UNIVERSITY OF HAWAI'I AT MĀNOA SHIDLER COLLEGE OF BUSINESS

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FAMILY BUSINESS MATTERS

The Newsletter of the Family Business Center of Hawai`i

FALL 2019

MESSAGE FROM THE FACULTY DIRECTOR

The old English adage "a picture is worth a thousand words" is depicted by the picture on the right of an early discussion session at this year's FBCH retreat. I can remember how nervous I was 13 years ago when we had our first retreat. David Bork phoned me a day in advance to tell me he was in Hawai'i, so I didn't have to worry about the retreat leader showing up. I was also performing a two-person play at that retreat and was sure I would forget my lines. I had never been to the hotel before and always get lost when I drive somewhere for the first time. In the end, it all worked out, and so did the subsequent retreats.

The members of the FBCH are the main reason for the string of successful retreats. This year Michelle Moku joined us as the new Program Manager for the FBCH. Krystal Lee, who has held that position for a number of years and been a mainstay of our program, is taking on new responsibilities. I and the members will miss her. Good luck to Krystal and welcome to Michelle.

Another element of a successful retreat is the behind the scene efforts of our Retreat Program Committee. This year Jami Burks of the Makana Aloha Foundation, Wendy Shewalter of Contract Furnishers of Hawai'i and Myron Nakata an FBCH stalwart did an outstanding job organizing the retreat.

Discussion Session at the 2019 13th Annual Retreat of the FBCH

Finally, it was nice to see so many new faces at this year's retreat. Yes, it is also nice to see those who have attended all 13 retreats, and there were a few of them also present. It was nice to see lots of younger members attending. This signals that the FBCH remains relevant to the next generation of family business leaders in Hawai'i.

UPCOMING EVENTS

October 16, 2019 (Wed.) Next Generation Peer Group Meeting

November 8, 2019 (Fri.) 11:30 AM to 1:00 PM Oahu Country Club (O'ahu)
Speakers - Next Generation Panel: Chad Bloom, Vice President - The Zelinsky Group; Sarah Bow, President & COO - Bow Engineering Development, Inc.; Megan Takagi, Financial Advisor - Takagi & Takagi

November 12, 2019 (Tues.) 11:30 AM to 1:00 PM 'Imiloa Astronomy Center (Hawai'i Island) Speaker - Chad Bloom, Vice President - The Zelinsky Group

November 14, 2019 (Thur.) 11:30 AM to 1:00 PM Kahili Golf Club (Maui) Jim Doran III, Second generation owner of Ceramic Tile Plus and EY Design.

JASON HIGA SPEAKS TO HILO CHAPTER AND PROVIDES AN UPDATE AT WHAT ZIPPY'S DOING

Jason Higa, Chief Executive Officer of FCH Enterprises, Inc. (Zippy's Restaurants) Speaks to the FBCH (Big Island Chap-

On August 7, 2019, Jason Higa, CEO of FCH Enterprises, Inc. spoke at the Big Island chapter's meeting at the Hilo Yacht Club. This talk made a complete speaking cycle for Jason, having previously spoken at our Maui and Oahu chapters' meetings. The firm has undergone a great deal of transition during the past few years. Jason touched on several subjects of interest including, estate planning or the lack of it, succession, expansion, ownership consolidation and the role of culture plays in the success of these activities.

Estate planning is essential in general but Jason pointed out that it is even more critical in a family firm because the quality of the estate plan will also have an impact on the reorganization of the family business. I'm not out to generate business for local estate lawyers but this is an area that many of our speakers have addressed as extremely important at FBCH meetings.

Succession is also something that does not happen automatically. How often have we heard speakers say that it was just assumed "so and so" would step up and take over the leadership of the firm? Then, they found so-and-so was not interested. Jason pointed out that in the case of their firm, one of the family members finally indicated that working for the family firm was not something that "he had his heart in." This is a theme that has been raised by other speakers at our meetings. It is a clear indication that enthusiasm should not be assumed. On the other hand we should not assume that a family member is not interested in joining the firm because they appear to be successful in some other venture. It pays to ask and to ask in more than a cursory way. Being the "big boss" of a family business has both an upside and a downside.

