business and family apart but also by anticipating lesser concerns and offering advice on addressing them.

In an ongoing poll of family business advisers, we found that over half of their clients had conflicts that made it difficult for them to follow sound business advice. Accountants working with family businesses can do a better job if they understand the special dynamics of such businesses and use this knowledge to help their clients deal with important financial issues. In a sense, CPAs may need to become “financial therapists” to help family businesses through certain difficult circumstances.

Working as a family business counselor entails modifying the traditional CPA role in two ways:

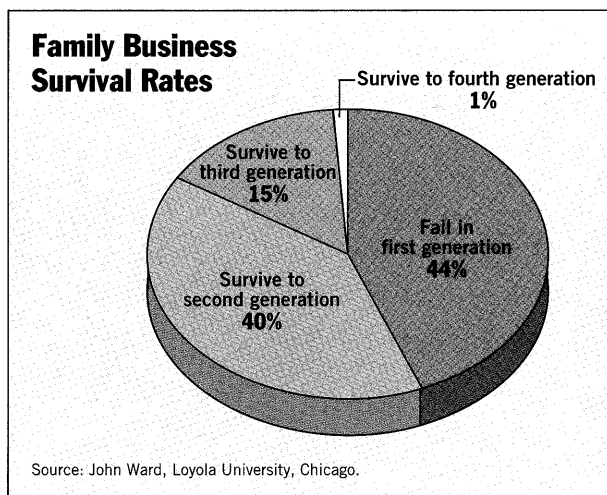
1. The CPA must strengthen his or

her role as an adviser to the entire family business and not just advise the individual business owner alone. CPAs should tell business owners explicitly that they must adopt a different role. In many cases, the difference between the two roles is negligible. However, the CPA needs to become an adviser to everyone who is a stakeholder in the business—including current or potential owners. This may mean telling the owner he or she needs to share more information with family members or involve more of them in the

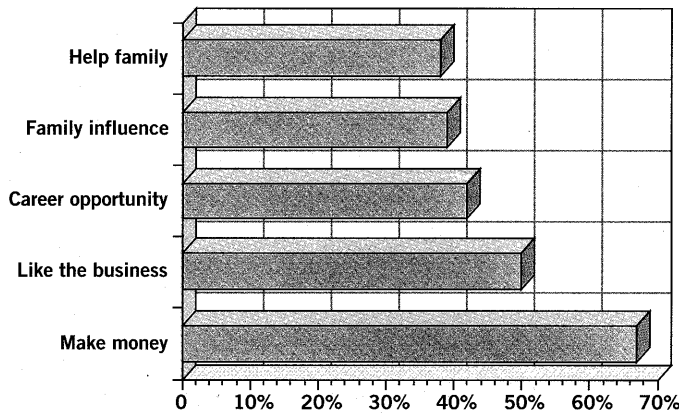
business. This role shift may help prevent conflict-of-interest problems for the CPA, for example when he or she is asked to do estate planning for the business owner and the owner's testamentary wishes are not in the best interests of the entire family.

2. The CPA needs to spend less time on current problems and more time looking ahead and helping the family develop processes, procedures and agreements that anticipate difficulties. Issues such as succession, future strategic choices or employ-

ing family members are things family business owners often try to put off. CPAs must let the owner know this delay may be costly. Helping family businesses anticipate concerns and draw up policies to deal with them can prevent conflict. For example, if a family develops a family employment policy that describes who is entitled to join the business and under what circumstances, it is less likely that family members will feel the resentment that occurs when employment decisions are made arbitrarily.



Why Children Enter the Family Business



Source: Nancy Upton, Baylor University, Waco, Texas.

THE PSYCHOLOGY OF FAMILY BUSINESSES

Issues such as a family member's role in the business, compensation, control, succession and sharing information and power are not unique to family businesses. Nor are conflict, greed or jealousy. But the intensity of feelings, the confusion of family roles vs. employment roles vs. ownership roles, the history of relationships and psychological baggage all add to the unique challenges CPAs face when advising family businesses.

