

RE_LAtively SPEAKING

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THE NEWSLETTER FOR FAMILIES IN BUSINESS

Sponsored by Belew Averitt LLP and Horwath International

SAIL THE "SEVEN Cs"

How many times have we heard the expression, "The only constant in business is change?" Enough, probably, to make our ears sore. But like many clichés, this one also rings true.

Over the years businesses have been revolutionized, renovated, restructured, remodeled, reorganized, and reengineered. Both giant corporations and small family businesses are adopting the latest technologies, applying global perspectives and spending billions of dollars on management training programs. They are doing this in an effort to become more competitive and increase market share and profits. Everything seems to be changing at breakneck speed except relationships with employees.

Throughout history managers, whether sovereigns, military leaders or straw bosses, have had to deal with dramatic change. Today, entire categories of jobs have disappeared while new jobs, with new skill requirements, have emerged almost

...up to 80% of American workers are not satisfied with their jobs.

instantly to take their place. The jobs may come and go and the industries may turn on a dime, but people will always be required to "make it happen." Knowing this, have managers kept pace with learning how to motivate employees?

The latest trend and most quoted source in management these days is *DILBERT*, the harassed and unappreciated comic strip worker. Maybe our fascination with *DILBERT* and his gang comes from a recent survey that revealed up to 80% of American workers are not satisfied with their jobs.

The biggest challenge for managers is not with the inevitable industry changes, but with the people they manage. Managers are responsible for discovering the keys to employees' motivation to perform their jobs and contribute to the organization's goals.

If managers are still adhering to the management/worker attitudes of the Samuel Gompers era, it is time to recognize that today's workers are better educated, have higher expectations, have abandoned the traditional work ethic for new life-styles and desire meaning from their work.

Today's workers are more demanding and are constantly challenging the traditional manager's way of thinking and acting. Yet, unfortunately, some managers attempt to force modern employees into centuries-old structures that were better suited for indentured servants.

Douglas McGregor, a pioneer in organization behavior, classified managers' values as either Theory X or Theory Y. Theory X held that workers are basically lazy and will avoid work, dislike responsibility and lack ambition, are generally not intelligent, innovative or entrepreneurial, and are self-centered and resistant to change. In contrast Theory Y affirms that workers are not passive by nature and the expenditure of physical and mental effort at work is as natural as it is at play, that employees are willing to learn to accept and will seek out responsibility and will exercise a high degree of imagination and creativity to solve organizational problems.

Students of management may argue endlessly, and with passion, over which view is more accurate. But if you are the manager on the job, the most important and really the only view that matters is your own. If you treat employees as though they are basically no good, that is probably what your company will reflect. More often than not, while at work, employees mirror the beliefs of their leader.

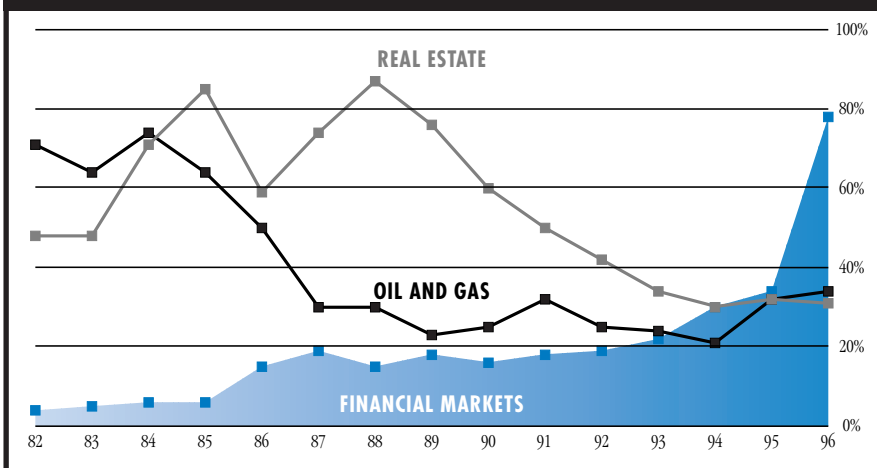
Day in and day out, good management is the best and most durable of all methods to motivate employees. And, just like sailing, good management is a skill that can be learned. Good management is producing results without unintended conse-

(See SEVEN Cs on page 4.)

