The Commerce Bank of Oregon

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FAMILY BUSINESS newsletter

Part of a Larger Community

Applejack Mindful of Responsibility to Family

by **Loren Faye**

Located in Wheat Ridge, Colo., Applejack Wine & Spirits is the largest single beverage alcohol retailer in Colorado with more than 15,000 different products sold and 100,000 square feet of retail and warehouse space.

Built in 1961 by Herb Becker and purchased by Alan Freis in 1980, the company is known for its service and enormous selection of wines, beers and spirits. Their unique inventory includes special and vintage wines, Cognacs and Armagnacs, hundreds of single malt and specialty scotches, vintage ports, and hard-to-find imported wines.

Today the company is owned by Freis' son-in-law, Jim Shpall, a former attorney who began management of Applejack in the mid-90s. Shpall grew up watching his entrepreneur father run Lane Supply Company with his brother-in-law Harold Lane for 35 years. Having witnessed a business interwoven with family employment helped Shpall develop a family business value system he utilizes today.

"I realized there are special dynamics that exist in such family organizations early on," says Shpall. "Obviously all successful businesses command a serious work ethic, and all companies should respect their employees, but in a family business there is a unique closeness. There are more stakeholders than just the family — we are so mindful of the responsibility to our employees, their families and the lives that depend on how well we run our operation."

Uniquely, Shpall deals with many other family run businesses such as craft brewers and makers of artisanal spirits. He likes the continuity and commitment to quality these family owned businesses provide.

"These companies aren't part of a large public corporation where the individual spirit and contribution could be lost," he says. "Everybody who calls on us is trying to support themselves and their families, and if you lose sight of that, then you've lost sight of what's really important."

Whether Shpall's children, now ages 21 to 26, will one day join the family business is yet to be determined.

"These are certainly crucial conversations to have," he says. "We talk about what the opportunities are and aren't; they see the beauty of being one's own boss, but understand the responsibility of being accountable for others' livelihoods and to the community. My only hope is for them to find their level of happiness whatever that may be: An entrepreneur of their own, joining this company, joining another one or traveling the country with community action groups such as Teach For America. They have to make a life for themselves. I can just open doors."

Former owner Alan Freis with current owner, and son-in-law, Jim Shpall, of Applejack Wine & Spirits.

Community involvement is especially vital to Shpall, and Applejack is a major sponsor of many charitable organizations, including the Denver Art Museum, The Children's Hospital and Denver Public Schools Foundation, among others.

"Not only is our business here, but our family is here," Shpall says. "It's really not just about the business, but everything about being part of a larger community and contributing to it, and doing what we can as citizens to make sure we have a vital and vibrant community for everyone who lives here."

When it comes to how Shpall would advise other family run businesses, he says, "When all is said and done, all that ever matters is family, whether it's your personal family or your family at work. We all should recognize that people generally want to do their best and have a wonderful lifestyle. Our job is to help them pursue their happiness, however we can." ▪

Owners' Discussion on Selling the Business

by **Jennifer Pendergast**

Few family business discussions can be more contentious or fraught with emotion than the discussion about selling the business. There are instances when the ownership group agrees that sale of the business is the only answer. More often, it is not clear that selling the business is in the owners' best interests, or it may be that selling is in the best interests of some owners but not others. It is under these circumstances that a thorough dialogue on the sale option will help owners make the appropriate decision and execute it successfully.

An interest in selling can be generated from a number of sources. A few examples include an offer for the business by an outside party, financial distress within the business, dissent among family members leading to a desire for some family members to exit, and lack of commitment of current or future owners to provide the support necessary to move the business forward. How do you begin the dialogue on considering a sale? You might think that the conversation would depend upon the reason for considering the sale — after all dissent among family members is a very different reason for a sale than receiving a great offer for the business.

> The objective is not just "to sell or not to sell," but a genuine analysis of strategic alternatives for achieving the owners' goals.

The truth is that regardless of the reason for considering a sale, the right place to start the dialogue is with a discussion of the long-term vision for the business. For owners to make an educated choice between keeping and selling a business, they need to understand what the future of the business might look like (and understand what the future looks like without the business — more on that later). Questions that need to be raised in this dialogue include:

- What is the long-term business vision and is it inspiring to owners?
- Are owners capable of executing this vision, as either managers or overseers of strong outside management?
- Does the vision create a financially attractive result for owners?

A decision is a trade-off between two or more alternatives. In the case of a business sale, the most simplistic alternatives are to sell or not to sell. To make an informed and wise decision, owners must understand what they are giving up if they sell. This requires an understanding of future strategy and a financial outlook for the business as well as an appreciation of the legacy and values that the business represents.