Entitlement, for example, is a major source of conflict: "As oldest son, I am entitled to be president." "As owner of a (minority) interest in the company, I am entitled to tell employees what to do." "As a member of this family, I am entitled to represent the business in the community." "As chief financial officer, I am entitled to tell my cousins how to spend their dividends or to withhold them entirely if they are wasting the money."

These statements use the business to reflect a family expectation. Family businesses may go to great lengths to avoid talking about such expectations. For example, if a business owner planning her estate fears that conflict will arise among her offspring about succession, she may avoid completing her will or taking other actions, often with grave financial consequences. But such avoidance comes at the expense of considerable financial benefits to her children. A CPA can help by working with family members to explore the conflict and bring the concerns to the

surface. This can be done by probing the mother's concerns and helping her speak to each of the heirs—together or separately—about her intentions. The CPA's goal is to make sure the issues are addressed directly because resolving them means the mother can complete her estate plan.

Business issues often are surrogates for much larger unresolved issues between siblings that may go back to childhood. Two brothers may squabble over the smallest business decision—while neglecting big issues—and the business suffers. The sibling rivalry that once existed over bicycles, baseballs and bats now involves products, machinery and capital expenditures.

The CPA must help the family make the important distinction between the family's goals and those of the business. The family's goal is to develop self-esteem and to nurture the children so they grow into responsible adults. The focus of the business, on the other hand, is to generate profits and be economically successful. When these goals get mixed, problems almost always develop. Since the family's goals usually take precedence over those of the business, the business suffers from family-oriented decisions. The CPA can help the family explicitly define goals for the business and for the family and point out instances where the two sets of goals conflict.

There are several ways CPAs can help families untangle a family business. First, the CPA can help family members see they are mixing family with business. While this is not wrong,

the family must begin to see the need to add some order to dealings between the family and the business. Such dealings, when they occur, should be at arm's length. After pointing out the problem, the CPA turned family business adviser should gather the entire family together to begin working on crucial issues. By convening and facilitating a family meeting or a series of them, the CPA—frequently with the help of a family business consultant—can educate the entire family about the responsibilities they have to the business and help them to

- Explore family issues, feelings and concerns that get in the way of sound business practices.

- Talk about issues before they become crises.

- Develop agreements and guidelines that anticipate conflict but allow flexibility.

CREATING FAMILY GOVERNANCE STRUCTURES

The most effective tools to facilitate problem solving between a family and a business are family governance structures that create clear boundaries

and understandings among family members and manage the boundary between the family and the business. These structures include family councils, family boards and other groups that define relationships among the various stakeholders and give them a legitimate voice in the company. The structures are, in effect, the “constitution” or ground rules for family relationships. They are supported by well-conceived policy statements and legal documents such as buy-sell or shareholder agreements that help families get through troubling times such as the death or withdrawal of an owner.

Since the family is responsible for a large amount of wealth and a number of people, it needs to formalize how it operates on financial and business matters. While there are many special situations and many types of governance structures, all family businesses need two basic structures.

Family council. This is a group—composed of all adult family members, including spouses—that meets regularly to make agreements and share understandings about the family's role in

the business and in promoting the growth, development and welfare of family members. As such, it can consider any type of issue. Family councils become more critical to families facing significant transitions, such as succession. In the council, family members can present issues, share information, clear up misunderstandings and resolve private matters without involving the entire business. Many family councils meet at least annually, usually in a retreat setting. They include time for family relaxation and fun and can become a meaningful way for family members to tell each other about nonbusiness activities and to discuss the future.

Family board. Out of the family council comes a smaller group of family members who are owners or key managers in the business. In most cases, this also is the board of directors, although as the business grows, typically a need arises for a board that includes outside members but may not be able to include all family owners. The family board manages the boundaries between the family and the business, dealing with issues of en-

EXECUTIVE SUMMARY

- **FAMILY-OWNED BUSINESSES ARE** threatened by special challenges, including compensation, control and succession, many of which are related to difficulties managing the complex boundaries between the family and the business. As close professional advisers, CPAs are positioned to help family businesses overcome the dangers they face.

