PIFB Newsletter

Summer Edition

PURDUE UNIVERSITY | Institute for Family Business
COLLEGE OF AGRICULTURE

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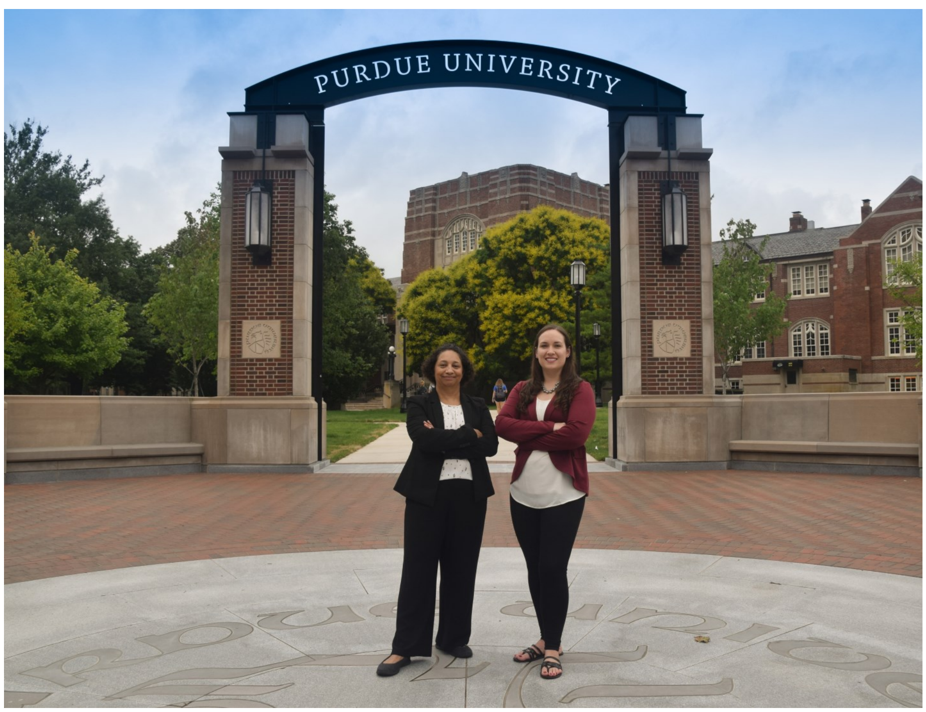
Included in this Issue:

PIFB: Why the Name Change?

The Department of Agricultural Economics has a new institute, the Purdue Institute for Family Business (PIFB). What previously started as the Purdue Initiative for Family Firms has now grown into a permanent, holistic center for family businesses. The Purdue Institute for Family Business is aptly named to reflect its permanent and ever-important presence in the state of Indiana and at Purdue University. Director of PIFB, Dr. Maria Marshall, has an integrated research, teaching and Extension program focused on family businesses. PIFB's aim is to enhance the knowledge of family business owners, successors, employees, advisors, and educators to improve family functioning and business success. According to Dr. Marshall, "PIFB's purpose is to enhance the resilience of family businesses". Dr. Maria Marshall and Renee Wiatt (family business management specialist for PIFB) will continue to conduct high-quality research focused on family businesses, along with Extension programming around the state of Indiana.



PIFB Director Dr. Maria Marshall (left) and Family Business Management Specialist Renee Wiatt (right)

All family businesses need some type of governance. As a family business owner, you have probably heard this a lot. It might sound like something only big corporations might need to align incentives to business profit goals and keep employees from straying from corporate policies. So, why does a family business need effective governance--*and* what do I mean by governance? I mean the rules, procedures, and policies for making decisions by which family business owners set and achieve objectives. As a family business owner, you want to enjoy the outcomes of good governance such as family harmony, effective conflict resolution, hiring and developing employees, and increasing profits and growth.

