THE COMMERCE BANK OF OREGON

FAMILY BUSINESS newsletter

Five Brothers From Cyprus and an American Dream

Growing up on a family farm on a Mediterranean island uniquely prepared the Havadjias brothers for success halfway around the world.

Farmer Boys® Restaurants were founded by the five brothers in Perris, California, in 1981 when they opened their first restaurant with an over-sized hamburger and their original recipes for fried zucchini, onion rings, chili and more.

Their concept of serving farm-fresh food in generous portions quickly gained them an ardent following. Their expansion really took off when the Havadjias family members sold their first franchise in 1998. They currently have more than 90 locations.

Growing up on the island of Cyprus, the brothers worked on the family farm and in the family restaurant. When asked how they all manage to work together and get along, CEO Makis Havadjias states with a laugh, "a very strict father." This family dynamic in place from their youth has certainly worked well as the brothers have expanded rapidly ever since that humble beginning.

"There are two axioms in life. Axiom one, you have to work for your life," he said. "In axiom two, you have to choose someone to work with in your life — and we have chosen to work with each other."

Their mission was to "make it right, make it fast, make it friendly." They also adopted the Greek word "philoxenia" as their mantra, which translates to "friend to the stranger." It's their way of making sure that every guest is treated with hospitality when they're away from home. Each restaurant also has a bell for customers to ring when they've experienced great service, food and friendship. The bell rings loudly and often.

Today, Farmer Boys® Restaurants is a bustling chain with its headquarters in Riverside, California. With locations in Southern California, Central California, the Inland Empire and Las Vegas, Nevada, they're poised to continue to grow rapidly toward their goal of conquering the entire West. Their dedicated following of rabid fans can't get enough of their Farmer's Burgers, specialty sandwiches and farm-fresh breakfast.

"We're in a growth mode," Havadjias said. "It's been challenging with COVID, but somehow, someday things will get back to normal, and it has not affected our growth plans. History has shown that when there's a downturn in the economy, franchisees show up. We want to double the size of the company in five years. That's our goal."

Members of the next generation in various roles including accounting and franchising are helping the family achieve that goal.

There are more than 90 Farmer Boys® Restaurants in operation including corporate-owned/operated locations as well as those operating under franchise agreements.

Thanks to their ever-expanding franchise operation, the Farmer Boy® Restaurants continue to grow. Makis and his brothers work together to expand their empire and build on its astounding success.

The featured family businesses are clients of one of Zions Bancorporation's collection of great banks: Amegy Bank; California Bank & Trust; The Commerce Bank of Oregon; The Commerce Bank of Washington; National Bank of Arizona; Nevada State Bank; Vectra Bank Colorado; and Zions Bank. All other images are stock photography.

The Dark Side of Being Too Generous to Family Employees

By Barbara Dartt

"I feel trapped," Charles said. "I don't trust my sister as my partner or as my co-worker. My dad knows I love the business — he can't understand why I don't just suck it up and put up with what I think are bad behaviors. He said my perks look like a good trade-off to him."

"Have you looked elsewhere?" I said. "It seems that this relationship with your sister is having really negative consequences on your marriage and your health."

"Yes. And I realized there is no way I could make what I'm making here, and I wouldn't have the flexibility, either."

Charles' situation isn't that uncommon. His salary and benefits were set by his father who, at the time he made the decision, was the leader of the family and the business. It would have been more effective and caused less long-term discord if Charles' employer had set the pay instead.

The Real Trap
Charles' father fell into a classic trap that wrapped a family employee's compensation with a lot of emotion and role confusion. The amount of compensation may have been adjusted by Dad's:

- Care as a father;

- Guilt as an absentee parent;
- Experience that family employees bear unique responsibilities and pressures;
- Desire for convenience because it allowed child and parent to have similar standards of living; and
- Generosity of wealth sharing since the business performance allowed it.

Dad set his son's pay at about 140% of market at his entry to the business. He also allowed Charles considerable benefits above and beyond those provided most nonfamily employees including extended vacation time, flex hours, use of a company vehicle, extra travel perks and a bonus that was decided more on need than on performance.