- **TO WORK AS A FAMILY BUSINESS** counselor a CPA needs to modify his or her traditional role—first by advising the entire family business, not just the current owner. CPAs also need to spend less time solving current problems and more time helping the family anticipate problems and finding solutions for dealing with them.

- **AN IMPORTANT DISTINCTION MUST BE** made between the family's goals and those of the business. When those goals get mixed, problems almost always develop, particularly when the business suffers from family-oriented decisions.

- **THE MOST EFFECTIVE TOOLS CPAs CAN** recommend to facilitate problem solving between a family and a business are governance structures that help manage the boundary between the family and the business. These include family councils, family boards and other groups that define relationships among stakeholders and give them a legitimate voice in the company.

- **ONE OF THE MOST IMPORTANT AREAS** the family board will be asked to handle is compensation and employment of family members. These areas are troublesome because they tend to invoke questions of fairness and differences of ability among siblings. Having written family business compensation guidelines and a written family employment policy can help avoid problems.

- **BEING AWARE OF THE POTENTIAL** pitfalls of family dynamics and how to work around them will make it easier for CPAs to work with family-owned businesses.

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CASE STUDY

Helping Business Owners Prepare for the Future

The statistics can be staggering. With more than half of U.S. business owners today age 60 or older, only 30% of closely held businesses will survive to the second generation. Why? The answer, according to Jeffrey M. Davidson, a tax partner of Deloitte & Touche LLP in Cincinnati, is they don't take the time to plan for the future. Only 28% have succession plans. Davidson, who works with D&T's Center of Excellence for Financial Counseling Services, is national project leader for the firm's succession planning efforts for closely held business owners.

THE NEED FOR COMPREHENSIVE PLANNING

According to Davidson, when people refer to succession planning, they're thinking mostly about the transfer of ownership in the business. "The real problem for companies," he said, "is they haven't focused on the transfer of the management of the business." The owner may have a great estate plan but no management team in place. Davidson said succession planning can have different focuses—such as retirement planning or estate liquidity—depending on the planner's expertise. "We look at it more comprehensively—helping a business owner plan for the transfer of both ownership and management. Some call it a holistic approach."

Business owners can be difficult to work with, Davidson said, particularly entrepreneurs, because they are busy making their businesses successful. "One of the cornerstones of what we do is talk with the owner about the importance of setting goals. We try to help the client think comprehensively about the challenge of succession." Davidson said his firm helps facilitate family meetings and gets participants to talk about goals and objectives for the future. "In some situations," he said, "the father thinks all three of his children want to be in the business when, in fact, none of them does. Or



Jeffrey M. Davidson said the biggest problem family businesses face today is communication.

he thinks his oldest son should be his successor but he's not interested and it's really the daughter who has the interest and the other son who has the best skills." In such situations, D&T does what it calls a "management talent assessment" to help owners determine a match among family members and other key management personnel with a list of management criteria. It's important for a company to have a succession program in place—whether children or other key managers—because, as Davidson pointed out, "the owner needs the company to be successful to fund his or her retirement."

DEALING WITH FAMILY CONFLICT

When personal family conflicts threaten a businesses, Davidson said he can see CPAs generally are reluctant to do the counseling that may be necessary because they don't think they have the skills. Davidson, who has 26 years' experience working with closely held businesses, said, "You reach a point in your career when you have the confidence to talk to business owners about what is right or wrong in the way their businesses are being run or how they are dealing with family situations." The degree of CPA involvement also depends on "how long you have been working with a particular family or company and the extent to which you are considered the most trusted business adviser." Davidson empha-

sized that ultimately CPAs can be most successful when they are perceived in this way.

It's also important, he said, for CPAs to know when they need help dealing with a conflict. "In reality," he said, "we should be able to facilitate family problems, but we also should be smart enough to know when a conflict requires us to bring in a special consultant." Davidson said his firm uses a network of psychologists who do nothing but work with family businesses.

