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From: **Steve Leimberg's Business Entities Newsletter**

Subject: **A Book Review by Jeffrey A. Galant: Revisiting John Ward's Perpetuating the Family Business**

"John Ward's Perpetuating the Family Business is not about saving taxes, rather it is about saving the family and its business. The book, a self-help guidebook to family business owners, is a synthesis of Ward's experiences in advising such owners here and abroad.

From those experiences Ward draws both insights and lessons to inform family business owners in their pursuit to guarantee the continuity of the business for future generations. He raises the existential issue of whether the family wants to continue to control the business.

The book is focused on the family issues and does not deal with business matters. For a business to have a successful transition to the next generation, Ward's 50 lessons should be seriously considered."

We close the week with **Jeff Galant**'s review of John Ward's Perpetuating the Family Business.

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Here is his commentary:

EXECUTIVE SUMMARY:

John Ward's Perpetuating the Family Business[1] is not about saving taxes, rather it is about saving the family and its business. The book, a self-help guidebook to family business owners, is a synthesis of Ward's experiences in advising such owners here and abroad. From those experiences Ward draws both insights and lessons to inform family business owners in their pursuit to guarantee the continuity of the business for future generations. He raises the existential issue of whether the family wants to continue to control the business. The book is focused on the family issues and does not deal with business matters. For a business to have a successful transition to the next generation, Ward's 50 lessons should be seriously considered.

FACTS:

Insights

If the family desires to pass ownership and control of the business to the next generation, much work is required. Ward's basic advice (which he refers to as his "insights") is that the owners must: (1) respect the challenge to keep family control of the business (e.g., leadership, succession, family unity); (2) recognize that most issues confronting the family and the business are not unique, although the resolutions may be (e.g., avoid isolating family and encourage seeking help from professionals); (3) understand the indispensability of transparency (e.g., maintain openness in communications with family members); and (4) commit to planning (strategic planning; succession planning regarding leadership in both the business and the family; succession planning regarding ownership; personal financial planning; and planning for family continuity).

Target Audience

Ward's target audience is the family business owner. However, lawyers and other professional advisers can only gain by knowing what Ward has observed and what he portrays as important advice. It is of course very helpful to know what the issues are that family business owners face and the possible solutions. For example, Ward's point that the issues that families face though similar from family to family (to wit: leadership succession, employment policies, and stock ownership) generally require resolutions crafted on a case by case basis. What works for one family may not work for another due to cultural or other factors. Of course, it pays to study such issues and how they have been resolved in other cases. Ward provides food for thought for the lawyer who represents a family business or one or more of the family members with respect to the issues of leadership, succession and its impact on the family.

Estate Planning

The book is not about estate planning, although Ward encourages it with regard to dealing with ownership succession issues and the minimization of estate taxes. The use of trusts is mentioned only in passing. But there was enough presented to at least get me thinking about the role of trusts. Anecdotally, at the very least, we lawyers know that due in large part to the attempt to minimize transfer taxes as well as to protect property from creditors and disgruntled spouses many family businesses today are owned in whole or in part by trusts of one sort or another. This phenomenon of course adds to the complexity of ownership and brings the concept of fiduciary ownership into the mix.

Alleviating the Inherent Conflict

Ward describes the inevitable conflict between the Family System and the Business System due to their disparate characteristics – i.e., the Family is emotion-based, socialistic in nature and not voluntary – you are either a member of the family or not! On the other hand, the business is objective and rationally based, capitalistic and voluntary. Ward points out that the fundamental dilemma is the inherent conflict between the needs of the business and the needs of the family. In other words, how will the business and the family share the finite amount of available resources? As a general proposition, the business continually needs to grow, innovate and perhaps change with the times, and it will likely require capital to do so. On the other hand, financial security is of the utmost importance to family members.

Related areas of conflict between the two systems concern who in the family is entitled to employment and promotions, the amount of compensation that should be paid to family members working in the business, the fair valuation of the business[2], the reinvestment of profits in the business, and who is making all of these decisions. To help avoid the potential roadblocks, Ward's prescription to the owning families is to abide what he calls the "Four Ps":

1. Adopt **policies** before they are needed (e.g., policies regarding employment of family members, compensation of family members, mandatory retirement age, meritocracy, dividend and redemption plans);

2. Articulate **purpose** , that is, spell out the reason or reasons for maintaining the business and, notes Ward, it should be more than just about the money. For example, providing for the support and well-being of the family, providing support for the local community, facilitating philanthropy, and safe guarding a public trust;

3. Establish the **process** or processes that the family should engage in to resolve the various conflicts and issues that may arise. Communication among family members is the crucial ingredient; and

4. **Parenting** – educating children about the family, the business and encouraging them to be happy and successful whether they work for the business or not.