The story of Zippy's expansion is one that involved some happenstance when a retiring couple asked Francis and Charles Higa to buy their restaurant, which became their second Zippy's Restaurant. Their subsequent expansion was more opportunity-based. The best-kept secret in town was not that Zippy's was considering opening a restaurant in Las Vegas. Come to think of it keeping anything secret is pretty hard in Hawai'i. In a few short months visitors to Las Vegas won't have to forgo their favorite Zippy's dishes. It is also pretty exciting to see a family firm from Hawai'i extend its reach to the mainland.

Many family businesses find that as the family grows, governance becomes a challenging issue. The circle model of family business highlights this by pointing out that there will be family business owners working in the firm, some in very senior positions while others will only have ownership interests. Finding ways for family members to sell their ownership positions is extremely difficult but this pruning can enhance the prospect for longer-term survival. Jason Higa pointed out that they have been able to do this but it also means that owners have to recognize that they may need outside management at the President level.

Jason also touched on the issue of having non-family members in the most senior management positions. FCH Enterprises has a non-family member serving as president. He pointed out that he was comfortable with this and it allowed him to spend more time considering strategic issues while the president focuses on operational issues. I think we also have to recognize that entrusting a non-family member with the firm's management does not have to be a permanent situation and in many cases later generation family members join the managerial ranks of the family firm.

THE SHEPLERFAMILY AND THEIR THREE GENERATION EFFORT TO BUILD BOTH A SUCCESSFUL BUSINESS AND A SUCCESSFUL FAMILY

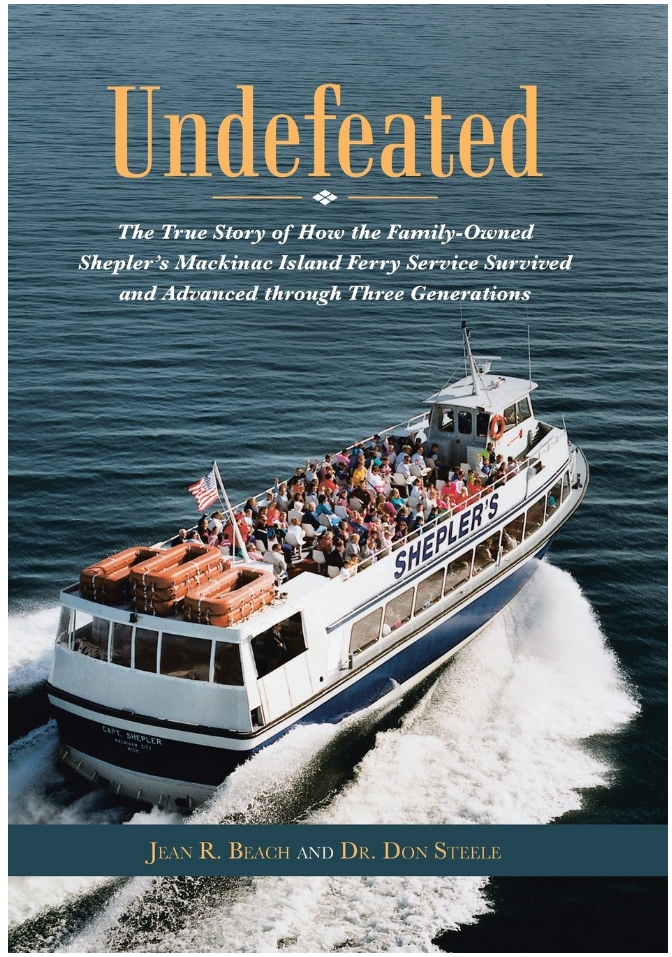
In early June, I had the opportunity to hear Chris Shepler (3rd. generation) speak at the Family Business Alliance's annual meeting in Grand Rapids, Michigan. I was even more excited when I found out that the history of this family and their business had been captured in a book entitled "Undefeated" by Jean Beach and Don Steele. Most books about family businesses tend to focus on the family and usually the dysfunctional aspects of the family. The theme of this book is very different in that it focuses on a series of "crisis" business situations and shows how the family's response strengthens the firm and the family. This is a story of success, not one of a family's tragedy.

