

FAMILY BUSINESS MATTERS

The Newsletter of the Family Business Center of Hawai'i

WINTER 2019

MESSAGE FROM THE FACULTY DIRECTOR

We had a speaker at the Shidler College of Business last week. She was Prof. Gabrielle Adam from the University of Virginia's Frank Batten School of Leadership and Public Policy. Saving face and forgiveness are two of the topics on which she does research. It occurred to me that most of us are pretty generous with forgiveness in the family setting but we may be a little more stingy extending it in an organizational setting. One of the interesting aspects of her research is that it focuses on both what to do and what not to do when apologizing. While her published research looks at larger firms, the lessons may also apply to family-firms of all sizes. She points out that we should pay attention to how we apologize. For instance, she noted that when Netflix's CEO Reed Hastings apologized for an ill-advised price increase he had a big broad smile on his face after saying "I'm sorry." Customers continued to cancel their subscriptions. On the other hand, when the CEO of Maple Leaf Foods issued an apology for the deaths of 20 people his product had caused, he was seen as genuine in his sadness and the sales volume of the firm quickly returned to former levels. Prof. Adams studies suggested that for publicly traded firms that an apology

delivered by someone high in an organization can impact the firm's stock price. Facial expressions appear to be important and they are interpreted by many as a measure of sincerity.

The key seems to be that there has to be a certain amount of perceived genuineness in our apologies, whether at the personal and organizational level. Research shows that apologies, when adequately delivered benefit the organization and they would also benefit our work relationships. Carrying a grudge around is not good for the transgressor or the offended party.

It would seem that a transgressor's apology would benefit the offended party and the transgressor, which would be good for the firm and family dynamics. The research also suggests that a transgressor should be careful to look sincere when delivering an apology. I suppose that would be easier if one were actually sincere. The offended party would also be wise to accept the apology and work to restore their relationship with the transgressor.

We are always going to have conflicts and disputes in the workplace and the message seems to be that putting them behind us as quickly as possible is good for all the parties involved.

UPCOMING EVENTS

April 5, 2019 (FRI.) 11:30 to 1:00-Kahili Golf Club, Maui. "Family Business Succession from the Third Generation Perspective," Ryan MacLaughlin, Principal Broker and Owner, Island Sotheby's International Realty

April 10, 2019 (WED.) 11:30 to 1:00 Imiloa Astronomy Center, Hilo. "How to Craft a Family Constitution," Dana Telford, Principal Consultant, The Family Business Consulting Group

April 17, 2019 (WED.) 11:30 to 1:00 Oahu Country Club, Honolulu. "Successfully Growing Sun Noodle: A Global Brand that Stays True to Its Aloha Spirit," Kenshiro Uki, Vice President of Operations, Sun Noodle

May 7, 2019 (TUES.) 11:30 to 1:00 Ohau Country Club, Honolulu. "How to Craft a Family Constitution," Dana Telford, Principal Consultant, The Family Business Consulting Group

May 8, 2019 (WED.) 11:30 to 1:00 Kahili Gulf Club, Maui. "How to Craft a Family Constitution," Dana Telford, Principal Consultant, The Family Business Consulting Group

May 21, 2019 (TUES.) 5:00 to 7:30 PM-Hilo Yacht Club, Networking Social

May 23, 2019 (THUR) 5:00 to 7:00 PM-The Brilliant Ox, Networking Social

June 4, 2019 (TUES) 4:00 to 6:00 PM-Next Generation Peer Group Meeting, Venue TBD

July 17, 2019 (WED.) Oahu Country Club, Honolulu. "The Family Business Journey of FCH Enterprises (Tale of Two Brothers)," Jason Higa, Chief Executive Officer of FCH Enterprises, Inc. (Zippy's Restaurants).