Once the owners have a clear picture of the business vision and opportunities, those who advocate selling must articulate what they hope to achieve through a sale. The goals for the sale can be diverse, including a desire for liquidity by some owners, a wish to reduce risk associated with problems in the business, or an effort to remove circumstances leading to family discord. Or perhaps an offer was made that's too good to pass up. Understanding the objective(s) and motivation(s) is important because, as the old saying goes, there is more than one way to skin a cat.

The objective of the sale will define the range of possible solutions, of which selling will be only one. For example, if the objective is to provide liquidity for owners, there are other options besides selling the business, including taking on additional debt or selling part of the business to an equity partner. If the objective is to address unhappy owners who want to exit, it might be possible to finance a buyout of those owners while retaining control in the hands of a consolidated ownership group. If industry consolidation prompts consideration of a sale, the owners could think about being buyers instead of sellers.

Another important part of making a good decision is understanding the implications of making the decision versus not making the decision. In the case of keeping the business, owners must understand not just the financial implications, but also the implications for the owners' and managers' roles and the long-term opportunities and challenges the business may face. In the case of a sale, owners must understand the implications as well.

Financial implications of a sale can be obvious: keeping the money in the business or earning an immediate return. However, even this scenario must be considered carefully. What is the outlook for long-term return from the business versus the outlook if the money is invested elsewhere (or spent)? Understanding the financial trade-offs will require a conversation about what happens to the money after a sale. Does the family intend to retain the proceeds in an investment vehicle, or do members want to take their individual pieces and make their own investment decisions?

Nonfinancial implications are more difficult to quantify. For instance, what happens to family members currently employed in the business? And what are the implications for next-generation members who were considering employment? If the business is the glue that holds the family together, is there a desire to recreate that glue by developing a joint investment vehicle or a philanthropic entity? The family also will need to consider the impact of the inflow of liquid wealth on current and future generations.

Beyond the impact on the family, a sale will have an impact on nonfamily employees, many of whom may have dedicated years of service to the business. A sale also will have an impact on the communities where the business operates.

Given the breadth of topics that need to be considered, it is very unlikely that the decision to sell the business could ever be accomplished in one meeting. For this reason, we choose to use the word "dialogue" in framing the sale discussion. How does this dialogue start? Typically, an owner or group of owners will need to decide that the topic is worth broaching. This dialogue could start as an informal conversation among owners or a more formal presentation, depending upon the reason for the conversation as well as the size and complexity of the ownership group. Regardless of how the conversation starts, we strongly encourage owners to fully consider all the elements of the dialogue we have outlined — business vision and strategy, objectives of the sale, alternatives to a sale, and implications of a sale — before reaching a decision. The objective is not just "to sell or not to sell," but a genuine analysis of strategic alternatives for achieving the owners' goals.

Even if a sale is a foregone conclusion, a full and informed discussion of these topics will ensure that the impact of the sale is well understood and managed and the outcome is as positive as it can be. ▪

Jennifer Pendergast, Ph.D., is a management consultant specializing in strategic planning for family owned businesses and has been a professor and Wall Street investment banker.

Honoring Both Family and Business Considerations in Compensation Approaches

by **Amy Schuman**

One of the most challenging policy areas for families in business together is compensation. As with many issues, approaches tend to be divided into two camps. Opinions and emotions can run quite high on both sides.

The "Market Camp" says that a market-based approach to compensation is the only acceptable and professional alternative. Family members should be paid what anyone else in their positions would be paid, and perquisites for family members are to be avoided. According to this view, any other practice is uncompetitive, is unsustainable and jeopardizes the success of the business.

The "Family Camp" insists that special considerations in family compensation are legitimate and appropriate. The family may decide to pay family members approximately the same salaries no matter what their positions, in order to preserve family harmony. Alternatively, family members may be paid a premium wage or receive special perquisites such as paid memberships to a country club, extra vacation time, or the use of company resources such as cars. These special rewards recognize the extra burden of ownership borne by family members, who often put in many extra hours of work during evening and weekend community and family events.

Wise and experienced families find it impossible to embrace one of these two approaches to the exclusion of the other. They seek to operate in a way that balances the wisdom found in both approaches.

In addressing this dilemma, a polarity map (originated by Dr. Barry Johnson) is very helpful. Polarity maps help us to appreciate complex ongoing challenges that involve contradictions that must be managed, not problems that can be directly solved. A polarity map that helps us appreciate the Market and Family perspectives on compensation in a family business would look something like the chart here.

By looking at this polarity map, we can see the danger in choosing one alternative to the complete exclusion of the other. Although we may have a strong preference for one pole, we cannot ignore the wisdom inherent in the other. Upon some reflection, we can see that investing in one pole will strengthen the other. For example, market-based compensation approaches contribute to stronger, less confused family relationships. At the same time, monetary recognition and reward for the long hours invested by family members in support of their business can foster their support for a data-based compensation philosophy in the business.

Let's provide a hypothetical but realistic example.

