PIFF Newsletter

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Welcome to PIFF!

The Purdue Initiative for Family Firms (PIFF) is an initiative in Purdue's College of Agriculture. PIFF is an integrated research, outreach, and teaching program. It offers educational programs that address the major competencies needed for effective family business ownership and management. The goal of the initiative is to prepare family business stakeholders—strategically, financially, and emotionally—for the significant and sometimes unpredictable transitions and decisions that must be made, which determine the success and continuity of the family business.

PIFF provides multi-generational family businesses with research-based business management resources aimed at improving personal leadership performance and driving operational growth. Our ambition is to prepare family business owners, managers, and stakeholders (including non-owner spouses and future owners) to be effective stewards of their family enterprises.

PIFF publishes a quarterly newsletter that will house an article from each part of the pie, found on our website – purdue.ag/piff. The four quarters of the pie include topics of: estate and personal financial planning, strategic business planning, maintaining family bonds, and leadership and succession planning. Each section houses articles, guides, and assessments of related topics which can be viewed online or downloaded. Also found on the website is a *Question of the Month*, PIFF Research, an option to subscribe to our quarterly newsletter, and upcoming events.

Sustainability: Some Tips on Protecting Your Business from a Natural Disaster *by Holly Schrank, Anna Josephson and Maria Marshall*

"A once-in-500-year storm should happen every 500 years, right?
Fact is there have been 26 in the last decade." Allstate commercial

Climatologists point to an increase in environmental conditions that are leading to rising sea levels and stronger, more frequent storms. There are very few regions in the country that are not subject to at least one type of natural disaster capable of serious business damage such as hurricanes, tornados, floods, earthquakes, wildfires, landslides, or sinkholes. In addition to that, businesses face other disasters such as structure fires, extended power outages, extended road closures, and terrorism that can cause significant disruptions to income flow. It does not matter where you do business, both natural- and human-caused disasters can put your business at risk. A common characteristic of disasters is that they create rapid change and disruption to business operations, and that disruption can be overwhelming without preparation.

Fire damage of a business in Paradise, CA (link).

Think about these questions for starters:

- ⇒ How long can your business go without sales revenues and still survive?
- ⇒ What would you do to restore operations if your building was severely damaged?
- ⇒ How would you do business if one or more key utilities were "out" for an extended period of time?
- ⇒ What have you done so far to protect your business assets from losses? Do you have property insurance? Do you know exactly what it covers and does not cover?
- ⇒ What are the risks your business faces that could be severe enough to close it at least temporarily?
- ⇒ How are you protecting your business records?
- ⇒ Do you have an action plan?

These are questions that are important in assessing the risks that your business and livelihood could face; they also guide you to choose the appropriate means of protecting your business against these risks. Implementing protections does not mean that no damage will occur, but the right choices do significantly increase the chances your business will survive the event.

Assessing risks is an essential first step. Much like the business mantra of "knowing your market" in order to successfully sell a product, you need to "know your risks" in order to successfully protect against them. Once you know the potential risks, there are many possible actions you can take to protect your business in the event of a natural disaster.

The remainder of this article will focus on several strategies that apply to nearly every business. A list of resources that provide advice and suggestions for other strategies for protective action, can be found in the notes at the end of this article.

To begin, we want to point out a common factor that applies to all businesses and is not mentioned in the disaster preparation lists. Based on post-Katrina small business recovery research conducted by researchers at Purdue, protecting your business from disaster begins with your choice of business location.

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The businesses that were never able to reopen after Katrina had locations that had much greater risk of storm winds and surges. Many of these businesses could have been saved if owners had chosen a location even a short distance away from the water threat. When choosing a business location, it is important to consider not only its rent and location vis-à-vis your customers and suppliers, but also its potential risks.

A common factor among businesses that ultimately met demise after Hurricane Katrina was their exposure to water. They were located in or near flood zones, or in coastal areas prone to flooding. This same locational water hazard is common to businesses not in hurricane zones such as Grand Forks, ND, Ellicott City, MD, Des Moines, IA, and many other cities and towns with bodies of water that flood. Floodwaters present costly hazards. Buildings located within or near flood plains are particularly susceptible.