Sep. 21-22, 2019 (FRI. & SAT.) Annual Retreat, Moana Surfrider Hotel

NORMAN NOGUCHI SPEAKS ON OAHU AND HILO ON LEADING THE FAMILY BUSINESS WHEN YOU'RE NOT PART OF THE FAMILY

Norman Noguchi, President and Chief Operating Officer of Marcus and Associates, Inc. spoke before the Oahu Chapter of the FBCH on January 29th., at the Oahu Country Club. Then he graciously agreed to make the trip to Hilo where he spoke to the Big Island Chapter on February 20th. Marcus Nishikawa founded Marcus & Associates in 1971 (pictured in the left side of the picture on the right) In 1983 Norman, and Marcus' brother Dale formed Marcus Property Management, LLC as a residential and commercial brokerage firm. Later, several other related firms, for example a plumbing firm, were founded that served their property development and managed properties. In 1997 Marcus passed away at the age of 55. Fortunately, the firm had a life insurance policy that allowed it to buy his stock, which allowed his beneficiary to receive cash. Norman pointed out that in 1990 they had the foresight to formulate an agreement as to what would happen if one of them died. This is a good practice that would serve most firms well. At this point, Norman and Dale took over the managerial operation of the firm. They positioned their desks next to each other in the same room as a well to facilitate coordination. Now that Norman and Dale are thinking of retiring and the second generation sons of Marcus Nishikawa are in the process of taking over some of the management duties and eventually ownership of the firm. We all know that there are issues related to being a non-family member in the family firm, but it is nice to get some information from somebody who has experience in the role. Norman agreed to answer some additional questions in writing, which were asked by Myron Nakata and are listed below. His presentation is also available on video at the FBCH website.

1. What type of training was provided for the next generation?

Nothing formal. It was on the job training. We were fortunate that the boys gravitated toward leadership positions. We did tell them a long time ago that for them to become leaders they first needed to earn the respect of their peers and employees. How to do that was left up to them.



Norman Noguchi, President and Chief Operating Office of Marcus & Associates speaking at FBCH meeting at the Oahu Country Club.

The picture on the screen to his right is Marcus Nishikawa.

2. Since you were not a family member, was it easier for you to evaluate them?

I think between Dale and me, he was more critical of their performance than me. I treat them as if they were part of my family as well. However, we both managed them in the same way as we did for any employee. They are held to a higher standard. My interactions with them were not any different than if Dale their Uncle were talking to them. I've always been "uncle" to them.

3. When and what criteria were established for them to participate in the succession plan?

Dale and I continuously discussed our exit strategy and succession plan from the time that we were given the reins after Marcus passed away. Since we both came from corporate backgrounds, which involved a lot of strategic planning (too much and overkill at times), we were indoctrinated in the culture of longevity and succession planning. With this in mind, we observed how the two brothers interacted and performed throughout the years. You and Dale reinvested in the company with the office renovations to make your succession easier.

4. How was your strategic plan incorporated into a succession plan or vice versa?

We have annual planning retreats, which Dale and I started when we first joined up with Marcus. These had set agendas that the executive committee, which included Dale, me, the CFO, the Senior VP's of HR, and Marcus' sons Kevin and Jason. This was normally done in December. We discuss the past year's performance, projections for the upcoming year by division and companies, the theme for the year, and compensation for employees. Then we invite the department heads and VP's to attend to discuss any issues they might have and any suggestions for improvements going forward. We wrap it up and have cocktails and pupus for all.

Then in January we have our annual corporate meeting in the evening. This year it was at the Oahu Country Club. The entire company is there and we give them a summary of how the prior year was performance-wise by divisions and companies. This keeps everyone engaged and involved. We also award any top producers, announce promotions, and tell our employees the theme for the new year. Then we have cocktails and pupus.

SPIKE YOH OF DAY & ZIMMERMANN: ONE OF THE GOOD GUYS

Most of the books written about family businesses seem to highlight family conflicts that lead to disastrous business or family results. I suppose the publishers know what people want to read. I am going to tell you about a book that is about a family and family business where the joys of both the family and the business are highlighted.

Bill Yoh, a third generation member of the firm, started by his grandfather Harold L. Yoh. He has written a biography about his father, Harold L. Yoh, Jr (known to everyone as Spike) and the personal and business successes that highlighted his father's life. The Yoh company was founded in 1940 as a staffing company, which provided services to firms that needed outside expertise. During World War II it experienced rapid growth by filling lower-level staffing needs of firms. I said it was an uplifting book but you have to wait for that. Spike's father was married four times, and there was not a very affectionate bond between father and son. His father eventually purchased Day & Zimmermann, a firm that provided technical services and incorporated Yoh Co. as a subsidiary into Day & Zimmermann. Although there is no public data on this firm, it is generally believed to have revenue of almost \$4 billion and approximately 42,000 employees. Most of that growth occurred under the guidance of Spike and then his oldest son.

