THE COMMERCE BANK OF WASHINGTON

FAMILY BUSINESS newsletter

How the Walls Family Turned a Single Duplex into a Real Estate Success Story

***Below:** Burt Walls with his son Preston Walls*

Of the dozens of real estate deals Burt Walls has made over the years, the number that sticks in his head his $11,771. That was the amount he paid for his first piece of property, a duplex in Seattle's Queen Anne neighborhood. It was 1962 and 18-year-old Burt had saved a small nest egg working as a house painter the previous summer.

Burt's father, who had acquired some real estate properties to supplement his professor's income, owned an apartment building next to the duplex. He encouraged Burt to buy the property, cosigning on a $1,000 loan for the $3,000 down payment.

It would be some time before Burt purchased another property. He became a general contractor, then started an electrical contracting business. As he gradually acquired more real estate, he used his employees to do the electrical wiring, taking care of the painting and repairs himself. Eventually, owning and managing real estate became a full-time enterprise.

Today, Walls Property Management owns 90 buildings and nearly 1,000 units in the Seattle area. Since 2008, the family real estate business had been led by Burt's son, Preston Walls.

Preston, like Burt, learned everything he knows about real estate and property management from his father. One of his earliest memories is of a weekend trip with Burt to fix the water heater in an apartment unit.

"I got to tag along to help out with project," Preston recalls. "I was probably eight or nine years old."

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The featured family businesses are clients of one of Zions Bancorporation's collection of great banks: Amegy Bank; California Bank & Trust; The Commerce Bank of Oregon; The Commerce Bank of Washington; National Bank of Arizona; Nevada State Bank; Vectra Bank Colorado; and Zions Bank. All other images are stock photography.

Next Generation Development with a Mentor Team

By Stephen L. McClure, Ph.D., and Christopher J. Eckrich, Ph.D.

Career development for next-generation family members who aspire to leadership in a family business can be quite challenging. One of the biggest obstacles is providing these individuals honest feedback on their current job performance and objective advice on steps they can take to get the opportunities they will need to make it to the next level in the business. Family leaders in the business may be uncomfortable or unable to give objective feedback to a family member, and many nonfamily executives may also struggle with being entirely objective with the boss's son or daughter.

Quoting from "Nurturing the Talent," a book from the Family Business Leadership Series: "A mentor is an older, more seasoned person who wants to share his or her experience with someone younger." A mentor is also a resource to whom the mentee can turn with a question or concern — a trusted advisor. In addition, the mentor can point out when the mentee needs to adjust something in his or her work performance and can give the mentee insight on opportunities he or she should pursue.

Finding a person who can adequately fulfill this role can be a challenge. As a result, some family businesses have explored developing a mentor team to give the next-generation family member access to a broader range of perspectives and to give mentors a little cover so they can be more honest in their feedback to the family mentee. A mentor team may include a long-

term employee who can provide insight on fitting into the culture and another member who might provide industry insights or deeper knowledge in an area of business that appeals to the mentee. In addition, if suggestions and feedback come from the "group," it can defuse some of the tension or concerns executives might have in being honest about the limitations of a person who is related to the boss and who could one day become their boss.

> A well-designed and -implemented mentoring program may be the only way next-generation family members gain objective feedback on how they handle their responsibilities in the business.

So how might one go about setting this up? First, a mentor team may be appointed by either the board of directors or through consensus among the ownership group (if there is no functioning board). This team is accountable either to the board (or owner group), and in larger firms, the head of the human resources department may coordinate the mentor team. In some firms, the mentor team provides an annual report on its objectives and general progress on objectives. When practical, this team could include executives from outside the business — either members of the board who are willing to take on this developmental role or business leaders from other companies who can be uniquely objective.

Mentor contact does not need to be with all mentor team members simultaneously; one-on-one contact is encouraged when practical. Mentors might provide practical and conceptual recommendations to a family member as well as providing reading suggestions or introductions to other resource individuals as deemed appropriate. As it is expected that next-generation family members have access to the knowledge and experience of their senior relatives in the business, a mentor team's existence should not prohibit contact nor replace learning through family relationship channels. A formal mentor team can also help provide reliable oversight of the successor's professional development for the ownership group or the board.