The Fire Dog Saloon was located in Bay St Louis MS and had a thriving business until it was gutted by flooding and surge. The business never recovered.

Perhaps you chose your location because the rent was lower, or it was close to suppliers or customers and that has a high marketing value and greater profit potential for your business. If that is the case and you cannot change the location or do not have multiple locations, then it is important to purchase insurance riders (e.g. earthquake, wind, wildfire, flood) to cover potential loss of your business assets. Regular structure insurance policies have tight limits on what damage they will cover. They *do not include* damage from floods and often do not cover damage from other disasters, such as earthquakes and wildfires. Most businesses will need a special rider on a property insurance policy to cover natural hazards.

Reduce risk by using the idea of "multiple baskets". For example, it is wise to avoid putting all the value of your business and property assets in one structure. Business owners who own a structure and run a business in that structure face a double whammy in the event of a disaster. As residents along the Gulf Coast can tell you, you will not necessarily be able to insure your property going forward, so it may be difficult to rebuild or sell. It may be better to put your eggs in more than one basket, e.g. own a property you rent to someone else, and run your business as a tenant owner in someone else's property. At least you have reduced the risk for your business operations if the structure is damaged, and your operations are not locked into a property you cannot rebuild or sell going forward. This strategy of "multiple baskets" also reduces the risk because it is less likely that multiple locations would be hit and it may make it easier to recover after a disaster.

Photo taken 7 years after Hurricane Katrina; all that remains of this business is the slab.

Another common factor that emerged from Katrina research is that you need to identify and insure those physical assets essential to your operations. Do you have structures, inventory, or other essential equipment such as production machinery, computers, and vehicles that would need to be replaced? It is surprising to learn that many business owners do not know what their policies cover and assume it is "all hazards", when, in fact, few structure and vehicle policies actually do cover everything. One common factor among businesses that did not survive Katrina was that their owners had not adequately insured their business assets.

⇒ It is important to do your homework before you buy or renew insurance to make sure you know what to ask.

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- ⇒ Spending some time looking at insurance company websites can help you formulate those questions and identify those assets you need to protect.
- ⇒ You also want to be sure your insurance contract actually covers the risks your business faces and be sure you really KNOW what is in the contract. Insurance policies may cover assets you do not have (an unnecessary expense) and not cover all the hazards in your risk list (increasing your financial risk).

In addition to insuring physical assets, you may want to consider how you can protect your revenue stream during the recovery period while the business may be without power, the roads are impassable, your suppliers or customers are displaced and your sales are non-existent, or you are rebuilding the structure where your business operates (or waiting for your landlord to do it). One option might be installing a generator, although that does not fix impassible roads and displaced customers. Another option would be to move the business after the event, but rents will surely be higher if destruction of commercial buildings is widespread. You may also want to consider the purchase of business income disruption insurance as a means of bridging the revenue gap until your business recovers. It is not necessarily an inexpensive coverage, so you must consider the size of your revenue stream as well as whether you can bridge the gap with other resources.

The third common factor we learned from Katrina research is that it is pretty difficult to survive a natural disaster if the records of your business are destroyed in the event. Why is this a problem? Insurance companies often need documentation of the value of an asset before they will pay on a claim, thus records of purchases of structures, equipment, inventory, and supplies may be needed to recover their value. You would not be able to apply for Small Business Administration financial support unless you can provide documents such as a current income statement and balance sheet.

Disaster preparation sites suggest that you need are likely to need copies of insurance contracts, recent bank records, records of building repair and upgrade, computer passwords, and tax records.

- ⇒ These records are going to be of use to business recovery, but they need to be reasonably current, and they need to be backed up on a regular basis.
- ⇒ Physical or electronic copies need to be kept in a safe location or in the cloud away from the business to ensure that at least one set of records survives.
- ⇒ You need these records for any kind of disaster, including fire, theft/burglary, tornado, flood, etc.

Finally, one thing we learned from our Katrina research is that failing to make a plan and implement it very often leads to financial loss and eventual closure. Those businesses that had a plan had a much better chance of recovering from the hazard that interrupted business because they had thought through what they could lose. And, they were prepared for those losses. As Alvin Toffler stated in "Future Shock", the best way to prepare for a "shock" that may occur in the future is to identify it, think about how it could impact your operations, and then plan how you will protect your operations so that the business can adjust and recover. Is your business in good hands?