So what are the costs of ineffective governance and lack of policies and procedures? It can lead you to hire family members for positions they are not suited for, which leads to incompetent control and advice. Altruistic feelings and a concern for harmony can blur your decision-making and the quality of monitoring. You pay private expenses with company money. You may continue to pursue legacy activities even when they are no longer profitable because of attachment to the "product or service that got us here". You have not specified the qualifications and entry levels for family members who want to work in the business, which results in conflict and resentment. Sometimes the symptoms of poor governance seem to come from the family system but they soon find their way into the business system.

Ultimately, effective governance has three principle goals: 1) making sure that the family is competent to make decisions regarding the business; 2) ensuring the cohesion of the family; and 3) keeping the family in control of the business. Here is a small sample of issues to think about as you set policies or guidelines for your business:

- Do you need a family code of conduct?
- Do you have a social media policy for family members tied to the family business?
- Should you have requirements for family employment in the business? Can anyone who wants to be part of the business join the business?
- Does everyone with a position in the business have a job description?
- If family members are employed in the business, is everyone paid the same regardless of skill or ability? Should you have guidelines for how family employees are compensated?
- Can in-laws be part of the family business? Are prenuptial agreements mandatory for family business owners and successors?
- Do you have a process for family decision-making?
- Do you have a personal retirement plan?
- How will you handle ownership succession?
- Will ownership and management transfer to your successor(s) happen at the same time?
- How can you maintain family cohesiveness and harmony while also sustaining family ownership?

Thinking through these issues will most likely lead you to think about other policies or guidelines that you feel your family business needs. It is easier and more effective to set these policies in place before they affect a particular member of the family. This ensures that the rules do not seem arbitrary to the successor or seem instituted for a particular person. Remember that at the end of the day, governance is about setting policies that work for you, your family, and your family business in order to have competent owners, family cohesion, and family control.

Financial planners often speak about mistakes surrounding retirement, IRA accounts, stretch distributions, spousal rollovers, Roth and traditional IRA's; the list goes on and on. However, the biggest mistakes are often made due to lack of communication between the recipients of an inheritance (whether it is cash, land, investment accounts) and the financial advisor who managed the funds before the accountholder's death. In fact, one of three beneficiaries has blown through his or her inheritance and has a negative account balance within two years (O'Brien, 2015).

Consider inclusion versus exclusion. Every family business is structured differently, whether discussing legal structure, management structure, or ownership structure (not to mention family structure). Communication also varies business to business in terms of who is included in conversations, how much insiders and non-insiders are privy to, and who in the business meets the advisors. Some members of the incumbent generation of a business may not feel comfortable sharing all of the financials with successors, but transitions are easier when individuals are better informed (Wiatt and Marshall, 2016).

Educate the beneficiaries. A predecessor may have spent as many as 80 years gaining knowledge about investment, living within his or her means, and other proper money management strategies. However, beneficiaries could all of the sudden go from putting $100 in savings a month (in the good months) to having a very large sum of money to his or her name. Even with using what would seem like "smart" money management techniques (i.e. paying off debts, putting a little money in savings, contributing to children's college funds), beneficiaries could face huge taxes and penalties due to early distributions from the predecessor's retirement account (MFS Fund Distributors).

Include everyone in the conversation with the advisor(s). Smith (2015) urges families to focus on the beneficiaries to be sure that they are properly informed. Financial literacy, along with the correct advisors involved in every step, can ultimately lead to a successful inheritance transfer within a family and a business. Every generation can benefit from meeting with the family's advisors. Lawyers, financial planners, bankers, etc. can ensure that the next generation are stewards of what the incumbent generation worked so hard to build.

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The Differing Values Within the Family Business

Glenn Muske

Family businesses form a significant segment of businesses, especially small businesses. And while for the business side, the same tools are used to operate and manage the business, family businesses have some unique challenges that take additional planning and management for them to be effective.

One such differentiating aspect between family businesses and small businesses comes from the difference in how each system operates. Businesses, by their nature, need to focus on long-term success. This means goals of profit and growth. The relationships within the businesses are more impersonal. You will often find written roles and policies. Employees are evaluated and promoted based on performance. People enter through a hiring process and leave because of retirement, promotion, or moving to another company.

Family businesses certainly have the profit motive in place and often the growth goal as well. And many have some or all of other policies and procedures we would expect in any business.