Joseph Construction Company is a preeminent Midwestern firm entering its third generation of family ownership and management. Several years ago, when the siblings entered the business, they embraced a market-based compensation approach. Their HR staff regularly adjusts family and nonfamily compensation based on regional and national salary surveys. Performance appraisals are conducted regularly and form the basis of salary decisions at all levels. The family sees this professional approach to compensation as a cornerstone of its continued growth and success as well as its ability to attract and retain top nonfamily talent.

However, over the years, the siblings have come to see the value of incorporating several family based elements into their total compensation approach.

For example, performance reviews are standard practice throughout the company and provide an objective basis for salary increases at all levels. However, family salary increases are not tied to annual performance reviews, because the siblings have never really received performance appraisals.

Also, family member pay is slightly above market rates for their jobs. This is in recognition of the extra time and effort put forth by family members. They are all active in the community

Higher Purpose: Destroy Both Family and Business			
Upside	• Affirms family membership as a crucial contributor to business success. • Recognizes the nontraditional (off-the-clock) contributions of family members. • Affirms the value of relationship-based rewards in creating a sustainable family business.	• Affirms job-related skills and experiences as crucial contributors to business success. • Recognizes the job-related (on-the-clock) contributions of employees. • Affirms the value of performance and merit-based rewards in creating a sustainable family business.	Upside
Family Based Compensation Elements			Market-based Compensation Elements
Downside	• Market value of job-related contribution ignored or minimized. • De-motivates workforce and makes it harder to attract and retain the best talent. • Family entitlement mentality could threaten business sustainability.	• Market value of family contribution ignored or minimized. • De-motivates family and creates distance between the family and the business. • Overemphasis on evaluation and measurement could threaten sustainability.	Downside
Family Based Compensation Elements			Market-based Compensation Elements
Deeper Fear: Destroy Both Family and Business			

Every successful family business finds its own unique compensation approach.

and spend many evenings and weekends representing the family and business at charitable events. They have also taken on the role of organizing family meetings and preparing the next generation for their responsibilities, much of which takes place outside usual business hours. These activities are critical in creating conditions for sustainable success. Family and nonfamily executives know about this "family pay premium" and recognize its value.

Although the company has a vacation and time-off policy that is strictly enforced for nonfamily employees, the siblings' vacations and time off are not monitored or tracked. While none of the siblings abuse this privilege, none of them limit themselves to the company standard of two weeks of vacation per year. In fact, when their children are young, family members frequently leave work in order to attend their children's events and tend to their needs, a privilege that is not extended to nonfamily employees.

Finally, all four siblings attend an annual family business seminar (often in exotic, luxury locations) paid for by the business, and this time off is not counted as part of their vacation time.

However, all these family based compensation elements take place alongside a professional, rigorous, market-based salary and bonus system throughout the company.

This hypothetical family illustrates a realistic and positive approach to considering both family and market-based considerations in total compensation of family members.

Every successful family business finds its own unique compensation approach. As you seek to establish your approach, be aware of the importance of balancing these two important forces. Which approach do you prefer? Are you emphasizing one approach to the exclusion of the other? If so, perhaps this article has offered you some ideas that can help you strike the most productive balance for your unique situation. ■

Amy Schuman consults with family businesses on leadership development, communication skills and team building, and was the founding facilitator of the Next Generation Leadership Institute at the Loyola University Chicago Family Business Center.

10 Strategic Questions for the Next Generation

by **Craig E. Aronoff**

Among the many issues that confront family businesses in times of generational transition, strategic direction can be crucial. The strategy that has provided direction for the business during the incumbent generation's watch may be faltering or tired or largely completed. Strategic modifications, reinvigoration or even a reinvention of the business may be required with the aging current leadership unmotivated, unwilling or unable to lead the process of change. Strategic stagnation may set in with what can sometimes be disastrous consequences if the business loses its ability to compete.

Next-generation managers may recognize the problem but be in a poor position to do much about it. Their elders, still in control, may resist change and the risks that change implies. They simply may not wish to challenge established practices. Or they may fear being seen as lacking answers and the power to lead — but still not ready to let go.

Next-generation managers also can have their own difficulties. With heavy operational responsibilities, they may be focused on the present with no time to consider the future. When you are fighting off alligators, it is easy to forget that the job was to figure out how to drain the swamp. The next generation may be lulled into false confidence by accepting the status quo or by their respect for their elders. Or perhaps they've fought for change and lost their battles. Or maybe the strategic differences among members of the next generation have not been addressed.

