THE COMMERCE BANK OF WASHINGTON

Spring - 2013

FAMILY BUSINESS newsletter

Relevant Resources to Help Your Family Business Succeed

by **Harris H. Simmons**
Director, The Commerce Bank of Washington

Welcome to the first issue of our quarterly Family Business Newsletter. We've always had a strong conviction that banking, at its best, is a very local business—and one characterized by strong and long-lasting relationships with our customers. We're dedicated to helping your business succeed, and hope that providing relevant resources and useful ideas is one of the ways we can offer value to you.

While providing banking services to more than 200,000 businesses around the western United States, we have found that a sizeable portion of our clients' firms are family-owned, ranging from very small sole proprietorships to substantial multinational corporations—all dealing with common issues like succession planning, working with multiple generations, and next steps following a transition.

A couple of years ago, I received a call from a client who asked if I would go to lunch with his family to help them think through some succession challenges. A few weeks later, I had a similar call from another family business owner thinking through dividend and liquidity issues. It dawned on me that we have many clients facing issues specific to closely-held and family-owned businesses.

I grew up in what felt very much like a family business. My father put together an investor group and acquired majority control of the first of our affiliate banks in 1960. The company went public in 1966, after one of his partners died unexpectedly and cash was needed to provide for his widow and children; but my parents, my siblings and I have been deeply involved in the banking business for over five decades now. We also developed business interests in broadcasting and real estate, and found that these businesses brought our family together with a common sense of purpose.

I remember the week after I turned 16, my father put me to work filing cancelled checks. As I worked alongside him, I gained a richer understanding of my dad's many strengths (and perhaps a weakness or two!) having gone through the same kind of experiences I imagine that a lot of you go through with your own families, I realize that family businesses are very unique. You're given the opportunity to cultivate family relationships and both teach and learn valuable life lessons.

But if managed badly, relationships may be destroyed and rifts can occur. We hope we can help you avoid such outcomes by periodically providing information you might use in running your family's business.

We're privileged to work with an amazing variety of companies, from furniture designers to water pump distributors. It is a reminder to me of the great diversity and dynamism that we see in our nation's economy—much of which is built on a foundation of great family businesses. We hope that this newsletter, and those to follow, will create some helpful dialogue within your family.

Thank you for your business. We are honored by the trust that you place in us as a financial partner. ▪

At 28, CFO Harris Simmons (far left) joins his father, Roy Simmons (far right), at a board of directors meeting in 1982.

Are Next-Generation Family Members Qualified to Lead?

by **Jennifer Pendergast**

"Do I deserve this job?" This is a question many next-generation employees in family businesses ask themselves. Some are filled with self-doubt, thinking the only reason they have their jobs is because they were born with the right last name. Others may feel fully qualified but may struggle with the skepticism they perceive from other family members or nonfamily employees who doubt their qualifications.

While many next-generation employees have a leg up over employees who are not part of the family, the boost they receive is not just from being in the family. Family members are often exposed to the business from a young age, providing an opportunity for them to begin learning the business much earlier than non-members can. This exposure can even occur outside of the formal confines of the office. In many cases, children witness their parents working through business problems, which provides the model for how they might perform in the future. And don't forget that next-generation members may inherit "leadership genes" from the business leaders.

For these reasons, it can be inaccurate to assume that a next-generation family member unjustifiably received his or her position rather than earning it. A great example of next-generation members earning their way is present in the entertainment industry. Because entertainment professionals don't work within a business hierarchy, they can't inherit a job in the same way that the next-generation CEO of a manufacturing business might. Certainly, a well-known last name may help in getting initial auditions or introductions to important people. An example is Bryce Dallas Howard, daughter of director Ron Howard, who appeared as an extra in her father's films Parenthood and Apollo 13. But Bryce didn't lean on her family name. She applied to drama school as Bryce Dallas, dropping her last name to eschew special treatment. During her studies at the Institute of Performing Arts within NYU's Tisch School of the Arts, she appeared on Broadway. Well-known director M. Night Shyamalan discovered her there and cast her in several of his movies. While her name may have gotten her a leg up early in her career, her skills and experience earn her the job in every new production.