THE FAT CAT 400 and how they got that way. Source of the Forbes 400's Fortunes

In 1982 the "Fat Cat 400" (aka Forbes 400) was dominated by wealth from the oil and gas and real estate industries, while only 4% (15 people) on the list made their wealth from financial markets. Over the succeeding 14 years there has been a steady increase in the number of people in the financial markets. Today, over 300 Fat Cats earned their wealth from financial markets.

(Percentages exceed 100% since some fortunes are derived from multiple sources.)



Source: BARRON'S • Arbor Trading Research

ONE PLANNER'S APPROACH TOWARD BUSINESS SUCCESSION PLANNING

Studies show that approximately two-thirds of family businesses fail in transition of management to children. One study of family businesses from 1924-1984 reveals that 80% of these businesses had died, 13% were still in the family, 5% were sold to outsiders and 2% went public.

Business succession planning often does not yield immediate benefits and may be difficult to work through. However, time devoted to strategic planning for business succession is vital to the "net net" bottom line.

ELEMENTS OF SUCCESSION PLANNING

A business succession plan is a strategy (preferably written) detailing the systematic transfer of the management and ownership of a business from one individual (or group) to another. It consists of various elements – which are divided into the following six steps.

1. Management Succession

- ▶ Entrepreneurs-by their nature-are reluctant to give up control.
- ▶ Developing, motivating, training and nurturing successors is vital.
- ▶ Dealing with unmotivated children, or children who are not capable of providing needed management may be extremely painful for the business owner to address.
- ▶ The business owner must separate personal from business goals.
- ▶ Consider utilizing outside directors and advisors to bring objectivity to the process.
- ▶ Equitable compensation planning is essential in dealing with management issues. This includes addressing equitable compensation for both family and nonfamily employees as well as for active and inactive shareholders.
- ▶ Ultimately, a plan must be developed for delegation of responsibility and authority to successors.

2. Ownership Transfer

The decision of who will *own* the business is separate from the decision of who will *manage* the business. The two decisions, however, must be in concert.

Ownership Successor

The business can be transferred to one of three potential groups: family, insiders and outsiders. Most family business owners desire to continue the business in family hands. However, the owner should carefully consider whether their motivation is in the best interest of the family. If family members are not able to continue the business successfully, the owner may best assure the long term security of the family by planning for a transfer of ownership outside the family. Many family business owners are extremely devoted

to non-family insiders. They should also consider what is in the best interest of those insiders.

Lifetime Transfer

If an owner decides to transfer the business to outsiders, they should consider and plan for a lifetime transfer of the business. A business should be transferred when it is at its maximum value. A business is usually more valuable before its owner dies. A lifetime sale permits a smooth transition from one owner to the next and avoids the no-win "fire" sale.

Structure of Ownership Transfer

Ownership can be held in various forms. Consider:

- ▶ Voting and non-voting interests. Non-voting interests allows greater flexibility for transfers during life.
- ▶ Different classes of interests. One class of stock could have limited future appreciation.
- ▶ Debt vs. equity interests. Some children may be given debt interests – such as note payments – rather than equity ownership interests.
- ▶ Separate assets from the business. For example, real estate used in the business may be left to a family partnership that would predominantly have non-active children as limited partners. Lease payments could supply desired cash flow to non-active family members.

Timing and Mechanics of Ownership Transfer

Will the transfer be made during lifetime or at death? If during lifetime, will the transfer occur by gift or by sale? Will the transferee be a family member or an entity for the benefit of the family member (for example, a trust or a limited partnership)? If the transfer is at death, will the interests be bequeathed to the ultimate successors or be left equally to family members with provisions for transfers to active family members in a buy-sell agreement?