Although Spike and his father were not close, he joined his father's firm after graduating from Duke University in 1958. Graduating from Duke University became something of a tradition in the Yoh family. Spike also got an MBA with a specialty in marketing from the Wharton School at the University of Pennsylvania, while working at the same time, something they don't allow today.

Spike continued to gain promotions and in 1975 a business broker came into see him about a potential buyer for Day & Zimmermann. Spike didn't know his father was considering selling the firm. Spike told the broker to tell his father he was also interested in buying the firm. Harold told Spike he would sell him the firm but at "full value." He even went out and found other potential buyers to jack up the price Spike had to pay. A deal was struck. Spike was now the owner of Day & Zimmermann.

One of the interesting thing about Spike Yoh is that he was often the opposite of this father. He had one wife, was close to his children, and significantly involved in civic activities, serving as chair of the Duke University Board of Trustees, active with the U.S. Olympic Committee and held several important Boy Scout leadership positions.

Yes, all of Spike's children got their degrees from Duke University. He also had to make some of the tradeoffs many men of his era made. He stated that "if the business didn't work, nothing was going to work. During some of those days, family had to come second. The matter of balancing family and business was a tricky one." He attributed their success to his wife Mary "who knew the lay of the land and what needed to be done at home with the kids. "

Yes, the story is mostly a happy story. All five of Spike's children joined

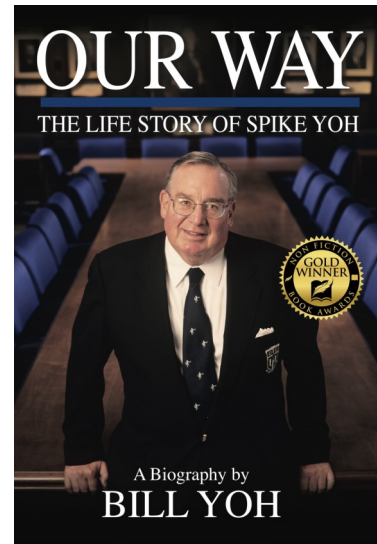


Photo Permission by Bill Yoh

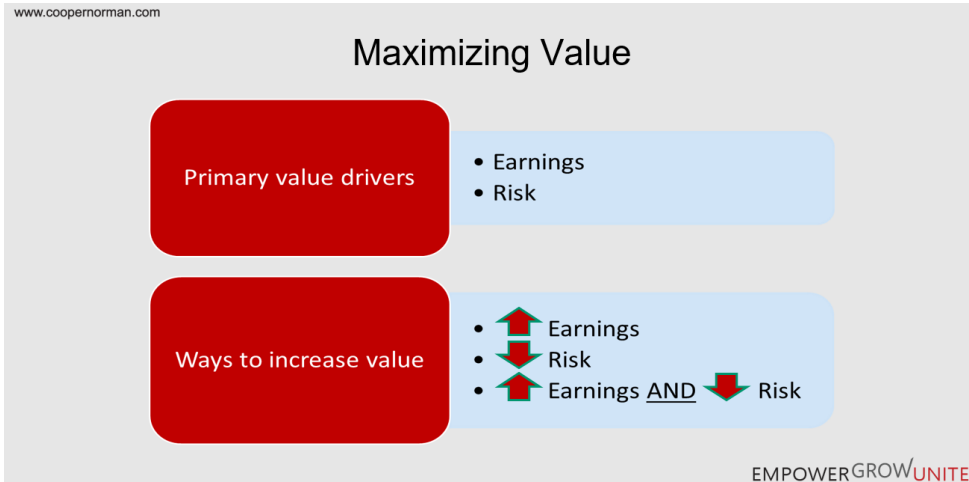
the firm, although one son left to successfully start his own firm and his daughter left and engaged in philanthropic activities. Spike was also well known for seeking the best talent to work in the firm, and it helped if they had a degree from Duke. The book doesn't mention salaries but the fact that executive turnover was low indicates they must have been competitive. The book does say that Spike took executives on cruises and had a large number of celebratory events for employees.