Resource notes: Trade and government publications provide a lengthy list of recommendations to business owners, recommendations intended to help owners bring their businesses back to normal after a disaster. Our federal government offers an excellent website with many suggestions for protection of structures (both business and residential) and human life (www.ready.gov). The Small Business Administration (SBA) provides similar advice focused on preparation of businesses for natural disasters (www.sba.gov/sites/default/files/articles/FINAL_2017_SBA-Disaster_Preparedness_Plan.pdf). Another valuable resource is EDEN, the Extension Disaster Education Network (this resource compiles many useful articles about planning and preparing for specific types of natural disasters) (https://nifa.usda.gov/extension-disaster-education-network).

Business organizations and county governments may offer online information, and local officials may provide opportunities through meetings to help business owners assess and address local risks. Despite all these resources, there are some fundamentals that they do not address or that you may not find in a list of strategies and actions to be implemented to protect your business. If you are a member of a trade organization such as National Federation of Independent Business or National Association of Manufacturers, check to see what resources it has available for you. Be sure to check commercial insurance company websites for a variety of information about insurance products. Learn their terminology. Buy wisely.

More People, More Problems? Governance is Family Business *by Maria Marshall*

According to the Institute on Governance (https://iog.ca/what-is-governance/), governance "determines who has power, who makes decisions, how other players make their voice heard, and how account is rendered". There is no one-size-fits-all governance structure or structures. Every family business is different in terms of family cohesion, ownership structure, and business structure. What we do know is that every family business needs some type of governance. The type of governance needed will vary depending on the structure and stage of the family business.

The structure and stage of the family business usually starts with a founder who is the owner and manager of the family business. The most pressing governance activity for this first generation business is to plan and design a succession process. Even though most small and medium sized family business do not have a board of directors, they should seriously consider establishing a board of directors in order to receive outside expertise. One thing to keep in mind when establishing a board is that it should not be made up only of family members and your banker or attorney. At least one member of the board should have no direct relationship with the family business. Why is this important? Because your banker and attorney do not want to lose your business; therefore, they could be reluctant to tell you exactly what they think about your business strategy or your management of the business.

Family businesses usually grow from a founder/owner-manager business to what is usually called a sibling partnership. This is a type of arrangement where siblings co-own and usually co-manage the family business. The types of governance activities that sibling partnerships might need are establishing a board of directors, drawing up shareholder agreements, establishing an employment policy with performance-based pay and a process for fair decision-making.

The next most common type of family business structure is a cousin consortium. In this type of arrangement, cousins co-own the family business but the business is managed by a few members of the family and/or non-family members. The types of governance activities needed for this structure are establishing a board of directors, drawing up shareholder agreements, conducting family meetings, creating family agreements, educating the non-management owners, nurturing the family's ties to the family business, establishing an employment policy with performance-based pay and a process for fair decision-making, and creating a common vision for the family and the family business.

The purpose of governance in a family business is to ensure control, cohesion, and competence. For example, a board of directors ensures that even at the cousin consortium structure, where a business might be managed by non-family members, family business owners do not give up complete control of the family business. Family meetings and shareholder agreements ensure that members of the family share the values and goals of the family business. Shareholder agreements and employment policies safeguard the business so that family members are competent to run the business.

All family businesses need some type of governance. Most family businesses, regardless of structure, will need some form of corporate and ownership governance. The more family members and non-family owners and managers involved, the more governance the family business will probably need. Thus, sibling partnerships and cousin consortiums will also need to add some type of family and wealth governance. However, every family and family business is different. So, you should identify what types of governance activities will work best for your family and your family business.

Reference: *Managing the Family Business: Theory and Practice* by Thomas Zellweger.

Selling Your Business to Your Other "Family" - Using an Employee Stock Ownership Plan (ESOP) for Business *by Corey Rosen*

Congress designed ESOPs to be the most cost-effective means for both owners and companies to provide for business transition. ESOPs are the most tax-effective way to do business transition.