A buy-sell agreement requires careful planning. At a minimum, every family business should have a buy-sell agreement that provides for right of first refusal restrictions on transfers. Sales of business interests under a buy-sell agreement must be planned to avoid a myriad of tax traps.

3. Treating Family Equitably

If all children of the business owner are not actively involved in the business, the owner may not want to leave the ownership of the business equally to all of the children. Even if ownership is equal, management control and compensation may not be equal. Equal ownership among the children may cause family fights when inactive children who do not provide services and therefore do not receive compensation from the business want a return on their owner-

ship in the form of current cash flow. This is especially difficult for a "C" corporation that would have to pay dividends, which are effectively subject to double taxation, to distribute cash flow to the inactive shareholders.

Grappling with this difficult issue may be gut-wrenching and is the primary reason that many business owners "put-off" addressing succession planning. Family pride is associated with the business, and unless the children are aware of the difficult problems that may occur (potentially for all of the children) from equal ownership, hurt feelings may result. Involving all of the children in the decision making process does wonders for long-term relationships.

We often find that determining the realistic value of the business is a necessary first step to effective planning to divide the business owner's estate equitably among the children.

One common technique is to leave the business interests equally to the children under the business owner's will, but to have a plan under a buy-sell agreement for either the business or the "actively-involved" owners to purchase the interests of the inactive children.

4. Liquidity Planning

Can the business survive taxes and expenses associated with the death of the owner? Federal and state estate taxes are often about 55% of the total estate. What business do you know of that could survive a 55% mortgage every 25 years without getting any proceeds for the mortgage? In addition to liquidity for paying estate taxes, liquidity planning is also vital if inactive children will be "bought out" at the business owner's death. Proper liquidity planning is essential to avoid crippling the business.

5. Tax Reduction

The business owner, perhaps more than any other type of client, may be able to achieve enormous estate tax savings with proper planning. Central to these savings programs are gifts, sales and "opportunity transfers." The primary estate tax problem is not the large amount of estate taxes that is payable on the current value of the business, but the estate taxes that will be payable on the FUTURE GROWTH of the business. Consider this example, a business worth \$1,000,000 growing at 12% per year increases in value to approximately \$9.6 million in 20 years. Shifting a substantial part of that future growth will result in significant estate tax savings. A variety of estate planning techniques may be used to shift future growth out of a business owner's estate for

(See PLANNER'S APPROACH on page 3)

BOOK ReVIEW

HIDDEN CHAMPIONS

Lessons from 500 of the World's Best Unknown Companies

by Hermann Simon (Harvard Business School Press, 1996)

Hillebrand, Brita, Hauni? Recognize any of these names? If not, don't feel bad because according to Hermann Simon these three companies are among the unknown 500 *Hidden Champions*.

This book's destiny was etched back in 1982 when Peters and Waterman penned their first cross-over best seller, *In Search of Excellence*. Where Peters and Waterman centered their research on the likes of Exxon, General Foods, McDonalds, General Electric, General Motors, and the IBMs of the world, Simon captured data on companies with sales under \$1 billion, with low public visibility and with a world wide market share ranking of either first or second. Statistically, Simon's champions have annual revenues of \$130 million, employ 735 people, are 67 years old (mature stage) and are family-owned. The results of this exhaustive project are contained in 280 pages filled with charts and graphs.

Simon argues convincingly that "*buried deep below the headlines of sensational business successes and innovative breakthroughs lies a totally ignored source of management wisdom.*" Similar to hitting the Las Vegas jackpot, generations of business leaders have been turned on by the rags-to-riches, Horatio Algers stories of success. These stories purport that the large corporations should be the role model for companies. Journalists and academicians celebrate successful large enterprises and imply that smaller businesses should learn from and emulate these giants.