In 1996 Spike, age 59 decided it was time to move on and set up a two-year succession plan. He chose to promote his oldest son Hal to become president because he had an engineering background. When his wife Mary asked if he was ready, Spike responded "I don't know if he's ready, but we're going to find out." I won't keep you in suspense. Early in the process, Spike exercised some oversight but mostly asking him how things were going.

Spike also differed in that he sold the firm to his five children. He sold at the lowest price the tax attorneys could justify, with each child acquiring 20% of the firm. There was some personal loss when his daughter Karen died in 2007 at the age of 45. His wife Mary, a Duke University graduate, died in 2015. They had been married for 57 years.

Obviously, Spike has some of the health problems of anyone his age, but he still remains active and engaged and sat for many interviews so that his son Bill could tell the story of his happy life. If you want an interesting read that is more focused on life's joys I highly recommend this book. It also provides some valuable family and business lessons.

ETHAN LEE ADDRESSES ISSUES RELATED TO BUSINESS VALUATION AND SUCCESSION PLANNING AT MAUI MEETING OF FBCH



Ethan Lee, a partner at Cooper Norman (pictured at right), speaking to the FBCH, Maui Chapter at the King Kamehameha Golf Club on firm valuation and its impact on succession planning. This is the second time Mr. Lee has made an FBCH presentation.

Most business owners would like to know what their business is worth and many have an inflated view as to what that number is. When Ethan Lee, a partner in charge of forensic and valuation services for Cooper Norman, an Idaho-based CPA firm, spoke to our Maui Chapter he outlined a real case where the owner had received an offer of \$2.5 million for his firm. The owner wanted to sell but he thought the firm was worth \$5.0 million. Lee's firm was contacted to conduct a professional valuation and they came up with a value of \$2.0 million. The story had a happy ending and when two employees found out the owner wanted to sell and Lee helped them make a longer-term structured offer, that made the old owner happy and the employees' owners of the firm.

The liquidation value of the firm's assets set the floor for valuation, but the ceiling is the future cash flows that the buyers expect the firm to produce. Historical cash flows provide a base for these calculations, but as Lee pointed out, buyers are interested in future cash flows. The industry in which one operates also has an impact on valuation and sets the baseline for a professional valuation.

When selling to an outsider, there are a few ways to enhance value. In some cases agreeing to stay on for some time can increase the likelihood that customers remain loyal. This relates to reducing risk, which is the percentage that a buyer attaches to the riskiness of buying the firm. The higher the percentage (interest rate) connected to risk, the lower the projections of future cash flow. It is just the opposite of a savings account where a higher percentage is good. For the buyer lower risk means a willingness to pay more for the firm, which is also good for the seller. The figure on the right summarizes some

ways to manage risk.

What if I want to sell the business to one or more of my children? In this case, most parents will not want to maximize the valuation of the firm and the IRS allows some ways to minimize the value of closely held firms, which are not traded publicly. Situations differ, so it is best to get some professional advice. Don't confuse the estate tax exemption with the gift exemption. They are vastly different and gifting can result in a significant tax liability for the person receiving the gift. Lee pointed out there are many ways to efficiently handle sale/gifting of a firm to a child and that the process should begin early.

Maximizing Value - Risk

Risk Considerations

- Reliance on key employees (you?)
- Depth of management
- Independent Board of Directors
- Established supply chain
- Customer / supplier concentrations
- Contracts with customers
- Geographic diversification
- Quality of internal controls and financial reporting
- Growth prospects