Because of the public personas of actors, many people are familiar with the multigenerational acting families. Next-generation members in the spotlight today include Gwyneth Paltrow, Michael Douglas, Charlie Sheen and Kiefer Sutherland. Less familiar are multigenerational legacies on the business side of entertainment. Take the case of Jenny Gersten, who is an associate producer at the Public Theater in New York—a job that her father, Bernard Gersten, held 40 years prior. Jenny's story and other similar family legacies were featured in a recent article in the *New York Times*. Jenny says, "I think theater gets to be a family business just like any other." However, as has Bryce Howard, she has proven herself on her own. Her first job out of college was with the 52nd Street Project, a theater mentor organization. The project's executive director says that Jenny "met and worked with tons of people here she didn't know through her parents." It is interesting to note that the job she holds is one that her father was once fired from. While his daughter admits that theater is a family business, Bernard counters, "This isn't dynastic. It isn't Bernard Gersten & Daughter, like Russ & Daughters, the food shop on the Lower East Side."

These examples serve as a good reminder that many next-generation family business leaders do earn their stripes through the skills and experiences (and even genes) they inherit. ▪

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.

Living with Your Will

by **Ross W. Nager**

It can be difficult for your spouse to live with your will.

I recently struggled to help a widow pass her husband's estate to their children. That's exactly what he wanted, but the marital trust provisions in his will are in the way. The real shame is that, if you're married, your will likely contains similar provisions.

I attribute the problem to 1981 tax legislation that created an unlimited estate tax deduction for property left to your spouse. Previously, you could leave up to one-half of your estate to your spouse without tax. The other half was taxed regardless of the lucky inheritor's identity.

> YOUR WILL CAN BE A FINAL EXPRESSION OF YOUR LOVE AND TRUST, OR A STRAIGHT JACKET DESIGNED TO CONTROL FROM THE GRAVE.

Everyone cheered the proposal to allow unlimited property transfers between spouses. However, members of the bankers and lawyers associations raised a concern. They suggested that few people would be willing to take advantage of Congress' largess for the extra half. Why? What if the surviving spouse remarries and leaves the results of your hard work to a new spouse or children from a second marriage? People may be comfortable taking that risk with half of their property, but will they risk it all?

Enter the QTIP

In response, Congress authorized a new entity. The Qualified Terminable Interest Property trust (affectionately known as the "QTIP") was born. Since then, QTIPs have become a staple of testamentary planning and seem to find their way into just about all married couples' wills.

Congress imposes only a few constraints on QTIPs. The surviving spouse must be the only beneficiary and must receive all income annually for life. When the survivor dies, the QTIP property is subject to estate tax as if it is part of the survivor's estate. Beyond that, the terms basically are up to the creator or, more realistically, the drafting attorney. This is where the plot thickens.

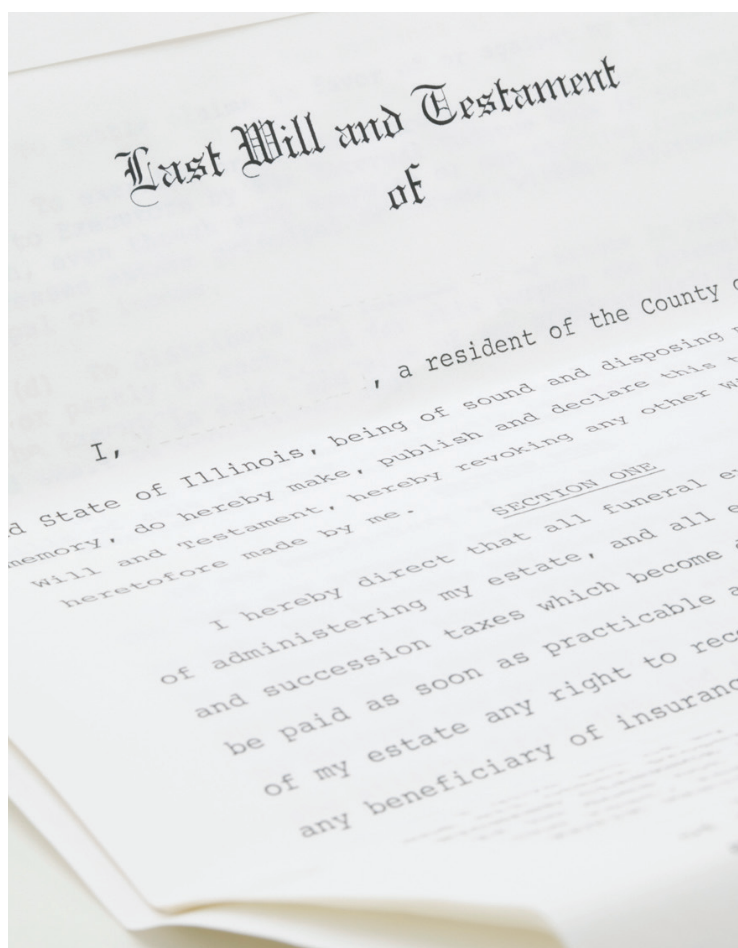
The QTIP's creator can specify who receives the principal of the trust upon the surviving spouse's death. That's the key appeal, because it assures you that your heirs get the dough, not your spouse's potential newfound love and his/her rug rats. Attorneys, who are intent on looking out for your property interests, inevitably restrict your spouse's rights in order to maximize what's left for your heirs.