Many families have members with personal problems that can have a negative impact on the family business. In working with those individuals, Davidson said, you have to find the common denominator with other family members. "What is their one common area of interest or need?" Typically, Davidson said, the answer is "the success of the business." Even the troubled family member needs the company to be successful so he or she can stay alive economically. As long as the CPA can focus attention on that one common interest—the success and continuity of the business—he or she has a place to start in deciding the next step. Usually this involves identifying who should be running the business and who should leave. As Davidson pointed out, "someone who is a family member, works in the business and owns stock may have totally different interests from those of a family member who is only a shareholder." If you can't work out the conflict, he said, "you may find yourself in a situation where people have to be bought out or the company has to be sold."

Helping differentiate between family and business is a problem Davidson faces with many clients. "Some of the consultants we work with have a philosophy called 'business first—family first' to help the family separate business issues from family issues." The family first approach to a problem might be to do whatever

avoids conflict in the family. The business first approach, on the other hand, would be to choose the solution that works best for the business and then manage the consequences to the family. According to Davidson, "Really good family businesses have this problem under control. They are able to separate the two issues and deal with them professionally." When you see it working, he said, it is very effective.

WHO IS THE CLIENT?

In doing business succession planning, CPAs face the age-old question of "who is the client?" According to Davidson, there is much debate about whether the client is the primary owner, the family or the business itself. Sometimes, Davidson said, when a CPA is allied with one constituency the others say, "we want our own advisers."

It's important, Davidson said, for the CPA to work with family members other than the primary owner. "In a family business I worked with 20 years ago," he said, "the parents ran the business and had teenage children. The son is now in his mid-30s and owns a large company that was recently sold. Our firm was able to stay on and bridge the generations because I had formed a relationship with the son when he was a teenager."

HELPING BUSINESSES SURVIVE

In Davidson's view, the biggest problem family businesses face today is communication. Many times, he said, the business owner has a vision for the future—what he or she wants for the company and the family—but has never articulated it to anyone. The owner needs to sit down and bring the family—and other key management people—together and give them an opportunity to buy into his or her vision. But, Davidson said, this isn't always easy. "Many entrepreneurs think they are going to live forever. They don't like to sit down and plan."

How does Davidson overcome the barriers? "We have 10 questions we call the business survival test (see box, this page). Recently, a client told

Deloitte & Touche Business Survival Test

1. Have you defined your personal goals and vision for the transfer of ownership and management?
2. Is your successor identified, ready and in place?
3. What is the importance of family involvement in the leadership and ownership of the company?
4. Are you currently using techniques to mitigate or eliminate estate taxes?
5. Do you have enough liquidity to avoid the forced sale of your business?
6. Do you have buy-sell agreements in place?
7. Have you had your business valued recently?
8. Do you have a contingency plan should you become disabled?
9. Have you considered different corporate structures or stock transfer techniques to help you achieve your goals?
10. Are you going to depend on your business to meet your retirement cash flow needs?

me his business was in good shape. After we had gone over the 10 questions, however, he admitted he had some work to do." Some owners, Davidson said, will never be ready to plan—"and there's no way you can force them. I don't like to tell clients war stories. What I would rather do is focus on successful transitions. There are a lot of good stories out there in the public domain."

Davidson believes CPAs are well suited to helping business owners with their succession problems. The most effective adviser is "someone who has worked a lot with middle market companies in his or her career and is a good listener and a good problem solver," he said. "I think the CPA fills the role of being the business owner's most trusted adviser."

—Peter D. Fleming

Exhibit 1: Family Business Compensation Guidelines

1. Family employees should receive compensation and benefits based on being employees, not on their ownership positions. Family member employees should be paid fair market value for their positions. This means they should receive the same salaries, have the same bonus plans and get the same perks and benefits as nonfamily members in the same positions.
2. Owners (whether working in the family business or not) are compensated through their return on shares (dividends or other payments). These benefits should be based on ownership and allocated pro rata.
3. Compensation should be based on performance, not longevity.
4. Large amounts of money should be taken out of the company only in good years and only out of profits, after the company's other cash needs have been satisfied.
5. Family employees should adopt life-styles commensurate with their usual levels of income and not depend on extra money coming out of the company each year to help make ends meet.
6. All distributions from the company should be made in the most tax-advantaged way.
7. All compensation policies should be written.

try, compensation, ownership and management succession. It is most effective when family members can air succession issues long before they become crises. For example, the family board can set the expectations for succession and the process for selecting future leaders.