For this process to be taken seriously by all players, many mentor teams use contracts that engage all parties in the commitment. Specifically, such a document sets mentoring objectives and clarifies how the family member to be mentored will make progress on objectives and how often the mentor team will meet with the individual. A contract also provides a means to maintain the effectiveness of the arrangement, and if it is not working, a way out.

Many firms choose to be less formal in setting up a mentor program in their family businesses. It should be noted, however, that a well-designed and well-implemented mentoring program may be the only way next-generation family members gain objective feedback on how they handle their responsibilities in the business. The involvement of a team of nonfamily employees as mentors can help build commitment outside the family for a successful succession process. A formal mentor team can also help provide formal and reliable oversight for the ownership group or the board.

In summary:

Value to the next generation entering the business:

1. Provide objective, honest, and constructive feedback.
2. Provide multiple resources that supply a variety of experience, skills and style.
3. Provide objective, impartial resources that offer advice, counsel and listening that is both supportive and challenging.

Value to the owners or board of directors of the business:

4. Assurance that the next generation is being provided with dedicated support toward their success in the business.
5. Regular communication regarding the progress of the next generation in meeting their developmental goals.
6. Objective resources to help with the development of the next generation of family business leaders.

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Cover story continued:

Following college on the East Coast and a four-year stint working on Wall Street, Preston returned to the family busines in 2002. Trading in his pinstripes for Carhartts, he was immediately put to work digging a sewer ditch for a company property. While Preston's background and interest were in finance and acquisitions, Burt had him learn all aspects of the business, from construction and maintenance to sales and accounting, before giving him a management role.

"We had a healthy tension working together," Preston says. "When I came up with a new building to buy, he would invariably take the opposite side and list all the reasons I should not buy it."

For Preston, emerging from his father's shadow meant becoming confident in his ability to make sound real estate decisions and following his convictions despite opposition. For Burt, the transition in leadership was knowing when to step back.

"You can't have two captains of a ship," Burt says. "That came through to me when we were both trying to run the business. I decided at that point to retire and let Preston run it. He took the company to the next level."

Preston steered the company into a period of expansion: syndicating, purchasing, building and renovating properties. Most recently, in 2021, Walls Property Management completed a 61-unit building on Seattle's Capitol Hill and broke ground on a 55-unit building in the hip waterfront neighborhood of Ballard.

For Burt, the best thing about running a family business has been keeping the family in close contact. When his children, Preston and Annie, were young, the job afforded him flexibility to attend their soccer and lacrosse games, and coach some of their sports teams.

He gave the kids their own real estate early. By the time they were five years old, both children owned duplexes, which they later traded in for multi-unit apartment buildings. Preston and Annie — now a medical doctor — still own these buildings today, among other properties.

"I think my legacy to Preston and Annie is getting them comfortable with real estate at an early age so they can make informed investment decisions," Burt says. "It's a risk-taking environment, but with a little confidence, the risk can be managed."

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The Five Fundamental Building Blocks of Strong Family Businesses

By Dana Telford

Business activities are often compared to sports. The analogy is straightforward. Sporting events take place in arenas, where coaches field their best players to execute their strategies. The goal is to win. Business owners follow a similar pattern, organizing and assembling leaders and employees to charge boldly into competitive marketplaces. The goal is to make profit.

Before competing in a new sport, one must first learn the basic set of skills — the fundamentals — that are the foundation for success in the arena. When a team loses, its coaches often adjust their training and practices and re-focus on the fundamentals. In American football, the fundamentals are called blocking and tackling. In baseball, fielding and hitting. In basketball, dribbling, shooting and rebounding. Without proficiency in these basics, it is hard to imagine that any team would achieve victory in the arena.

I believe there are five fundamental building blocks of family business that must be learned and consistently revisited in order to give the business the best chance for success.

1. Aligned Owners

Owners who are not aligned consume precious energy and resources as they try to wrestle each other into agreement.