QTIP Problems Surface

That's fine. After all, it is your property. But, let's think about the results, which are beginning to surface as the early vanguard of the QTIP generation begin to "tip over," as one of my associates refers to the event that causes a will to "mature."

The widow mentioned above recognized that the future estate tax bill on the QTIP property is rising due to successful investing. She wants to make lifetime gifts to reduce the tax. Also, the kids have financial needs that she would like to satisfy. But, she ran into a brick wall. The tax law prohibits QTIP distributions to the kids. Furthermore, the trustee refuses to distribute principal to her because her husband's will permits distributions only for her health, support and maintenance. Supporting the kids and estate tax planning are not included.

Just like her husband, she wants to maximize what will pass to their children. Unfortunately, her husband's QTIP blocks her efforts. It gets worse. The trustee controls her financial affairs. She detests



explaining her living expenses to a bank trust officer whom she hardly knows. (At least her husband didn't name the kids or one of his drinking buddies as trustee. She says that would be downright embarrassing.) She's stuck with this arrangement for the rest of her life. And, she's beginning to wonder why her husband didn't trust her to do the right thing with what they built over the course of a prosperous and happy marriage.

My concern is that this widow's dilemma will become the norm, not the exception. Rightly or wrongly, lawyers like to point out the worst case, namely that your spouse may leave everything to some bum you don't even know. Sure, that's possible, so the knee-jerk reaction is to use a QTIP.

However, let's be realistic. Even if your spouse remarries, will she love your kids less and disinherit them? If I tip over early, I actually hope my wife finds happiness elsewhere. I don't begrudge her the ability to share some of "my" wealth as she deems appropriate. Heaven knows she earned that right after raising our kids and putting up with me! And, I doubt that I'll be bothered by her decision after I'm gone. The alternative of tying her hands and preventing her from being responsible for both her and our kids' financial destiny is simply not acceptable to me.

QTIP Compromises

I know it's not always that simple, especially in second marriages where there are kids from prior marriages. It also is complicated by a desire to keep your family's business in the bloodline. But, please think about it. Perhaps there are appropriate compromises. Consider authorizing the QTIP trustee to make distributions to your spouse for use in lifetime estate planning. Leave part of your estate to your spouse outside of the QTIP so that there will be some flexibility. Use a buy/sell agreement to provide protection from the risk that the stock finds its way outside of your bloodline.

Your will can be a final expression of your love and trust, or a straight jacket designed to control from the grave. The choice is yours. But, consider the possibility that going to an extreme to protect your wealth from the family may be contrary to the reason you are protecting it in the first place . . . like your family's financial and emotional well being. ▪

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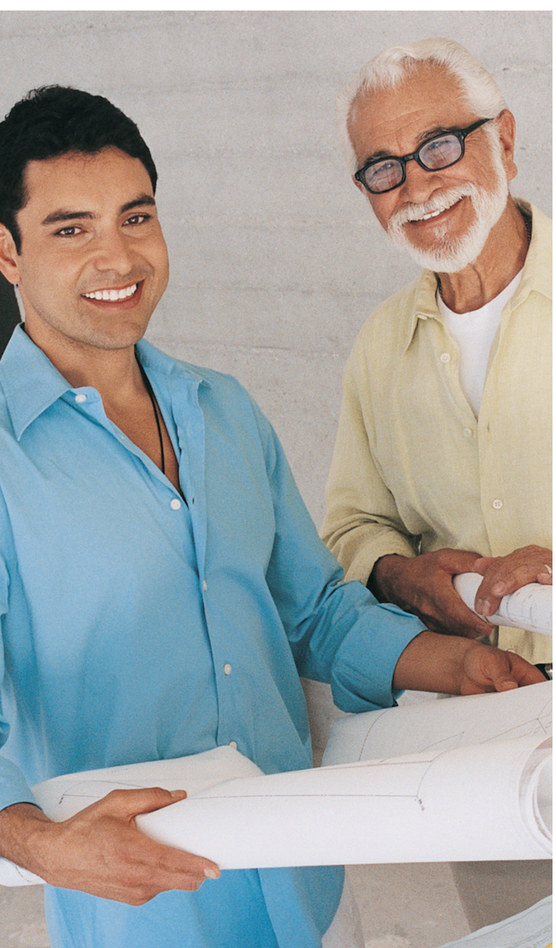