The well-known case study method used in many graduate business schools does nothing to dispel the notion that we learn best by vicariously walking in the shoes of a Jack Welch, a Lou Gerstner or a Mike Eisner. No doubt these business icons have much to offer, but the most valuable business education for leaders of small businesses may be to reverse the assumption that learning is top down.

Consultants, known for generating lists, commonly narrow success into a few bullet points that fit nicely onto an overhead chart. Simon's chart of success for hidden champions begins with the desire to obtain the market leadership position. Champions accomplish this goal by creating their own market, by expanding a narrow product focus to meet the

needs of customers around the world, by avoiding outsourcing, diversification and strategic alliances, by staying close to their customers without having a marketing department, by achieving low employee turnover with a high continuity of leadership from executives that are both authoritarian and participate. Who can argue?

Simon highlights several noteworthy accomplishments of the champions to support his claims, such as comparing companies with the largest number of international patents. Siemens wins hands-down with 40,000 patents among 400,000 employees or, for comparison purposes, 10 patents per 100 employees. On the other hand, Fischerwerke, a hidden champion has obtained 5,500 patents with only 2,350 employees for a patent to 100 employee ratio of 234. From examples like this, Simon concludes that the global success of these champions is built largely on superior technological competence and innovativeness and is not a matter of luck or favorable circumstances.

Large, high profile successful companies will never go away but as Simon envisions, may become either big champions or clusters of hidden champions. Playing his trump card in the final chapter, Simon pulls a quote from Peter Drucker which supports his claim, "*The advantages of smaller size are becoming very great. When you look at who is exporting, it is not the big companies. Yes, GE has done very well with aircraft engines, and Boeing with aircrafts, but other than that, practically all of the exporters of manufactured goods are medium-size companies, highly specialized. I don't think big companies will disappear. But I see more and more businesses where medium size is much better and where it simply diffuses results and destroys profitability to try to be big.*"

Unlike the "pop" books on management and the "how to" manuals for business managers, *Hidden Champions* offers something for the serious business leader. Normally, hard-core business books do not make *ReLATIVELY Speaking's* Book ReVIEW, but for family-owned businesses, *Hidden Champions* promises to make you pause and think about the way you may grow your business.

Oh yes, Hillebrand is the largest shipper of wines in the world, Brita enjoys an 85% global market share for point of use water filters and Hauni is the worlds market leader in cigarette machines and is the only supplier of complete systems for tobacco processing.

(PLANNER'S APPROACH)

estate tax purposes. The key is to act early before significant growth occurs.

6. Act

Planning for the succession of a family business is not necessarily a difficult or costly experience. In fact, our experience reveals that family business succession planning not only serves to enhance the wealth of the family but can serve as a catalyst to bring a family together.

The most important element of all of the steps in the business succession planning process is TO ACT.

Steve R. Akers, J.D., partner with Ernst & Young U.S. LLP, is the director of the estate and business succession planning practice for the Southwest Area of Ernst & Young. Steve has previously served as chair of the State Bar of Texas Real Estate, Probate and Trust Law Section, and currently serves as assistant secretary of the American Bar Association Real Property, Probate and Trust Law Section. David K. Walser, C.P.A., co-manages the estate and business succession planning practice and has extensive experience in dealing with the complex tax issues facing business owners.

OLD DOGS? NEW TRICKS!

You've got to keep learning new tricks to run with the big dogs. But if you find there are more old dogs than new tricks in your company, perhaps your managers need some training in the important skills of management.

After all, every dog has his day, but change has made this a new day in business. ReGENERATION Partners offers special courses in key areas of management skill that offer the latest management ricks for your business. Call Elizabeth Ellinor for course information and availability.

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SEVEN Cs (Continued from cover.)

quences. Producing results hinges on doing lots of little things, everyday, correctly. Vision, strategy, marketing plans etc. are all absolutely critical, but the real survival test for an organization rests with the managers who use their tools to create environments that motivate others to perform and contribute.