Dad was interested in his son returning to the business, and he felt there ought to be some advantages to being a family employee. But he didn't quantify the full value of the pay and benefits, explain or document the reasoning behind the above-market offer, nor did he let Charles know that he knew the offer was well above market value. Before Charles returned to the family business, he'd been employed by other companies for seven years. He knew that the offer was generous, but didn't ask his dad why he felt Charles deserved the pay.

Actions With Unintended Consequences
As I lay out this scenario, the pitfalls of Dad's decision (and Charles' acceptance without communication) may be pretty clear. And yet my colleagues and I regularly see cases of parental generosity and informality cause feelings of dependence, dissatisfaction, anger and bitterness. These emotions can exacerbate other relationship tensions within the business, including sibling rivalry, and get in the way of effective governance of a family business.

Overlapping roles in family businesses — like father and CEO — are always tricky to manage. But when dads (or moms) allow the family "want" rather than the business "need" to guide compensation levels, they create a nonsustainable process that often hamstrings the next generation's independence and objectivity. These are important questions to ask:

> "Short-run pain is essential to avoiding a more divisive future."

- When next gens (and their families) are dependent on a pay rate that isn't hooked to their value in the business, how is the family employee able to make clear, unbiased, business-focused decisions?
- How do they develop, implement or support an existing job family and pay-grade system for nonfamily employees that are based on fair market value when their compensation isn't?
- How do they rationalize their pay to nonoperating family owners, especially siblings?
- If other family employees join the business, how is their compensation determined? Value? Or need?

Actions for Mid-course Correction
To address this unsustainable approach, the next generation can lead the challenging work of unwinding the family-driven, need-based "structure" by creating a rational, professional and objective compensation approach. The shift in behaviors means addressing tough issues like quantifying the different levels of value family employees bring to the business, personal financial responsibility, lifestyle expectations and employee performance.

Of course, it is best if you set up the rational, objective process from the beginning. But, in the case that you find yourself some way down the road of a more need-based, senior-generation driven compensation approach, here's how you can begin the shift:

1. Communicate to the family and particularly, to family employees, that the compensation approach will be changing.

   - Share the rationale for taking on the change and the process that will be used as well as who has the final decision on the new approach, and, on anyone's change in pay.

2. Develop a compensation philosophy for your family business — a summary of the values and principles that guide decisions on compensation and benefits.

- Gather input from family, family employees and family owners.
- Be sure to discuss what was agreed upon and include the basis on which compensation will be determined. A market-based approach is the most objective and justifiable. However, if your family business has used another basis for a long time, an abrupt switch to market is not advisable. Sometimes a hybrid model must be adopted to transition from the current approach to fully market-based.
- Outside facilitation is often helpful to support open dialogue, hear different viewpoints and come to a consensus on a statement that represents the family and the business.

3. Get an objective assessment of family employees' current compensation and benefits packages relative to the market. You may also include nonfamily employees in this process.

- Again, be sure to be clear on who has the final decision authority over how this data will be employed to change compensation and benefits.

4. Adapt the market-based findings to your current situation.

- It may take several years to transition to a fully market-based approach.

Keep Communicating
Continue to remind stakeholders of the process and where your business is at within that process:

- Let them know that the process is hard now but this pain is being endured to provide the family and the business a stronger, long-term foundation.
- Be sure to emphasize that no abrupt changes will happen. All adjustments in pay and benefits will be done over time and with lots of notice.

This transition will produce emotional reactions and stress in the short run. If your goal is a sustainable family business that has the highest probability for family harmony and business success, this short-run pain is essential to avoiding a more divisive future.

Aronoff, C., McClure, S., & Ward, J. (2011). Family Business Compensation. New York: Palgrave Macmillan contains additional depth on the challenges and traps that exist in compensating family employees.

Barbara Dartt is a principal consultant for The Family Business Consulting Group helping families get aligned, anticipate and prevent future challenges, and communicate effectively to grow their businesses.

Looking at Family Business Trends

By Tom Emigh and Dana Telford

One benefit we experience from having 25 consultants who have worked in 70+ countries with over 2,500 business-owning families is the opportunity to spot emerging trends in our field. Through daily interactions, we keep an up-to-date sense of our clients' headaches and heartaches. By identifying the trends in these challenges and then working together to understand the opportunities they bring with them, we gain insights and knowledge to help our clients prosper across generations.