COMPENSATION AND EMPLOYMENT

The family board should be asked to mediate conflicts about the compensation and employment of family members. If a conflict has not arisen already, CPAs can expect one will at some point. Compensation and employment are hotbeds of potential trouble because they tend to invoke questions of fairness and differences of ability among siblings, which families tend to downplay or ignore altogether. For example: John doesn't work as hard as Fred and wants to play golf all the time but also wants to be paid as much as Fred. The family business compensation guidelines in exhibit 1, above, are helpful principles to sort through such concerns.

A family employment policy (see exhibit 2, page 48) is a practical tool for defining who can work for the family business, under what circumstances, the preparation required, how performance problems will be handled and how the person fits into the current and future organizational structure. Having open discussions and an established employment policy anticipates potential conflict and provides

the means to work out solutions before problems become serious. There are many reasons why families don't develop clear compensation plans. In some cases, the business is used to give family members gifts the parents think are due them.

Several common scenarios can lead to conflict:

1. The parents try to do everything equally. They want each sibling to have a place in the business, with equal salary, rank and ownership. While this may be fair for the family, it neglects issues such as who is giving more to the business, who is more capable and who has made a longer term commitment.

2. Treating the business as a family welfare agency. Parents want to take care of weak, unhappy, neglected or even drug dependent children—or an offspring who is having a child and needs more income—by putting them into the business. This raises the problem of more responsible siblings and other employees having to work even harder to make up for the child the parents are trying to protect.

Both of these scenarios demonstrate how some families use the business to do things the family should do on its own. Putting offspring into a business is very different from making gifts or helping a child make ends meet. The unintended effect is that helping one family member has adverse consequences on the people who are giving to the busi-

continued on page 48

Many family businesses will find seemingly loyal long-term employees will leave in response to unfair family compensation.

ness and who need to be fully committed to maintain and develop it for the future.

As a family business passes from its founders to the second or third generation, the issues of its strength and vitality are central to questions of compensation. As the business grows, the need for competent, contributing and committed employees grows. Employees are less close to the founder and less willing to tolerate family retainers. Fairness also comes up when an employee makes less than a fair market wage—or less in comparison to what family members are paid. Many family businesses find seemingly loyal long-term employees will leave in response to unfair family compensation.

Still, it's difficult to convince a family to rationalize its compensation systems. CPAs may discover this dilemma when asked to consult with a family about a related issue, such as succession or an estate plan. CPAs face two challenges:

1. To raise the issue with all family members and make the case for rationalizing compensation.

2. To deal with family history, such as past promises, misunderstandings and feelings of entitlement that are the residue of years of irrational compensation policies.

Here are the steps CPAs can recommend for adopting a fair system.

■ **Make the case for compensation as a purely business issue.** If there is no family council or family board, begin by presenting the business owner with concerns about the status of family members' compensation. Describe the drawbacks of the present compensation system. Let the client know that the most effective family businesses tend to shift to a business-first compensation system as the business grows, usually before it moves into a second generation.