Skillful managers are able to move comfortably between the hard and soft issues of management. Hard issues, such as setting job standards, teaching new jobs, resolving conflict, overcoming resistance to change, correcting problem behavior, interviewing, following procedures, measuring performance, etc.

...good management is the best and most durable of all methods to motivate employees.

are all skills that most people can learn by combining hands-on experience with good mentoring and relevant course work.

The softer side of management is about achieving desired results. Gaining buy-in, encouraging creativity, improving attitudes and building positive work environments all help motivate people in an organization to contribute.

Bridging the gap between these hard and soft issues is a delicate task that begins with driving out fear and building trust. Trust between managers and employees, although uncommon at the turn of the century, is a prerequisite for motivating today's employees. Building trust is a constant effort. It is a process that, in part, is created by adhering to the seven characteristics of good managers.

CONSISTENCY One of the cardinal rules of management is "no surprises." Being consistent reduces organization stress and has a calming effect.

COURTESY Effective managers are courteous, whether it is with a subordinate, peer or superior. Being courteous is not a 9 to 5 requirement for these managers but is a trait of their personality.

COMPENSATION More than just meeting financial obligations, pay is closely tied to self-esteem. For many people, fair pay is one way of "keeping score."

CONCERN Workers that feel high levels of trust respond that their bosses have a genuine concern for their co-workers. These managers know something about what "winds the worker's clocks." They know the name of the children, the hobbies and the dreams of their employees.

COMPASSION Good managers are able to show compassion and empathy for their fellow workers in times of need without crossing the line and sympathizing or assuming the pain and responsibility of their co-workers.

CONFIDENCE - Effective leaders are self-assured. Being self-assured requires a high level of work related self-esteem, which allows managers to take action in a direct manner.

CARE Remember, very few employees will ever care how much you know until they know how much you care.

It is unlikely that you will ever find these seven Cs in a text book or as part of the course offering in a graduate business class, but good managers, just like good sailors, are not born; they are developed.

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LIFE BEGINS AT FORTY

It was mid-life crisis and an observation by cowboy philosopher Will Rogers that turned Harlan Sanders' life around.

In 1930, Rogers observed on his radio show, "Let me tell you something, life begins at forty." This line has since become a cliché, but at the time it was new, and it made a big impression on Harlan Sanders. Sanders had coincidentally just turned forty and was in the throes of a deep depression. Looking back at his life, he determined that he had been a failure at everything he had tried and didn't have much reason to believe things were going to get much better.



Sanders had dropped out of school at age fourteen and hit the road. He tried being a farm hand but didn't like it. He became a streetcar conductor at age sixteen, but was fired a few weeks later. He

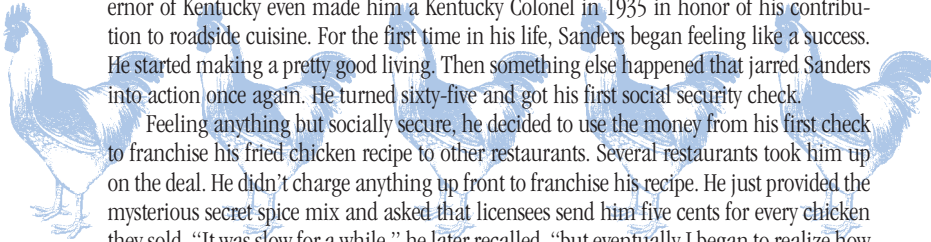
tried blacksmithing but could not make a living. Finally, he found a job he liked. He became a locomotive fireman for the Southern Railroad, that is until he was fired. Next, he sold tires, then insurance, followed by working on a ferryboat. Failing at all of these, he became a secretary. He believed he would always be a failure.