We thought it would be useful to describe the most compelling trends we see in our work today and offer a few suggestions for making the most of them. There are four trends:

1. Formalization of corporate governance;
2. Generational dynamics;
3. Mergers and acquisitions; and
4. Longer life spans, longer careers.

Trend 1: Formalization of Corporate Governance
Search "corporate governance" online and you will find an overwhelming supply of books, articles, webinars, podcasts and conferences. Business-owning families are increasingly investing time and energy in improving their governance structures and processes. According to FBCG co-founder John Ward, "Most family business owners report that the single most important decision they made over the development of their family business was the formation of a board and the hiring of outside independent advisers/directors to provide objectivity and wisdom."

It's important to note that governance in a family business system evolves over decades and that governance at the board, ownership and family level are each important. Early iterations of governance typically include chats with the family attorney or accountant "around the kitchen table." Over time, the venue changes to the boardroom and the topics expand to include competitive strategy, owners' alignment around growth, risk, profitability and liquidity, organizational design,

The leading generation seems to be staying longer and the next generation seems to want to lead earlier.

risk management, accountabilities, guidelines for choosing leaders, compensation, decision rights, and the extent to which the owners want family members involved in the business. No two governance evolutions are identical. Their pace and dynamic must fit the family.

"FBCG studies have shown that the highest-performing family firms tend to have a fiduciary board with the majority of board members as independent outsiders versus family members," reports Joe Schmieder, FBCG principal consultant, in his article "Evolving Your Family Business Board." Why is this the case? Consider the experience of a client family in the hotel and lodging business. The four sibling owners with a history of interpersonal conflict faced an important decision: Should they borrow 20% of their equity to expand their footprint or continue to focus on improving operational efficiency? Long-standing lifestyle and personality differences tainted every discussion and made it difficult to objectively consider each other's ideas. Plus, due to their concentrated regional focus, they recognized that their ideas were limited by their relative inexperience and lack of exposure to other markets.

To their credit, they realized that they needed outside advice and objectivity. Over a one-year period, the sibling group identified the desired characteristics, experiences and skill sets of new board members, hired an outside search firm, identified and interviewed potential candidates and invited the two top candidates to join their board. Now five years later, they credit the wisdom and counsel of the independent board members as fundamental to their expansion and success in their hotel business.

What made the difference? As one board member put it: "We could not see the forest through the trees of decades of fighting and negativity. These new directors helped us to separate the emotional history of our sibling group from the data that pointed us in the direction we ultimately went in. Without their guidance we probably would still be arguing over the same issues from 30 years ago."

Trend 2: Mergers and Acquisitions

We see an increasing number of merger and acquisitions discussions and transactions. There are many reasons for family business owners to consider a total or partial sale, or an acquisition. First, long-standing production and consumption patterns are being disrupted by the 83 million millennial-generation consumers. Those born between 17 to 36 years ago represented $1.6 trillion in buying power in the year 2020. Study their consumption patterns and you will quickly see that they look at many activities differently than preceding generations.

Second, family firms are finding this rapid pace of change to be either a great challenge or a ripe opportunity. Those who either cannot or choose not to make needed adjustments become targets for those with an appetite and bankroll for acquisition. Consider the *Washington Post*, which in 1997 was read daily by more than 50% of households in the D.C., Baltimore and Northern Virginia metro area. *Washington Post* leaders saw the digital revolution coming, but their structures, processes, habits and norms could not evolve fast enough to retain market leadership. In 2013, the Graham family sold for $250 million cash to Nash Holdings, controlled by Jeff Bezos.

Third, private equity coffers are swollen with more than $800 billion in funds, and private equity firms have high incentives to pursue acquisitions. Family firms are an increasingly attractive target and there is a growing trend of family offices functioning as a private equity arm of the family enterprise.

Baby boomer business owners, those between 55-75 years old, are firmly in their retirement years. More and more of them are engaging their families in hold vs. sell conversations and many are finding that their children are not interested in running the family business. When private equity firms come courting and offer huge sums, it's reasonable to understand why business owners sell and turn their attention to protecting wealth and pursuing philanthropic initiatives.