In 1945 Captain William H. Shepler (called Cap by almost everyone) opened a ferry service from Mackinac City to Mackinac Island, a beautiful summer resort in Northern Michigan. Mackinac Island is unusual because it has no cars and no chain hotels. Cap gradually added to his fleet naming his early acquisitions after his daughter and his son's fraternity. The first challenge is starting a business, which is something we often forget when looking at family businesses. Starting a ferry business in a location where one's business is stickily seasonal adds to the difficulty. It actually takes a while for a business to become a "family business" and most businesses don't make it that far.

In 1957 "Caps" son Bill joined the firm. This was also the year that the Mackinac Bridge was completed, a bridge first envisioned by Cornelius Vanderbilt in 1888. The bridge connected Michigan's North and South peninsulas and although initially seen as a possible threat provided new opportunities for Shepler's ferry service because tourists wanted to see the bridge being built. It also meant that they could transport freight and tourists from the Northern Peninsula to Mackinac Island. This openness to exploiting new business opportunities is a constant and reoccurring theme.

One of the most interesting stories in the book is about how Shepler's developed a culture based on high-quality service. In the early 1970s Bill took several seminars that Disney offered to business people. He noticed that the grounds and facilities for their customers were immaculate. He had a chance to look backstage at Epcot and noticed that the environment for Disney workers was an attractive as it was for their customers. He initiated the same beautiful landscaping and clean facilities at Shepler's for both their guests and employees. High-quality service, attractive facilities and safety highlight the Shepler culture.

One of the most challenging incidents described in the book was when Mackinac Island attempted to offer an exclusive franchise to one of Shepler's competitors in 2010, which would have effectively put them out of business. It is one of the only incidents in the book where lawyers play a role in the Shepler's success story. Bill's three children were now also involved in the firm and the battle to ensure that there were multiple franchises mobilized the family, their friends, business partners and loyal customers. Eventually, the island backed off, and the Shepler success story continues.



For further information read: Undefeated: The True Story of How the Family-Owned Shepler's Mackinac Island Ferry Service Survived and Advanced through Three Generations (2014) by Jean R. Beach and Don Steele . Published by Author House, Indianapolis IN.

(Photo Permission by Chris Shepler, Shepler's Mackinac Island Ferry)

The book is an interesting read because it details sixteen different incidents, each of which describes a challenge that could impact the firm, and also the family negatively. It details how they deal with them and provides a useful lesson for any family business.

13TH. ANNUAL RETREAT FOCUSED ON GOVERMANCE AND SUCCESS

This year's retreat was held on Sept. 20 and 21, which happened to be the day that the iPhone 11 went on sale. I noticed because their store was next to the Moana Surfrider and there was a line of over 100 people at 7:30 and the store does not open until 9:00 AM. I took this as a good omen for our retreat.

Dana Telford, Principal Consultant of the Family Business Consulting Group and Nicole Bettinger Zeidler, a consultant at the same firm led this year's retreat. This year's retreat drew over 100 members, representing 44 member firms, who attend the various events, which included several interactive sessions and plenty of delicious food. Yes, we are already beginning to think about both the format and location for next year's effort.

The retreat began with one member from each family briefly introducing their family businesses and family members. This has been done at a few earlier retreats but I noticed that the ones doing the introduction are getting younger each time this is done. In many cases, they highlighted the contributions that parents or grandparents had made to the firm and how they inspired them to carry on those traditions and values.