Will Rogers' observation jolted Sanders out of his doldrums. He decided to try something completely new as his forty plus life began. He opened a little gas station in Kentucky on U.S. 25, the main highway to Florida from "up North." He added a small luncheonette and started making food for travelers. Trying to fix his tasteless fried chicken, he started experimenting with seasonings. After weeks of testing he came up with his personal "Holy Grail" – the Harlan Sanders Kentucky Fried Chicken Secret Recipe with Eleven Herbs and Spices.

His fried chicken started getting famous among locals and frequent travelers. The governor of Kentucky even made him a Kentucky Colonel in 1935 in honor of his contribution to roadside cuisine. For the first time in his life, Sanders began feeling like a success. He started making a pretty good living. Then something else happened that jarred Sanders into action once again. He turned sixty-five and got his first social security check.

Feeling anything but socially secure, he decided to use the money from his first check to franchise his fried chicken recipe to other restaurants. Several restaurants took him up on the deal. He didn't charge anything up front to franchise his recipe. He just provided the mysterious secret spice mix and asked that licensees send him five cents for every chicken they sold. "It was slow for a while," he later recalled, "but eventually I began to realize how Mr. Woolworth built up such a big business with his five-and-dime stores. Those nickels really add up when they're rolling in."

Life began at forty for Harlan Sanders. And once he decided to make a difference, nothing could hold him back. Harlan sold his family business, and today PepsiCo Inc. guards the secret recipe that launched Harlan Sanders into a successful, internationally known entrepreneurial icon.



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ALTERNATIVE MINIMUM TAX

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The end of the year is rapidly approaching and for most of us that means tax planning. Historically, this is the time of the year when investment telemarketers and deal makers present their best tax advantage investments. **Buyer Beware!** All the best tax investments in the world will not help you avoid the Alternative Minimum Tax – AMT.

Tax investments have long been a key ingredient for wealthy families and individuals to reduce their tax obligations. Sensing something unfair, Congress enacted the AMT regulation which requires many individuals (or their agents) to calculate a return two ways. First, is the traditional method of income minus deductions. The second method, the AMT method, requires adding back almost all deductions and taxing this new gross number by a minimum of 28% (the rate is scheduled to step up to 35%).

The taxpayer is required by law to pay whichever method produces the highest tax dollars. For example, Kenzar Worthington, President and owner of Worthington Imports had a gross income of \$1,000,000 and total deductions of \$500,000. This meant an adjusted income of \$500,000. Kenzar's tax bite in this simple example is around \$198,000 (39.6%). Under the AMT method, Kenzar's tax obligation could be as high as \$280,000. Assuming these numbers are accurate, Kenzar owes the IRS the greater of the two calculations or \$280,000.

Although the AMT code was created to prevent high income individuals or families with lots of write-offs, credits and deductions from paying mini-

mal or, in some cases, no taxes, the gap between the regular tax rate of 39.6% and the highest 1996 AMT rate of 28% may cause taxpayers with relatively small amounts of tax deferred investments to pay the AMT rate. The calculation for AMT is very complicated but do not assume that you are exempt.

Special attention to both the regular and AMT tax effects should be considered if you have the following:

- ▶ Tax exempt interest
- ▶ Accelerated depreciation
- ▶ Bargain element on exercise of incentive stock options
- ▶ Gains reported on installment
- ▶ Depreciation on property placed in service after 1986
- ▶ State, local, real estate, school, etc. tax expense
- ▶ Medical deductions
- ▶ Charitable contributions
- ▶ Itemized deductions

Preservation of wealth requires tax planning. The strategies we describe in *ReLATIVELY Speaking*, although general in nature, are designed to save you money. This article is not intended to replace personal professional assistance. We are happy to individually discuss tax opportunities appropriate for your situation. For a copy of the 1996 year-end Tax Planning Memorandum, please contact Belew Averitt directly or put "Tax Planning" on the Boomerang card and return it to ReGENERATION Partners.

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