FAMILY BUSINESS CENTER OF HAWAII PHOTO GALLERY

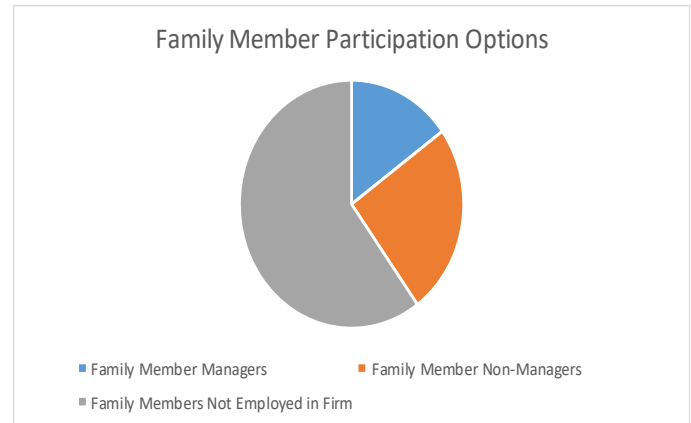


FAMILY MEMBER MANAGERS, FAMILY MEMBER WORKERS AND FAMILY MEMBER OWNERS ARE NOT THE SAME

Three of the most relevant roles that family members play in the family business are as an owner, a manager or a non-managerial employee. Many family members begin their work career during high school or college vacation, or holiday periods. Frequently, they perform mundane duties at a low wage. The significant benefit of this work is that they learn a great deal about the business and also earn a little money. There is some research that even suggests that this increases the probability that they will want to join the family firm and ultimately do so. The second two categories owner versus owner-manager have received less attention. We are fortunate that the Spanish government has devoted resources to collect a great deal of information about family businesses. A group of researchers used this data to explore the issue of the degree to which family involvement and the nature of the participation reduces the chances of business failure.¹ Since the data covers the period of the recent recession (2008-2010) the issue of business failure is especially relevant. The study involved 369 high-tech manufacturing firms and covered the period from 2006 to 2013. This type of study is important because research has also shown that the failure of the family firm has not just a financial impact but often a severe emotional impact on families. During this period the rate of bankruptcy increased by 900% in Spain.

The good news is that having family involvement at the owner and owner-manager level is good. However, when it comes to avoiding bankruptcy, it appears that being active in the management of the family firm does increase the probability of surviving. The research suggested two reasons for this. First, was the downside that firm failure has an immediate impact on the future job prospects of family-member managers and this may make more risk-averse. Second, manager-owners may be willing to accept lower levels of performance as a way to avoid firm failure. Just to be clear, they found that family ownership also reduces the chances of failure but not to the same extent as family management. Both appear to have beneficial effects with respect to firm survival. It should be noted that the “great recession” of 2008-2010 was not a typical period and one that hopefully does not reoccur.

The statistical results are somewhat complicated but an example related to the specific finding was that “a firm with 75% of its managers belonging to the controlling family would have a 22% lower failure risk than a similar firm with just 25% of the man-



agement team being members of the family” (pp. 372-373)

Most research has an “exception” that is built into its design and this is no different. Yes, there is a bit of a catch and it depends to a certain extent on the characteristics of the family member manager. In this research, they were also able to measure a psychological construct, which is called entrepreneurial orientation, for the family member managers in the firm. In large organizations there is evidence that having some managers engage in entrepreneurial behavior enhances performance. However, in family firms, the agreement and commitment of most, if not all family members to new ventures, products or services can have a significant influence on success. This may be especially relevant during a period of financial stress where taking on a risky venture could lead to firm failure.

This is exactly what the researchers found. They examined firms whose managers fell into the lowest 25% of managers in terms of their entrepreneurial orientation. Firms with 75% of their family managers in the lowest quadrant for entrepreneurial orientation had a 38% lower rate of failure than did firms that only had 25% of their managers with low entrepreneurial orientation scores.

In addition, they found that although it is generally better to have family member managers at those firms with high entrepreneurial orientation managers failed at a 4% higher rate than firms that just had family member-owners. In bad times, at least during the past recession, it appears that a more cautious approach paid off.

1. For more information see “Does family involvement in management reduce the risk of business failure? The moderating role of entrepreneurial orientation” by Antonio Revilla, Ana Pérez-Luno and Maria Jesús Nieto, *Family Business Review*, December, 2016, pp. 365-379.

Equipping, educating and celebrating families in business.

(Mission of the Family Business Center of Hawai'i)

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FAMILY BUSINESS QUOTATION OF THE SEASON

"We have to collect our thoughts and desires and expectations for the business and share those with one voice instead of 100 different voices."

— Stacy Mello, senior director of planning and communication at A. Duda & Sons Inc. and chairman of the Duda Family Council (Family Business Magazine, January/February 2016).

Family Business Center of Hawai'i
Shidler College of Business
2404 Maile Way
Honolulu, HI 96822
Phone: 808-956-5092
Fax: 808-956-5107

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