Here's an example: Two branches of a family in Latin America each owned 50% of a $500 million manufacturing company. Annual free cash flow was $75 million. The leaders of each branch disliked and distrusted each other for many decades. Their most recent disagreement was about how to distribute profits. Many hours of many days for many months were spent trying to convince the other side to alter their point of view. Each time a proposal emerged and alignment seemed imminent, attorneys were called in for final document reviews. New arguments emerged, and the cycle continued for three years. The real disagreement? One branch wanted an 18% profit distribution and the other 20%, a difference of $1.5 million. Split in half and after taxes, this amounts to less than $400,000 per family, not including legal and consulting fees. Was it worth the time and resources expended?

A better investment of irreplaceable time and energy would be to work to reach agreement on the six essential alignment questions:

1. Purpose: Why are we in business together? (For example, "We believe our family business is a force for good in our community and we are its stewards.")

2. Goal: What are we trying to accomplish? (For example, "becoming the best place to work in our city" or a statement of owner's alignment.)

3. Core Values and Code of Conduct: How will we treat each other and make decisions? (For example, guiding principles, rules of communication, calendaring meetings.)

4. Accountability: Who is involved, what are their respective roles and responsibilities, and to whom will they be accountable for their activities?

5. Metrics: How will we define and measure success? (For example, culture and employee satisfaction surveys, revenue growth, profitability, return on equity, risk, distribution, productivity.)

6. Timeline: When will we work on becoming aligned? When will we reach alignment?

If alignment is not met within the timeline and if little to no progress has been made, a logical question to respectfully consider is whether the family is the right owner for the business. Would it not be wiser to liquidate or go through a shareholder buyout rather than continue to try to convince or coerce the other side?

2. Effective Board of Advisors/Directors

The evolution of board governance in family businesses is predictable. Early-stage entrepreneurial companies often have what are colloquially known as rubber stamp boards. They exist on paper but don't really function as intended. As owners and businesses evolve, so do their boards. Advisory boards are often put in place prior to a transition of the business from the founder to siblings. Advisory boards might include family members and two or three nonfamily outsiders.

Fiduciary boards are more formalized and have a legal responsibility to protect the interests of the shareholders and ensure that the business is managed well from both a legal and financial perspective. In fact, each owner has the same fiduciary responsibility to all other owners, a point not often considered when selling or gifting shares to children or other family members.

The board has four primary responsibilities: first, to understand and protect the interests of the shareholders; second, to understand the company's competitive strengths and work with management to set a strategy that leverages them; third, to oversee and hold management accountable for the successful operations of the company; and fourth, to plan for continuity through ownership and leadership succession planning.

How well a board fulfills its responsibilities, be it advisory or fiduciary, relies on three main factors: first, how clearly its purpose and function is defined by the shareholders; second, how talented and engaged its directors are; and third, how well it is led. As family businesses evolve, it is crucial for family shareholders to understand and pay close attention to establishing and maintaining an effective board. A high functioning board can provide great value to shareholders and help them to pursue an authentic, compelling vision.

> Family business owners must master and consistently practice the fundamentals if they are to remain successful.

3. Strategic Planning

In athletics, talent and hard work go a long way, but champions aren't crowned without extensive competitive knowledge. In business, enterprises start with a belief that a product or service will be valuable to someone. This belief leads to the pursuit of identifying that someone — the ideal customer. Next, business leaders must understand what key activities they can provide better than their competitors. Fusing those two pieces together — understanding where a company's strength will be most well received and valued in a service or product offering — that is where competitive advantage lies.

As an example: a client in the restaurant business knows that their strengths lie in efficiently and graciously serving more guests per day (called table turns) than their competitors. With this knowledge in hand, they make choices about how they decorate their properties, prepare their food and train their staff members. These choices are designed to help them win and keep the customers who will value them the most. As an example, they don't have televisions in their bars and restaurants. Why? The television watching customer is most often male, tends to dine and watch alone and is prone to continue watching until a sporting event is completed. He slows the cycle of operations and hinders the restaurant from leveraging its competitive advantage of higher than market table turns.

As a result, the owners and managers focus their investment of resources in developing facilities and training that appeal to the dining-out female: the "date-night decision maker," one might say. They target a customer who tends to place more value in the ambience, the subtle beauty of the décor, the graciousness of the servers and the high quality of the food.