Governance, within or without a written constitution, was a dominant theme, which Telford noted "starts with getting enough information to make correct decisions." He also pointed out that different types of owners (e.g. governing owners, engaged owners, investor owners) need to be addressed differently when developing a written family constitution. In some cases, families may also want to weigh the votes of family members depending on the position they have or the role they play. In other cases giving all members an equal vote may be more appropriate or at least a way to ensure harmony. He related this to the things that a pilot needs. You can't just tell the pilot to fly; they need to know the details of the trip, which may determine things such as how much fuel they load. These same details are required by the operating managers in a family firm.

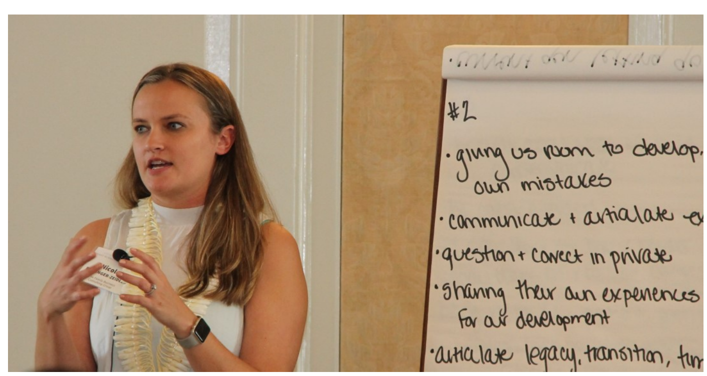
An issue related to governance is trust. Telford mentioned a client, whose family firm no longer has their businesses and provided three tips of things they should have done. First, govern the family relationships with the business. Second, make leadership decisions based on merit. Third, be as transparent as possible. He felt that if you don't have high levels of trust that this "will devour the firm over time." The implication is that a set of written governance policies can go a long way toward building a high level of trust.

The retreat, for the second year in a row, featured a panel composed of members (Chad Bloom, Sarah Bow, Guy Kamitaki) that discussed governance issues by their firms. Sarah Bow felt that clients like it when she says "we are a family business." She joined the firm after a

Left to Right, Dana Telford (Retreat Leader, Principal Consultant, The Family Business Consulting Group) Chad Bloom (Vice President, The Zelinsky Co.), Sarah Bow (Pres. & COO, Bow Engineering & Development, Inc.) Guy Gamitaki (Treasured HouseMart)

career as an elementary school teacher and said that they now have a constitution and a buy-out agreement. Chad Bloom pointed out that their firm has gone through two transitions, first from his grandfather to his mother and uncles, and then eventually his mother buying out her brothers. Guy Kamitaki says that when he meets with family members in the next generation, he shares with them the various provisions of their family constitution.

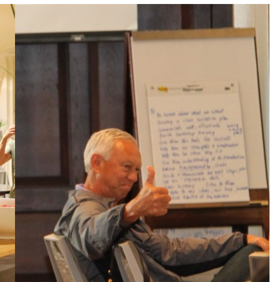
Guy also mentioned that running a family business has not all been roses and that some expansion investments have been more complicated than anticipated. Chad Bloom said the same thing about their advancement into drywall installation. Sarah pointed out that as a woman, non-engineer, she had to show the employees that she was competent and knew how to run the firm effectively. She said some of her success is related to the fact that she has excellent intuition concerning employee loyalty and competence. The panel was one of the highlights of the retreat.



Nicole Bettinger Zeidler (Retreat Co-Leader, Consultant, The Family Business Consulting Group)

FAMILY BUSINESS CENTER OF HAWAI'I PHOTO GALLERY














HOW MUCH EFFORT DO FAMILY FIRMS SPEND ON LEGITIMATE TAX AVOIDANCE?

There is a body of empirical research that shows that family firms are more focused on non-financial goals than non-family firms. Family firms are also focused on financial goals but not as exclusively as non-family firms. These non-financial objectives are usually seen as ways to increase the socioemotional wealth of the firm. The downside of this is that this could lead to less focus on cost minimization and taxes are a cost. A recent study by Professors Alexander Brune, Martin Thomsen and Christoph Watrin at the University of Muenster in Germany examined the extent to which socioemotional wealth goals may lead to a negative impact on how aggressive the firm seeks out tax avoidance options.[1] Tax avoidance is defined as having "the general intent of reducing the corporate tax burden." They did the study in Germany, but I think the desire to pay "no more than our fair share of taxes" is a fairly universal goal.