Many family-owned companies have no family members to take over ownership when the current owners want to transition out. ESOPs provide a tax-favored, practical way to transfer ownership to your other "family"—the employees who helped build the company.

An ESOP is a kind of employee benefit plan, similar in many ways to qualified retirement plans and governed by the same law (the Employee Retirement Income Security Act). ESOPs are funded by the employer out of future tax-deductible future profits, not by the employees. Stock is held in a trust for employees meeting minimum service requirements and allocated to employees based on relative pay or a more level formula, then distributed after the employee terminates. ESOPs cannot be used to share ownership just with select employees, nor can allocations be made on a discretionary basis.

ESOPs (employee stock ownership plans) can be a very attractive and tax-favored alternative. For the owner of a C corporation, proceeds on the gain from the sale to the ESOP can be tax-deferred by reinvesting in the securities of other domestic companies. If these securities are not sold prior to the owner's death, no capital gains tax is ever due. If the company is an S corporation, LLC, or partnership, it can convert to a C corporation before the sale to take advantage of this tax deferral. If the company stays S, the owner does pay capital gains tax on the sale, but reaps all the other benefits of selling to an ESOP. The most important of these is that the owner's shares are bought in tax-deductible dollars, either from company contributions or plan borrowings.

The sale can be all at once or gradual, for as little or as much of the stock as desired. For the employees, no contributions are required to purchase the owner's shares. The owner can stay with the business in whatever capacity is desired. The plan is governed by a trustee who votes the shares, but the board appoints the trustee, so changes in corporate control are usually nominal unless the plan is set up by the company to give employees more input at this level.

Financing an ESOP

The simplest way to use an ESOP to transfer ownership is to have the company make tax-deductible cash contributions to the ESOP trust, which the trust then uses to gradually purchase the owner's shares. Alternatively, the trust can borrow from a bank and/or the seller can provide the trust with a note. The price paid is determined by an independent outside appraisal.

If the company is a C corporation and the owner has held the shares for at least three years, once the ESOP owns 30% of the company's shares, the owner can reinvest the gains in the securities of other U.S. companies (other than real estate trusts, mutual funds, and other passive investments) within 12 months after or three months before the sale, no taxes are due until the replacement securities are sold.

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Making the Decision
All of this may sound appealing, but it is not feasible for every company. Several factors must include: enough profitability to buy out the shares, the ability to absorb the significant costs of setting up a plan, successor management, and being willing to accept a price that in a minority of cases might be less than what a competitor would pay (albeit without the tax advantages to the seller).

For more details on ESOPs, go to the web site of the nonprofit National Center for Employee Ownership.

Family-Owning Businesses and Mindfulness: Building a Case for Better Strategy and Family Cohesion *by Sandra Sydnor*

Family-owned businesses' successful transition from one generation of family ownership to the next is challenged, in part due to the low multigenerational survival rate for family firms. Some authors have suggested intergenerational communication and a shared vision of the business as critical to next-generation leadership (Miller, 2014). Honest and open intergenerational communication reduces the resistance to succession often present in family-owned businesses. Likewise, family owners' commitment to a shared vision creates inspiration, energy, and enthusiasm during tough times as well as a bridge from the present to a desired future (Nanus, 1992).

Developing strategy often feels weightier than other functions in business, especially for family-owned businesses (FOBs), and with good reason: the impact of strategic actions on the FOB affects both the family and the business. Some suggest that strategic involvement in FOB can be inefficient, mentioning owner-owner agency conflicts, resource constraints, and maximizing the family's utility to the detriment of firm value maximization (Zellweger, 2013).

Decision-makers in small, family-owned businesses may employ short-term strategic approaches to remedy the often frenetic lifestyle. These short-term strategic approaches allow FOBs to have the capacity for agile responses to dynamic competitive environments. The element of 'familines' in FOBs and separating personal visions for the business from family visions may result in narrower thinking rather than the adaptive thinking that contemporary business environments demand. What could be needed instead is delaying an immediate reaction. Creating cognitive space between experiences and thoughts, or, as Holocaust survivor Victor Frankl aptly suggested, between stimulus and response, is the power to choose one's response. In other words, we can learn to notice that there is a "space" and thoughtfully choose a response before we react. Frankl, an Austrian psychiatrist imprisoned at Auschwitz, is noted as having survived, despite his captors, because of this cognitive space and his thoughtful and chosen reactions.