4. Merit-Based Leadership

Families must find the most talented leaders to operate their businesses, regardless of their position in or connection to the family. In the fable of "The Goose and The Golden Egg," greed and a lack of critical thinking leads a countryman to destroy his unique animal. With careful thought and planning, a successful business family can avoid a similar fate. Why is the Golden Goose so valuable? It lays golden eggs — eggs (benefits) that the family can use to provide for their needs and support them as they pursue their life's objectives. Keeping the goose healthy and strong is

the most logical collective effort the family should undertake. Rather than worry about who gets to control the goose, the most important question to answer is: Who is the most talented gooseherd? (Yes, that's really what it's called.)

The two most essential questions in family business succession are first, whether any member of the next generation has the desire to lead the company, and second, whether she or he can lead as well or better than a nonfamily leader. If the answer to either question is "no," a nonfamily leader must be identified and hired. These simple questions are often forgotten in the emotion and competition that accompanies succession.

A former client is a successful entrepreneur and a world-class athlete. When he and I first got to know each other, I asked him about his children. Did they pursue sports in college like he had? Yes. Had any of them achieved athletic success to the same level as he had? No. When I asked him why he thought they had not excelled he said, "They are talented kids but they just didn't love their sport like I did. And still do. The love of the game fuels you to work harder than anyone else at turning your talent into on-the-field superiority. Desire unlocks the door for greater success. But ultimately it is your talent that opens the door and gets you into the biggest arenas."

If members of the next generation have the sincere desire to lead the family business, how can current leaders judge their abilities objectively? Based on our 25 years of advising business families, we have identified two critical elements in this process. First, the family must develop and distribute a family employment policy that defines its strong commitment to merit-based company leadership. Second, the owners must put together a focused, well-run board of directors/advisors, with family and nonfamily directors, and lean heavily on them as they strive to identify and hire the most talented leaders.

5. Engaged Family Governance

Most family businesses fail to transition to the next generation. From founder to siblings and siblings to cousins, the failure rate is over 65%. Why? One might guess that company leadership or strategy-related issues might be the culprit, such as lack of access to growth capital or inadequate strategic knowledge. Years of solid research from numerous credible institutions shows that, in over 60% of cases, the underlying reason for a failed transition is family dynamics and conflict. Disagreements about a vision for the future, strategies for growth, who should lead, accountabilities, compensation, shared family assets, standards for family employment, how to make decisions together and how to manage interpersonal conflict — they all create a palpable level of tension. Without appropriate governance, this tension will naturally escalate into enough turmoil that will lead family members to choose to disengage and pursue individual professional paths.

Taking the time to envision, create and maintain a system of family governance will benefit every family business. No two family governance systems should be exactly alike because no two family businesses are exactly alike. Start by identifying a team of at least three family members who share a desire to perpetuate the family business legacy. Have them pick a leader from among them. Encourage them to set a two-year calendar with half-day meetings every six-to-eight weeks (or more often if there is more urgency). Give them the mandate to work together and with other family members to answer the six essential alignment questions identified earlier in this article (see section No. 1, Aligned Owners), but this time from the family's perspective.

And finally, excellent governance comes down to excellent communication. Excellent communication is Clear, Respectful, Authentic and Consistent. It's arguably the single most important piece of family business success. So, CRAC the code for excellent communication.

Execute the Game Plan

Just as in the world of competitive sports, family business owners must master and consistently practice the fundamentals if they are to remain successful. Whether you and your family are rookies in the world of governing your business or seasoned professionals; continuous improvement through practice is the key. Any family will benefit from a consistent and thorough review of these fundamental areas. As an idea for doing so, in your next family meeting, have each participant work together to complete the following:

- Write down and create a personal priority list of the five fundamentals.
- Compare each other's priorities, explore and discuss each other's reasoning, listen to each other with a goal of understanding each other's unique perspective.
- Tally the scores and determine the collective priorities of the group.
- Take out personal calendars and, using a two-year timeline, pick one day every quarter to focus on each one of the fundamentals. Begin with priority one, end with priority five.
- Through discussion, assign one person to be accountable for each fundamental.
- Agree to the expectation that those who are accountable for each fundamental will lead the preparation for and management of the meeting.

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