■ **Present the issues to the entire family.** Assume it will be difficult for the business owner to make the case to the family. Ask the family to call a

Exhibit 2: Family Employment Policy

1. Who is eligible to join the business? Can both members of a couple join? Are in-laws eligible? Is family membership reason enough to join or does one need the skills, knowledge, experience and attitudes that will contribute to the company's success?
2. What qualifications are needed? Three to five years of experience outside the family business and demonstrated success before entering the business are advisable. Should new employees have education relevant to the needs of the company (either technical skills, business degree or other professional training)? A family member should have the education and training appropriate to the job and his or her expected career path in the business or should immediately develop them through proper education.
3. At what point are family members eligible to join the business? Can a young person straight out of high school or college join or should he or she have to get experience elsewhere first?
4. What will be their commitment to the business? Can family members work part-time, or should they each have a commitment to become a leader? Is the family business the employer of last resort for family members who can't succeed elsewhere or don't want to try?
5. What will family members do? Will positions be created or will they be required to fill existing positions by demonstrating that they have the qualifications to do so? Will an apprenticeship program be established to encourage family members to join in the hopes they will become tomorrow's leaders?
6. Will family members supervise other family members or be placed under the supervision of nonfamily members? Will they be trained, supervised and evaluated like all other employees or held to a higher or lower standard?
7. What will the conditions of employment be? Will family members be held accountable to perform at an acceptable level? Are they subject to the same evaluation or termination criteria as other employees? What are the expectations for advancement?

family meeting. The issues should be presented clearly to all the family members working in the business, as well as to those who may inherit ownership but who do not currently work in the business. Families often find it helpful to include spouses, because some work in the business or may in the future. If not included, spouses get a limited perspective on what is happening and sometimes can cause their partners to undermine family agreements.

Hold a meeting where you present a case for change in compensation and discuss it fully with the family. Make it clear that this does not have to be done all at once but that the process should be set in motion. Also, let it be known that the family has some flexibility in setting up compensation guidelines and that the entire family should meet to set them. Have them agree to begin discussing the issue.

■ **Review the family's history about money, business and compensa-**

tion. Explore the basis for past decisions and their consequences. Shifting from policies that have as their first priority satisfying family issues to policies that put the business first will take some work on the family's part, because its history includes many prior agreements and expectations. The family should look at some of the long-term consequences of the current compensation model and explore what changes are needed. This may lead to discussions about where the business will go in the next generation and who will become its owners. Compensation issues also link to inheritance of other assets and family gift-giving patterns. Generally, the policy that evolves should separate family gifts and inheritances from ownership of the business and working for the company.

There may be some dissenters, often those who benefited most from the old policy. They must be helped to

accept the new way by firm responses from the business owner or compensatory gifts or benefits from other parts of the family's resources.

■ **Help the family develop a plan it will follow.** The final task is to assist the family in drawing up a plan that blends the adviser's expert knowledge with what the family is willing to agree to. CPAs can propose several models for the family to consider or work with a family steering committee to develop guidelines. It's important that everyone is behind the model, not just agreeing to something they will undermine or question when the family gathering has ended. The agreement should include enforcement provisions—mechanisms to make sure they are implemented and penalties for not doing so—as well as a way of making sure family members follow up on their agreements. This usually takes the form of regular meetings of the family council to deal with internal family matters and of the fam-

ily board to administer agreements about family participation in the business. The family board typically reports to the family council on its policies and decisions to avoid misunderstandings and keep the entire family informed.

KNOWING WHEN YOU NEED HELP

CPAs will not be able to solve all a family's problems, particularly if nonbusiness concerns threaten to overwhelm everything else. The key is knowing when to call in other experts. Some CPAs are comfortable helping individuals and families deal with highly emotional matters, while others should seek help from a family business consultant. An important marker is the degree of conflict and emotional upset in the family. The greater the feelings, the more need there is for the CPA to seek outside help.

A family business consultant is a professional adviser who has a back-

ground in family and organizational dynamics. Such consultants are available to work closely with CPAs to help family members explore and resolve emotional issues that prevent them from operating the family business in an objective and straightforward manner.

Beware the Pitfalls

CPAs serve and help promote the viability of many important business institutions. Being aware of the potential pitfalls of family dynamics and understanding how to navigate around them will make it easier for CPAs to work with family-owned businesses. The key to being effective with family businesses lies in being able to shift from financial expert to family adviser. The tools CPAs will use are geared toward helping manage the relationship between the family and the business and helping the family create clear procedures to regulate its activities. ■