Should I call you DAD? And other perils of working for your family business

by **Stephanie Brun de Pontet & Carol J. Ryan**

There is a lot at stake when the next generation of working shareholders joins the family business full-time. The presence of motivated and competent family leaders in the business is likely to strengthen the family's commitment to the business long-term. While we would never advocate that family members should be given a clear path to leadership no matter what, it is in everyone's best interest that this experience be "successful," that the new family employee learn skills, earns respect, builds positive connections with employees and develops a greater appreciation for the business—whether they evolve into leadership or not.

However, in a family business, it is not unusual for non-family employees to feel next-generation family members who come to work for the company "have it easy" by virtue of their name. These co-workers will witness the family employee's easy access to top leadership, special opportunities and what appears to be an "automatic entry" into the organization. What they may not see is that the position comes with a host of challenges as well.

While it is true that other young recruits to the business may not have special opportunities to go to a trade show with the VP of sales or have access to a "custom made" training program, it is also true new family employees face hurdles and frustrations other employees will not experience.

It is important to educate the next generation employees, their supervisors, and other key stakeholders on how to handle the challenging situations that might arise as the next generation of family members come into the business full time. There will be awkward remarks, comments about their family members who work in the business and outside the business, and general pressure associated with the employees "watchful eyes."

We often work with families and companies to raise awareness of the issues that may come up with the arrival of the next generation of working shareholders. This can involve preparing the management team for the challenge of supervising a young family member, talking through appropriate professional learning opportunities for younger working shareholders, helping the family think through how this affects others in that next generation and if there are any new policies or issues this leads the family to address.

In the course of this work, we also like to spend time with the young adult family member who is joining the business to help make them aware of some of the challenges they may encounter, and help them think through strategies for coping effectively with these. Below are some of the issues that we find worth discussing as part of "on-boarding" a next-generation employee in the business:

NEW FAMILY EMPLOYEES FACE HURDLES AND FRUSTRATIONS OTHER EMPLOYEES WILL NOT EXPERIENCE.

1 Living under the microscope This is the very essence of where the "family name" cuts both ways. Yes, having the family name can give you a leg up in some circumstances, but it also means you are immediately under a different kind of scrutiny. You cannot as easily "learn from your mistakes" like anyone else because you aren't anyone else. While many next-generation family members have grown up with warnings from their elders to "behave," because their behavior would affect the family's reputation, this pressure is different when it comes to your work reputation. While we don't want to breed paranoia, people are watching you more closely when you are a family member employee. They are evaluating your performance and capabilities from the get-go, as many may wonder if, down the line, you may be in a leadership role. They are trying to determine what they believe about you: will you be good, fair, smart, quick to act, creative? In addition, as a working shareholder, you cannot make off-handed remarks about the business or a manager because the mere fact that it comes from you gives it a different meaning than if another co-worker had said the same thing. We have seen some families attempt to overcome this with extreme measures, for example:

"Your mother called to remind you to diversify."

One retail client we know, where the business goes by the last name of the owning family, a next-generation family member who wanted to come into the company was given a false identity in order to be able to work as an assistant manager in a store far away from the corporate headquarters, without his fellow employees realizing who he was. While this allowed him to have a first work experience free of this burden, it was very uncomfortable to be dishonest with those employees, and he eventually had to live through the microscope experience once he moved to head office two years later.

2 Coping with the legend In addition to how others may treat you, a lot of young family members struggle with their own ideas of "living up" to expectations and the traditions of accomplishment of their family. Whether you are following the shadow of the founder or are a fifth-generation family member coming into a long-standing legacy, many young people put a lot of pressure on themselves to live up to what prior family members have

accomplished. You (and sometimes others) may compare yourself to prior generation family members, what they accomplished, how they lead, etc. One trap many young people fall into is in forgetting that the business has changed a lot since the days their parent was starting out. When young folks are frustrated by their more limited authority in the business and say "dad was already running the plant when he was 32…," they may forget that the plant back then had 40 employees, and today it is a far more complex operation of 200, for example. While it is wonderful to have family members to whom you look up to and admire for their accomplishments, this admiration should never lead you to seek to emulate your parent or other family member. Each individual needs to find their own voice, role and strengths.