Their study is built around two concepts, socioemotional wealth and economic wealth. Generally, founders of family firms have been found to stress non-economic goals that they see as enhancing family cohesion and the likelihood that the firm will remain under the family's control. Some research shows that family firms in the United States are less aggressive about avoiding taxes than their non-family firm counterparts.[2] The explanation again relates to the family (socio-emotional) goals taking precedence over tax avoidance goals.

All of this research looks at legal tax avoidance and points out that there are two costs, one relates to the costs of hiring tax experts, where the expense of the experts has to outweigh the reduction in taxes. In Germany, there is also reputational issues. Family firm owners recognize that tax avoidance strategies have uncertain outcomes because tax officials may challenge them. Publicity from this could result in reputational damage, which family firms generally wish to avoid because it impacts both the firm and the family.

These researchers looked at 516 family firms over multiple years. Medium-sized family firms tend to be the norm in Germany and all the firms were corporations and 5% of them were publicly traded firms. Family members held at least 50% of the firm's equity. They then looked at three conditions. First, where the founding CEO is in control. Second, where there is a family descendent member or non-family member in control. Third, where the founder has stepped aside but retains a seat on the board or has a large equity ownership position. The third set of conditions is one that is quite common in family firms, where the founder retires but continues to interject themselves into both the operational and strategic issues of the firm.

When they examined the data, they found that founder-led family firms are less inclined to avoid taxes than descendent CEO of non-family CEOs. Thus, while they are in charge, the implication is that founders focus on other issues and it supports the notion that the founders of family firms are focused on family goals and increasing or at least maintaining the socioeconomic wealth of the family firm.

What happens when they retire? Well, the results here show that if the founder holds on to at least 25% of the firm's equity that tax avoidance efforts do not increase. However, if the founder relinquishes their equity position, descendent and non-family CEOs were found to increase their tax avoidance efforts.

Are there other ways than holding onto equity that owners can ensure that the focus remains more on the family? They can stay on the Board of Directors, called a Supervisory Board in Germany. They can also be a member of an advisory board, which has become increasingly popular with family firms in both the United States and Germany. This gives them a vehicle to make their wishes known. The results of this research show that they do, indeed make their wishes known. If the founder-owner is on either the Supervisory Board of Advisory Board, there is no increase in the degree of tax avoidance efforts.

The results of this research are especially relevant for family business founders. They could imply that they should spend more time reducing costs and that one of the expenses they should be focused on is taxes. On the other hand, the results could indicate that if they want the socio-emotional wealth of the family and the family firm to be maintained that they should either ensure that their descendent or non-family CEO shares that view or takes steps to ensure their views prevail. One way to do this appears to be something that is often criticized and that is to maintain involvement in the firm. Riding off into the sunset may not be what owners should do, at least not immediately. Obviously, at some point, they have to let go but the results here suggest that they do a rather poor job of conveying their socioemotional wealth goals to their descendent or non-family successors.

1 See Brune, Alexander, Thomsen, Martin & Watrin, Christoph (2019) *Family Firm Heterogeneity and Tax Avoidance: The Role of the Founder*. **Family Business Review**, Vol. 32, No. 3, pp.296-317.

2. See Chen, S., Chen, X, Cheng, Q. and Shevlin, T. (2010) *Are family firms more tax aggressive than non-family firms?* **Journal of Financial Economics**, Vol. 95, pp. 41-61.

Equipping, educating and celebrating families in business.

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

FAMILY BUSINESS QUOTATION OF THE SEASON

"What has been really helpful for us is going back and remembering and honoring our family history as well as our loved ones, focusing as a family on our common interests and causes. I think that's really helped to develop a family glue."

– Heidi Vermeer-Quist, chair of Vermeer Corporation's ownership council and a member of the company's board (Family Business *Magazine, January/February 2016).*

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