

# THE SECRET TO MIXING FAMILY WITH BUSINESS

Family businesses provide unique opportunities for personal fulfillment and wealth creation for owners and their descendants. However, those same opportunities can create risks or limitations that some family members are not willing to accept. Therefore, the secret to building the best family business governance, ownership and succession structures is in knowing how each of the owners and (future owners) view and prioritize the opportunities available to them.

Specifically, family businesses can serve the following objectives:

- Cash flow (through compensation or distribution of profits)
- Wealth accumulation (through appreciation in business value)
- Career/occupation (through employment in the business)
- Legacy (through association with family history and success)

Family members are likely to view and prioritize these objectives differently. For

example, one family member may consider the family business to be her best opportunity to have a fulfilling career (career/occupation) and play an impressive role

in a business that has a history of respect in the community (legacy). Another may wish to pursue a career outside the business and may view it as an investment that provides a secondary source of income (cash flow: dividends) and increased value upon liquidation many years in the future (wealth accumulation).

Further, the "risk to reward" ratio may vary greatly among the ownership group. A family member who works full-time for the business may have a higher stake in its fortunes (and also more influence on those fortunes) than a family member whose interest is limited to that of a passive investor.

An equal allocation of control, participation, reward and risk is rarely the best principle on which to operate a family business. Governance, ownership and succession structures work best if they are based upon a full understanding of each owner or future owner's unique objectives and needs. For example, a family member whose

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## Professional Opinion



**GREG F. MONDAY,**  
Shareholder -  
Business Law and  
Trusts & Estates  
**Reinhart Boerner  
Van Deuren s.c.**

## DAVID J. SISSON

Shareholder - Labor  
& Employment and  
Litigation  
**Reinhart Boerner  
Van Deuren s.c.**



Left to right: **Megan Darby**, **Julie Luedtke**, **Ellen M. Duhamel**, CFP®, Managing Partner; and **Thomas J. Dornoff**, CFP®, Managing Partner

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**GRANITE**  
FINANCIAL GROUP

175 North Patrick Boulevard, Suite 170  
Brookfield, WI 53045  
Office: **262-792-1111**  
[www.granitefgllc.com](http://www.granitefgllc.com)

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## Weak market segments

Just as financial advisers see opportunities in several segments, they are keeping their eye on other areas that they expect to underperform. Craig, for example, is bearish on telecommunications, consumer staples and utilities.

Dornoff is also concerned about utilities. "Utilities may face headwinds because they are very sensitive to interest rates," he says. Burish is staying away from new tech companies. "Their valuations are unsupported," he says. "Momentum has been propelling the stocks, but the earnings to support current market prices are simply not emerging. We think many of these names are due for a real fall."

## Reading the tea leaves

Financial advisers admit their focus can change quickly with shifting political and economic winds. One of their biggest hurdles is making sure the information they are viewing is both accurate and effective at revealing emerging trends.

"The biggest challenge we have is accurate information, especially when you look at companies outside of the United States," Dornoff says. "China is becoming more open, but it is still a closed society. Can you trust all of the numbers they provide? In fact, making sure you have accurate information is actually true of all governments." There also are political concerns. Iran's nuclear program, the Syrian civil war and Russia's involvement in Ukraine can quickly change the dynamics of the market. "If things ramp up politically with Russia there could be an impact on the economy, especially if there are disruptions in the gas flow into Europe or strong sanctions against Russia," Dornoff says.

With Asia, there's concern about potential economic slowdowns. There is increasing concern that the robust growth enjoyed by China over the last decade is coming to an end, even as Japanese Prime Minister Shinzo Abe's three-pronged economic initiative, commonly known as 'Abenomics' has failed to move that country out the economic stagnation it has endured for more than two decades.

"The economies in Asia have increasing importance on the global economy," Burish says. "Growth in China is beginning to flag and 'Abenomics' is beginning to run into

difficulties."

Domestically, financial advisers are closely watching the Federal Reserve's monetary policy and the impact of the Affordable Care Act on hiring and job retention. There is also increasing frustration with an economy that can't seem to get out of first gear for more than a month in a row.

"The U.S. economy is still not normalized or fully recovered," Craig says. "Employment is down by almost 700,000



**LORI CRAIG**

from where it was in early 2008 even as the U.S. population has grown. The unemployment rate is above the 5.5 percent rate that would indicate a very good economy and other measures show significant labor market slack, including the share of workers working part-time involuntarily and the average length of the workweek."

Craig also notes that industrial production, which measures the output of manufacturing, utilities, and mining, is less than 1 percent above its pre-recession peak in late 2007. "This indicates there is significant slack in output given that industrial production typically grows by about 2 percent annually."

## Finding the best mix

Given the political and economic uncertainty what is the best investment mix for today?

"That depends of course on the investor," Burish says. "For someone who wants moderate risk, we think an allocation of 50 percent equity, 20 percent short-term bonds and 30 percent liquid alternatives is appropriate with the equity allocation tilted more toward Europe geographically and old-line tech by sector."

Dornoff is a little more bullish on stocks with a generic recommendation that includes a mix of 60 percent equity, 15 percent fixed income, 20 percent hedge funds or other alternatives, and 5 percent cash.

Craig recommends 70 percent in equities with a bias toward U.S. companies. "There are some really nice opportunities in international markets, both developed and emerging, but one needs to be more selective there," she says. ■

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is due to 401(k) programs that include an employer's match and make it easy to set aside money. Nonetheless it is a promising trend. "That is one of the appeals I see to working with the next generation," Franks says. "If they can learn the habit of saving early they will have more control over their futures." ■

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priority is participating in the family business's legacy but whose career has taken him in a different direction may be happy to hold a small, restricted equity interest but play a more prominent role in a charitable foundation funded by the family business. In contrast, another family member may want to have full-time employment with the company as the primary means of providing income and health insurance for her family, and therefore may want to have a strong employment agreement and a substantial vote as to who serves on the board of directors.

Family businesses cannot be everything to everyone and should not try to be. Applicable laws allow them great flexibility in tailoring their governance, ownership and succession structures in ways that allocate opportunity and risk in accordance with the different objectives and needs of different family members. A family business organized and operated on that basis will be more likely to meet the expectations and needs of its owners and less likely to be weakened or distracted by owner discord. ■

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customized Social Security recommendations and create a plan that is specific to your situation.

Proper planning will not only provide peace of mind for you and your family, but can also offer the opportunity to maximize the Social Security benefits you receive during your lifetime.

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