3 Managing employee relationships Any new employee anywhere wants to make a good impression on his or her supervisors and colleagues, to be seen as competent, a team player, fun to be with, etc. When you are a working shareholder in your family's business, you may find managing employee relationships trickier than you expected. First, while you should be yourself and seek to have appropriate social interactions with employees, there are boundaries for family members that are different for other employees. You are "different" by virtue of being in the family and some in the business may treat you differently or make assumptions about you that you will have to work to overcome. For example, some employees may try to develop a relationship with you because they think it will give them better access to the powers that be. This can make you wonder if people are nice or complimentary to you for the right reasons. As was pointed out to one of us by a supervisor when I worked in my family's business: "Carol, you will never truly know if people like you for you, because your last name is the same as the owner." Also, whatever the protocols are for inter-company dating at your business, you can assume the restrictions should be even stricter for you. Any romantic entanglement between an employee and a family shareholder is fraught with risk and this is an example of a topic on which it would be helpful for the family to have a policy before the next generation joins the business.

Some employees might assume you have access to information about business strategy, changes, finances, etc., that you may or may not have, but that are not for sharing in any event; managing confidentiality and those employee/shareholder boundaries is hard. There may also be times when someone at the company makes an off-handed remark about dividends or wealth that catches you off guard. How can you respond to uncomfortable assumptions or comments of this nature? Until they get to know you and you have proven otherwise, there will be some in the business who will assume you are a spoiled rich kid and only working there because of your family name. While it can be frustrating to have to prove yourself to people who are judging you without knowing you, this is part of the challenge that comes with the territory. Rather than expend energy being angry about these types of interactions, it is important to think ahead about how to optimally respond in a way that enables you to maintain appropriate boundaries but not seem cold and distant.

4 Relating to family In addition to navigating complex interactions with non-family employees, there are a few changes to family relationships that you may encounter when you begin to work in the business. The most obvious is how to relate to your family members who also work in the business. From thinking about how to address your parent at the office — "Hey, Dad" might feel awkward in a business meeting or even in the hallways, but do you call him Bob, Mr. Smith, Sir…? — to thinking about the appropriate mentoring or work relationships you can have with other family members, you now have to establish professional relationships with people with whom you have a lifetime of personal history. Less obvious may be the new dynamic created between you and your siblings and/or cousins now that you are a working shareholder. As you transition into the role of insider—a family member working in the business—you may have added responsibilities among your generation for keeping them current on business matters and committed to the family's shared enterprise. It can be tricky to play this role

YOU MAY FIND MANAGING EMPLOYEE RELATIONSHIPS TRICKIER THAN YOU EXPECTED.

without appearing arrogant or making the others feel some guilt that they have not chosen a path in the family business.

5 Managing opportunities As a working shareholder, we would find it normal that you may be given access to special opportunities to help develop your technical knowledge, leadership skills, or knowledge of the broader industry. In fact, we often encourage an 80/20 model, where 80 percent of the new family employee's role is a "line responsibility" —that is, a job that needs doing, for which there are performance outcomes on which you can be objectively evaluated; while perhaps 20 percent of your time is allocated to special opportunities or learning that you may be granted by virtue of your dual role as employee and owner. Striking the right balance with this formula is not always easy, as you cannot allow yourself to get behind or not deliver on the core job you are doing, even if one of the special opportunities you have is suddenly ramping up. It will be important that you only take on special projects that you can realistically accomplish, given your other commitments in the business. In addition, the specifics of the opportunities or special projects to which you are assigned need to be given some thought. For example, it would be inappropriate for you to be invited to attend a meeting where the performance of your direct supervisor might be discussed. In addition, while you do not need to keep these opportunities secret from others, you do need to be mindful that your access to these opportunities to learn or interact with key leaders of the company could understandably make some of your work colleagues jealous.

Having the honor and opportunity to work for your family business is a precious one that many will never have. It is important to always be mindful of your role as a family member, to act with integrity, to be loyal to your family and supportive of the business. Never forget that all the rules do apply to you. The other special opportunities you are offered should always be treated with the utmost humility. It is a fact of life, inside and outside of family business, that not everyone will always like you. But to have the majority respect you? That can be accomplished easily by monitoring, managing and governing your own behavior.

Our experience is that next-generation working shareholders who have taken the time to think about these possible pitfalls (and others), are better equipped to handle the awkward moments when they inevitably arise. ▪

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