When a client was asked why she chose to sell her group of retail automotive stores, she replied, "It turns out selling the company was the best form of succession for our family. My three children had very different lifestyles and different visions for their future and owning an auto group didn't fit with any of them. I'm happy with my decision to sell. The valuation was more than I had ever dreamed and I'm enjoying the freedom to define my next phase."

Trend 3: Generational Dynamics

While the issue of tension and misunderstanding between generations is nothing new, the level of discussion regarding current generation gaps seems to be reaching a peak in volume and intensity. From puzzled statements about why "those millennials" do or don't do certain things to the "OK boomer" trend (with Gen Xers somewhere in the middle), the gap seems to be wider than ever. Of particular note is the interaction between the leading generation, mostly made up of aging boomers, and the millennial and Gen X cohorts who would lead the family business into the future.

For example, a common generation gap growing wider is around the use of technology to interact. Communication between the generations is always challenging — even more so when the preferred mode and medium of communication are completely different. The tension between preferences of phone calls vs. text vs. face-to-face can compound misunderstanding and create gaps in trust. The bottom line is that there is a failure to connect and share information meaningfully in ways to build trust and understanding.

However, once these gaps are bridged, and both "sides" realize that the other has significant value to offer, there can be learning and enrichment. Sometimes a face-to-face meeting is necessary to achieve the desired results — both with colleagues, family and customers. Other times, a quick text is efficient and effective.

One of the ways the next generation can energize a business is by bringing fresh perspectives about technology. These tools allow the entire business to collect and use data and communicate in ways that are more effective and efficient. This leads to cost savings and even further innovation as employees are able to see new emerging trends because they have better data. This data can be part of the information that allows the leading generation to monitor business performance as they begin to transition out of leadership roles.

We are also observing that social media is both an opportunity and a potential threat. The various social media platforms present many opportunities to clearly and repeatedly communicate positive messages about values, products, service and distinguishing characteristics.

On the other hand, social media platforms are public and permanent. Once a message is posted, it is available for all to see and share. This is a threat in the case of misstep or oversight. If grievances of the family or business are aired in this public forum, it can have the effect of reducing confidence in the business, the products and the people in leadership. These types of missteps are easy to make and very difficult to fix.

Trend 4: Longer Life Spans, Longer Careers
Two developing trends seem to collide in this category: The leading generation seems to be staying longer and the next generation seems to want to lead earlier. When both of these trends are present in a family business, we observe that things get "jammed up" and tension is created between the generations. And the longer this dynamic exists in a family business, the more tension can build.

Our clients have found it helpful to recognize that a diversity of viewpoints is essential in organizations of growing complexity competing in a global marketplace. Leading at the management and governance levels requires a broader perspective, and involving multiple generations can contribute to that.

The key is to manage the paradox of desiring continuity (the business lasting beyond the leading generation) and longer productive life spans. Families who purposefully navigate these generational dynamics create opportunities and build necessary skills for collaboration between generations. This allows for open conversation, planning, understanding and coordination regarding issues such as continuity and governance while maintaining or building family harmony and trust. One idea we have seen add value to families is to have each member of each generation create a list of those behaviors or beliefs that they need to "let go of" or "grab on to" in order for the family to achieve a higher level of success. These activities represent the mindset and innovation necessary for each generation to do their part as the baton is passed from one generation to the next.

Conclusion
These trends are affecting businesses in all industries around the world, but they show up in ways that are as unique and complex as the family businesses who are experiencing them. And they do not exist in a vacuum. Leaders can't simply pick one without dealing with the others. Instead, they must work together with their families, owners, boards and executives to identify how these trends are affecting them and make plans for using them to their advantage.

Dana Telford is a principal consultant, and Tom Emigh is a consultant with The Family Business Consulting Group. Telford specializes in helping family business owners plan for succession and manage the complexities and opportunities that are inherent to family business. Emigh has extensive experience working with family businesses, growing and developing multiple generations, and guiding succession implementation.

"My youngest is at that age when she can barely comprehend cost effective analysis."

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