COMMENT:

50 Lessons

Ward's lessons are addressed to the various stages of the business. Ward categorizes the stages of the business based on the generations participating in the family's ownership. Stage I (single owner-manager) involves the entrepreneurial stage where the owner - founder manages the business. Stage II (owners are siblings) is called the "sibling partnership" and concerns the business when it is owned by the children of the founder. Finally, there is Stage III (owners are cousins), referred to as the "cousins collaboration", when ownership is in the hands of the grandchildren and great grandchildren.[3]

Although all stages of the business face the existential question regarding continuing family control, Ward pays much attention to the Third Stage when presumably the business has matured and continues to grow new markets or new businesses and family members, whether they work in the business or elsewhere, are more secure financially. A key issue facing the Third Stage business is determining the family's appetite to continue as a family-controlled business. Of course, the family could decide it is time to sell, witness the Bancroft family's decision a number of years ago to sell its interest in Dow Jones, the owner of *The Wall Street Journal*, for $5 billion or so. At such time there were no family members working for the business, although the family did maintain some representation on the board. As reported, it was an agonizing decision for the family because of its deep feeling that it was the custodian of a public trust, i.e., *The Wall Street Journal*.[4]

Ward discusses in some detail the Ochs/Sulzberger family which controls *The New York Times*. He reports on two events that in retrospect were of crucial significance in continuing the family's control of the business, to wit: (i) the 1986 agreement among the family members which prohibited[5] the transfer of Class B stock (superior voting rights) to an outsider,[6] and (ii) the later decision of the members of the fourth and fifth generations to unify the ownership of the B shares within the family so that it would speak with one voice.[7]

The 1986 Agreement addressed two concerns, the first of which was to thwart corporate raiders. There had been a "greenmail" threat a number of years earlier when a notorious corporate raider tried to gather up Class A shares for the purpose of either being bought out at a premium or obtaining a seat on the board. And second, to facilitate the payment of estate taxes without loss of control. At the same time the 1986 agreement was signed the company recapitalized by having each holder of the Class B shares exchange each B share for nine shares of Class A stock and one share of new Class B stock. The idea was that if funds were needed to pay estate taxes (presumably GST tax in the fourth and fifth generations) the Class A shares could be sold without diluting the family's control.

One Family

One of the key lessons discussed by Ward is the "one family" concept. The idea is to avoid the inherent conflicts that will arise when different branches of the family are each voting in its own self-interest rather than what may be in the interest of preserving the business or preserving family control of the business.

Ward provides some history. Adolph Ochs acquired the insolvent *New York Times* in 1896.[8] Ochs ran The New York Times Company until his death in 1935. He left his shares in the company in trust (the "Ochs Trust") for the benefit of his sole surviving child, Iphigene Sulzberger.[9] Iphigene died in 1990 and the Ochs Trust split into four separate trusts, one for the benefit of each of her children (siblings - third generation) and their respective issue (cousins – fourth and fifth generations). Each separate trust had about $80 million worth of *Times* stock.

From a legal perspective, the trustees of a trust owe their allegiance to the trust beneficiaries and not necessarily to the business in which the trust is invested. As a result the trustee is expected to vote the shares of the business in the best interest of the beneficiaries of that trust. The trustees of other trusts with different beneficiaries having an interest in the same business may or may not vote the shares in the same way.