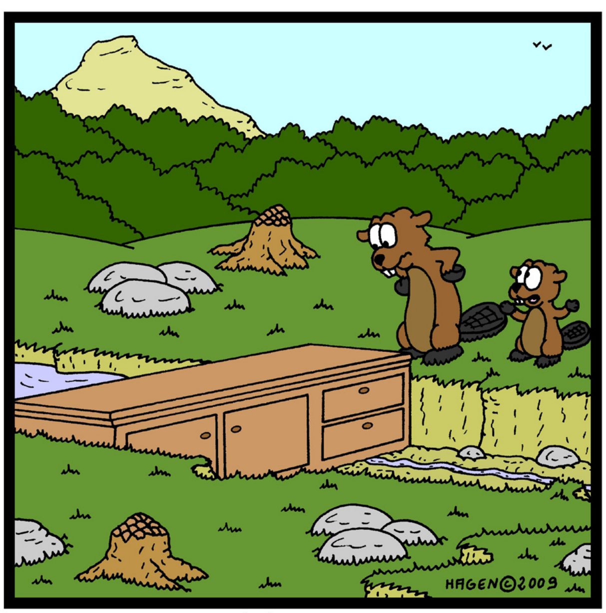
The result of any of these problems may be a lack of strategic leadership, which can leave a business, its management and employees adrift.

Our strong recommendation is that the next generation of family business owners come together early in the process of generational transition in order to achieve consensus on strategic direction. Once that consensus is achieved, it should be communicated to top management, which has responsibility for developing the business' strategic plan for approval by the board of directors.

When the next generation convenes to discuss strategic direction, we suggest that the conversation be guided by a number of questions. Indeed, individual members of the group should spend time in advance thinking about these questions so that each will be prepared to make effective progress toward the goal of being able to articulate strategic direction.

1. The most basic and fundamental question confronting each successive generation of family owners is: *Are we committed to continuing our family business together?* While basic, the question is not simple. Different family members may have different answers. Some may wish to cash out. Others' participation may be conditional ("I'm in, but only if I have a top management job.") Some may dream of their own children inheriting the business. Others may not have children. Motivations that were homogeneous in the previous generation can differ markedly among members of the next generation. These matters and the liquidity issues that may ensue should be worked through.

2. Next question: *Are we satisfied with our current strategy?* This is actually a very complicated question. To answer it, participants in the discussion must know and understand the current strategy and must be able to assess its effectiveness. That knowledge usually requires some rather in-depth discussions with the business' leadership and board of directors. Sometimes the conclusion is that the strategy is not clear — that it is inadequately effective or that the strategy is good but poorly executed. Such conclusions require many more questions to be asked.



Sorry Dad, but my true passion is for making furnitures, not dams...

3. *Are we satisfied with our rate of growth?* To answer this question, next generation leaders should understand the positives and negatives associated with growth, which vary by industry. Sometimes, growth is required to remain a viable competitor. Sometimes, more growth means increasing risk or reducing quality. These issues must be carefully examined.

4. *How does the availability of capital constrain our strategic choices?* The willingness of owners to provide capital to the business and to reinvest profits in the business has significant impacts on growth, diversification and other strategic options.

5. *What is our orientation toward risk?* The next generation should consider the financial structure of the business and their willingness to use leverage (borrow money) to pursue the strategies adopted.

6. *How patient are we with our capital?* Are the owners looking for current or quick returns, or are they willing to wait for the strategies to come to fruition? Reaching consensus on this question has a significant impact on strategy selection.

7. *What are our expectations about liquidity?* The group should reach consensus on their desires for distributions and the ability to sell shares.

Our strong recommendation is that the next generation of family business owners come together early in the process of generational transition in order to achieve consensus on strategic direction.

8. *What are our business' strategic strengths and weaknesses?* What opportunities and threats confront us? These questions are the basis of a widely used strategic planning tool called S.W.O.T. analysis (Strengths, Weaknesses, Opportunities, Threats). The exercise is one that owners should go through to sensitize themselves to the strategic planning process and to improve their ability to offer strategic direction and feedback.
9. *Are there strategic avenues recommended or precluded by our family's values?* Family owners may support or deny certain strategic directions because of family values. Reach agreement among owners on this issue and make such constraints clear to management and the board.
10. *What do our family business' history and traditions tell us about how we've handled strategic change in the past?* All business-owning families have had differing historical experiences relating to such matters as change, consistency, quality, risk, discovering and taking advantage of opportunities, and other strategic issues. These are worth reviewing for lessons learned or so that thoughtful departures from the past can be accomplished.

Your family may come up with additional strategic questions to consider. But it is important to encourage the rising generation of family business owners to engage sincerely in the complicated and time-consuming discussion required to reach consensus on strategic direction. The next generation must speak on this crucial subject with one voice to each other, to the board, to management and, someday, to their own children. ■

Craig E. Aronoff, Ph.D., is a leading consultant, speaker, writer and educator in the family business field, lecturing at more than 100 universities and authoring, co-authoring or editing more than 30 books.

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for our next
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GOVERNANCE AND OWNERSHIP IN THE FAMILY BUSINESS

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