But, family businesses also have the family system to consider. Thus, a family business may include objectives such as the development and support of family members and strengthening family relationships. Just look at the results of the April question posted by the Purdue Initiative for Family Firms. The highest rank mentioned disadvantage, by over 20 percent, was the “potential for personal conflict.”

In family firms you also may find informal roles and role expectations and rewards based on family status and not performance. Succession and business transition may also differ in a family business.

Not only are the values different, but family-business owners more often talk about balancing demands between the two systems, the dynamics of each, and how roles change for people as they step back and forth between the business and the family.

As you might expect, these differences create conflict. The level of conflict will vary based on firm age and size as well as how the owner sets up and manages the business.

Developing a successful, sustainable business comes from identifying and including values into the culture, policy and procedures of the business. In family firms, it also means including the differences in business and family management.

Families can bring a great deal to the business. They also bring challenges, but acknowledgement of the differences and planning can make opportunities out of challenges.

Does Insurance Aid in Small Business Recovery Following a Natural Disaster?

Renee Wiatt & Maria I. Marshall

After a disaster strikes, insurance is often the first thing that comes to mind to cover costs associated in recovery. Businesses can buy a variety of insurance policies related to their business. Policies can include flood insurance, business interruption insurance, business recovery insurance, casualty and property insurance, and other policies specific to the businesses' needs (for example, inventory insurance). In the event that a business is a home-based business, the business and homeowner may have flood insurance, property and casualty insurance, or a combination of other policies in place.

This article investigates small businesses in a 10-county area in southeastern Mississippi. Hurricane Katrina affected these Mississippi counties; some were coastal and others were further inland. Of the 347 businesses that survived Katrina, roughly 46% sustained major damage during the hurricane. Of the 116 businesses that have closed since Katrina, roughly 63% sustained major damage during Hurricane Katrina.

The regression results showed that small businesses were more likely be operational if the business had property insurance in place before the natural disaster. Sustaining major damage from Hurricane Katrina was found to lessen the likelihood of remaining operational. Although damage from a natural disaster is unavoidable, having insurance in place is within a business owner's control. The regression also showed that business age, having a male owner, the owner having postsecondary education, and having more employees had a positive influence on business survival.

Just because a business is in operation after a natural disaster does not mean that the business has returned to the level that it had attained pre-disaster (Marshall and Schrank, 2014). If a business is still in operation but not back to some pre-disaster level, then that business can be referred to as "survived". A business in operation and roughly at the same level as before the natural disaster characterized as "recovered". A business that is operating at a level that is higher than before the natural disaster can be referred to as "resilient". Another analysis measured the factors that affect small business resilience after a natural disaster, measured by higher revenue than before Hurricane Katrina and higher perceived success than before Hurricane Katrina.

Small businesses were more likely to be resilient in terms of revenue after Katrina if that business adjusted their insurance policy elections post-Katrina. These adjustments would assure that the business would be better protected in the event of another disruption. Some of the businesses that experienced Katrina were unlucky enough to be hit with an oil spill or Hurricane Isaac less than ten years following Katrina. Having a formal legal structure (i.e. corporation or partnership), being married, being male, and number of employees all contributed to higher levels of revenue after Hurricane Katrina. Owner experience was found to detract from likelihood of more revenue following Katrina.

Businesses were more likely to achieve higher perceived success after Hurricane Katrina if they owned the property where the business operated and had property insurance in effect before Katrina. Businesses were less likely to have higher perceived success after Katrina if insurance was unaffordable after the natural disaster. Roughly, 25% of small business owners could not get affordable insurance coverage following Hurricane Katrina. The business owner characteristics such as marital status and education influenced the likelihood of achieving higher perceived success after Katrina. Owners of older businesses were less likely to experience higher perceived success after Katrina. *(continued on page 6)*

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The goal for small business owners should be to have the correct safeguards in place to be able to survive a disaster, adapt and recover, and come out of the other side better than before – to be resilient. Insurance is not the only step that should be taken to protect small businesses, but it is an important one. Having the correct insurance coverage in place can be the difference between survival and demise for a small business.

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