Although it bucked family tradition at the time (1990s), the Ochs/Sulzberger cousins and their children started to meet as a separate group to discuss their future as the family that controlled the *Times.* As it turned out in about 1995 the cousins and their children decided after consulting with Craig Aronoff, a well known adviser to family businesses, that it would be in their best interest if they acted as one family rather than four separate branches, and in furtherance thereof, that each cousin had the same ownership interest (in terms of both voting and equity) so that the cousins would be completely aligned with respect to their ownership of the *Times* and the *Times* shares would be voted as a bloc.[10]

This plan eventually resulted in combining the four trusts into a single trust with each cousin having an equal share.[11] Apparently, those cousins with lesser members in their branch actually gave up equity as well as some of the vote. Ward calls this a remarkable development that helped preserve the company as a family business. Ward compares the Ochs/Sulzberger family's unified front with the Bingham family's feuding over money and its failure to coalesce behind its third generation leader which resulted in its selling the *Courier-Journal* after owning it for 68 years.[12]

Ward relates 50 lessons for the family business owner and further applies them to each of the three stages of the business. Some of the key lessons that lawyers may have an interest in are as follows:

1. Independence of board members;

2. Mandatory retirement age;

3. Meritocracy in employment and promotion: including family members working in business - set standards;

4. Fair redemption policy; and fair and flexible dividend policy (Educate family members that the needs of the business are paramount);

5. Support local community;

6. Transparency: merit-based compensation; sharing investment opportunities; and personal estate planning;

7. "Aggressive gifting" - minimize transfer taxes;

8. Family Code - a document setting forth how members treat each other and how they deal with non-family members;

9. Nest Egg concept - make younger middle aged family members independent of senior generation;

10. Bring in-laws into the fold: Communicate agreements and policies to the in-laws;

11. Importance of the family leader and that succession in family leadership is as important as succession in the leadership of the business;

12. Creative capital - planning to raise capital needed for business. Example provided of going public. (Consider private equity, ESOP, etc.);

13. Periodic family meetings;

14. Educate family members on responsible ownership – In the Times situation, the family lawyer instructed the children while they were relatively young about responsibilities of owning stock in the family company and concepts of corporate governance, etc.;

15. Philanthropy - family foundation(s) as place for those family members who are not working in the business;

16. One family concept (equality of vote/equity);

17. Mission statements for business and for the family;

18. Values Statement - same values apply to family business, foundation and family office.

19. Importance of process - how you get there is more important that getting there! The process itself is what brings the family together.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Jeff Galant

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CITATIONS:

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[1] John L. Ward, *Perpetuating the Family Business*, Palgrave Macmillan, UK 2004.

[2] Ward believes that it is important to fairly value the business in order to support a redemption price for buying out a family member who is desirous of selling some or all of such member's interest in the business.

[3] Of course, proceeding from one stage to the next depends on the circumstances. If a sole owner leaves the business to his or her only child, the business remains in Stage I. In such case it enters Stage II at the time the business passes to the

grandchildren. See, e.g., the Bingham family of Louisville, Kentucky, owner of the *Courier-Journal*. Page 38 of *Perpetuating the Family Business*.

[4] This transaction occurred after Ward's book was published.

[5] Class B shares could not be sold to an outsider. In such case, the agreement required the B shares first be exchanged for A shares.

[6] Although the agreement substantially reduced value in the event of a later sale, it was unanimously supported by the family since it had the salutary effect of enhancing the family's control. The Class B stock possessed greater voting power than the Class A stock, and through the ownership of the Class B shares by the Ochs Trust during Iphigene's lifetime, the family was able to maintain its control of the company. According to Wikipedia (citing proxy statement issued in 2005) the B shares controlled 9 out of the 14 seats on the *Times* Board .

[7] This is explained in greater detail in Tifft and Jones, *The Trust: the Private and Powerful Family behind the New York Times* ("Tifft and Jones"), Little, Brown and Company, 1999. (The same authors also wrote *The Patriarch: the Rise and Fall of the Bingham Dynasty*.)

[8] Ochs had acquired complete ownership of the *Chattanooga Times* in 1880. He then hired his father and his two brothers having in mind his objective of providing "security and employment for every member of the extended Ochs clan." Page 30 of *Perpetuating the Family Business*.

[9] Iphigene's husband, Arthur Hays Sulzberger, ran the company until his death in 1968 when their only son, Arthur (Punch), took over with the full support of Iphigene and his three sisters. Page 100 of *Perpetuating the Family Business*.

[10] It was reported that Aronoff asked the assembled cousins whether they were one family or four families.

[11] That is, *per capita* rather than *per stirpes* in legal terms.

[12] Tifft and Jones, p.587. Ward extends his great appreciation to Tifft and Jones for their extensive scholarship regarding the Ochs/Sulzberger and Bingham families. See footnote 3 supra.