MINDFULNESS
The study of mindfulness is regularly defined as paying attention, in a particular way, on purpose, in the present moment, without judgement (Jon Kabat-Zinn, 1994). Corporations from Pentagon to Apple, Facebook, and Google have been using meditation and mindfulness practices to enhance well-being, reduce stress, and increase creativity. Research also suggests this ability as a chief component of leadership. Although mindfulness may seem to be a new experience, it's not. Mindfulness first influenced business decades ago, when the firms dreamed up a cache of uncertain futures and novel scenarios with unforeseen sources of information. The most current research demonstrates that at the molecular level, mindfulness meditation practiced for as little as 20 minutes per day can have dramatic effects on brain function as measured by brain scans and brain function testing.

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MINDFULNESS AS A COMPETITIVE STRATEGY IN FOB BUSINESSES

The Sustainable Family Business theory (SFBT) (Stafford, Duncan, Danes, & Winter, 1999) proposes that family business sustainability is a result of two attributes: functional families and profitable businesses. It follows that successful strategy-making and implementation would be requisite for these businesses. Family member employees of FOBs may be closer-kinit than employees in non-FOBs, maybe even to the point of correctly anticipating reactions of other family members to market and environmental changes. The danger here lies in the fact that there is no space between stimulus and response.

Designing effective strategies is far from straightforward and arguably requires clear thinking. However, our decisions (due to mental shortcuts) are frequently based on old mental routines and associations. Mindfulness practices permit the space to notice how the mind reacts to thoughts and information, without judgment. Mindfulness creates the capacity for 'new eyes and empty mind', seeing past the old storylines and habitual thought patterns that may guide our behaviors and decision-making, unknowingly (Talbot-Zorn and Edgette, 2016).

Silicon Valley and other technology leaders, such as Apple's Steve Jobs and Google's Chad Meng-Teng, are known to have regularly meditated to bring about embedded thought patterns and bring about creative insight in planning. Hedge fund managers at Bridgewater Capital (in a notoriously high-stress industry) use mindfulness as a way to reduce stress and enhance productivity by breaching habitual thinking routines.

INTEGRATING MINDFULNESS INTO EVERYDAY LIFE

Mindfulness practices can fit into our lives more easily than one may think. Activities that induce mindfulness, the notion of a moment-by-moment gentle awareness of our thoughts, without judging them includes things as simple as a focus on breathing. A slowly inhaled breath through the nostrils, perhaps counting to seven, followed by an exhale through the mouth to a count of seven, with relaxed attention, counts.

Almost any activity can incorporate mindfulness. The walking meditation, for example, is a way of focusing attention on the feeling of your feet touching the ground. Ten to fifteen minutes of walking, concentrating on your feet through your legs, breath, or your hands, can be enough. Eating mindfully is another opportunity to incorporate a thoughtful emphasis in the present moment. Paying attention to how the food was sourced and how it arrived on your table invites decelerating. Looking closely at the food on your plate, examining the different lines and shapes it presents, and feeling the way your mouth experiences the foods' textures are all ways of being in the present moment. When your mind wanders, you simply observe it and bring your mind back to what's happening right now, in the present. This encompasses all that mindfulness is-being where you are, right now, without judgment.

It might be that emotions are more freely expressed in a family-owned business. Family-owned businesses benefit when their members manage the emotional demands of working together and remaining calm in the ups and downs that every business experiences. Victor Frankl coined the notion of a space between stimulus and response. In that space lies the power to choose how we respond to circumstances and opportunities.

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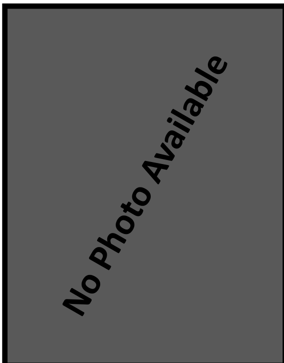

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