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THE IMPORTANCE OF ESTATE PLANNING IN FAMILY BUSINESS

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ABSTRACT

The topic covered in this research is estate planning and the family business. This topic can become an extremely complex issue. Due to this fact a wide range of issues are covered. An understanding of the characteristics and current state of affairs of the small/family business sector and the financial/small business advisor industry are import to estate planning for the family business. One of the most important steps that a family business owner can take is to seek the advice of a financial or small business advisor.

Estate planning, whether it is for a personal estate or that of a family business, can be a very emotional issue not only for the person planning for their estate, but also for the person's heirs. Their own mortality is something that both parties do not think about on a daily basis. When a business owner is planning for their business after their death, many more issues come into play besides the one that accompanies personal estate planning.

UNPAID FAMILY WORKERS IN METROPOLITAN AND NON-METROPOLITAN PENNSYLVANIA COUNTIES

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ABSTRACT

Residents of non-metropolitan counties may find it more difficult to find suitable employment due to lower levels of economic development and decreases in the health of those industries that exist in rural areas. This could lead to higher levels of self-employment as people are forced to choose between relocating and creating their own jobs. However, self-employment rates may not give a true picture of the proportions of people who are "self-employed" as many may work as unpaid employees in a family business. This study examines this issue by comparing the percentages of people who are classified as employed, but are in the subset of people who are unpaid family workers. Analysis of US Census data shows that in Pennsylvania, the state with the highest number of rural residents, non-metropolitan counties had significantly higher proportions of employed people who were unpaid family workers.

INTRODUCTION

Family businesses are unique in that the goals of the family members may supercede, or at least not be directly related to, strictly financial goals (Alderfer, 1988; Chua, Chrisman & Steier, 2003; Sharma, Chrisman, & Chua, 1997; Sirmon & Hitt, 2003; Ward, 1987). According to Chua and associates (2003, pp. 331-2), "The business must perform in a way that creates value for the family and the family must add value to the business in a manner that is impossible without family involvement." One obvious way in which family members may add value to the company is through unpaid labor. While the family members may receive both economic (food, lodging, etc.) and non-economic benefits that results from the business' proceeds, they do not receive actual wages.

This study examines and compares the proportions of Pennsylvania workers who declared themselves as unpaid family workers in the year 2000 U.S. Census (2004), and compares these proportions in metropolitan and non-metropolitan counties. These numbers will provide further insight into the numbers and proportions of people who are self-employed since non-paid family workers could also be considered, in a way, self-employed. If these numbers are found to be higher in one area than another, it may help explain differences in self-employment rates or provide a deeper understanding of firm financial performance

BACKGROUND ON FAMILY BUSINESSES AND RURAL AREAS

The interaction between a family and its business creates a unique set of resources upon which the family can draw (Cabrera-Suarez, De Saa-Perez, & Garcia-Almeida, 2001; Habbershon & Williams, 1999; Sirmon & Hitt, 2003). One of these resources is family members who can work without the benefit of additional pay, which can be not only an advantage, but a key to the survival of a family firm (Goody, 1996; Haynes, Walker, Rowe, & Hong, 1999; Horton, 1986; Sirmon & Hitt, 2003). This could be especially true in rural areas in which small businesses face numerous obstacles such as lower levels of economic development, small populations with lower incomes, and

limited access to business services (Fendley & Christenson, 1989; Frazier & Niehm, 2004; Small Business Administration, 2001; Tigges & Green, 1994).

It is also possible that a family member works without pay because other jobs are unavailable. The quantity and quality of jobs in rural areas have been seriously affected by problems such as sagging rural farm economies, increased foreign competition, and decreases in rural industries (Frazier & Niehm, 2004; Lichter, 1989). Many people, particularly those in rural areas, could work, but are limited by location, physical difficulty commuting to a work site, or personal and family situations (Coats, Jarratt, & Mahaffie, 1991; Tigges & Green, 1994). Lichter (1989) concluded that in 1985 one-third of rural women were underemployed, meaning they were not able to find full-time work or a job paying adequate wages. Rural women were underemployed at a rate 38% greater than urban women, and 42% higher than rural men. If a family business already exists or is started, contributing as an unpaid worker in a family business may be the best alternative given available opportunities.

In examining the rates of unpaid family member employment, it seems logical that areas in which there are higher levels of self-employment would also have higher levels of unpaid family member involvement. Hout and Rosen (2000) found that the sons of farmers, businessmen and professionals had higher rates of self-employment than did sons of clerical, retail, and manual workers. Robinson (2003) determined that there were significant differences in both men's and women's rates of self-employment in metropolitan and non-metropolitan counties of Pennsylvania, with the largest difference between metropolitan and non-metropolitan men.

Based on these findings, it could be expected that there would be higher proportions of unpaid family workers in non-metropolitan areas. In the following section, the methodology of this study is described, followed by results, analyses, and conclusions.

METHODOLOGY

There are a number of ways to define family business from very broad to extremely narrow definitions (e.g. Chua et al., 1999; Habbershon & Williams, 1999; Litz, 1995; Westhead & Cowling, 1998). Because this study analyzes data collected by the U.S. Census (2004), which simply asked respondents about the nature of their employment, it is impossible to tell exactly what definitions were used except to say that each respondent who declared himself or herself an unpaid family worker felt the business was a family business.

Data regarding the number of unpaid family workers in each county were obtained from 2000 Census Summary File 3 (U.S. Census Bureau, 2004). Rates for unpaid family workers were determined by dividing the number of unpaid family workers by the total number of workers. Counties were classified as metropolitan or non-metropolitan based on information drawn from the Economic Research Service (2003). Of Pennsylvania's 67 counties, 32 were designated as non-metropolitan.

RESULTS AND ANALYSIS

The results of t-tests conducted on the data are shown in Table 1. Overall, it is a small segment of the population, less than 1%, that claims this designation, but still a significant number of people when one considers that even in more sparsely populated rural areas, the average is well over 100 people per county.

Table 1. Average Number and Percentage of Unpaid Family Workers

	Number		Percentage	
	Non-metropolitan	Metropolitan	Non-metropolitan	Metropolitan
Total	119	413	0.53	0.33
t	-4.826		6.116	
sig.	0		0	
Men	57	167	0.45	0.25
t	-4.243		5.345	
sig.	0		0	
Women	62	247	0.6	0.41
t	-5.076		4.268	
sig.	0		0	

Further analysis of these data show that although there are higher numbers of unpaid family workers in metropolitan counties (as well as higher populations), the proportion of total workers who declare themselves as unpaid family workers is higher in non-metropolitan counties. Overall, non-metropolitan workers were approximately 61% more likely to claim themselves as unpaid family workers. This makes intuitive sense since there are significantly higher percentages of self-employed people in non-metropolitan counties than in metropolitan counties of Pennsylvania (Robinson, 2003). Breaking these statistics down by sex, non-metropolitan men were 80% more likely than metropolitan men to be an unpaid family worker, while non-metropolitan women were approximately 46% more likely than metropolitan women to be in this category.

While men in both areas of Pennsylvania were almost twice as likely to be self-employed as were women (Robinson, 2003), metropolitan women were about 33% more likely than metropolitan men to be unpaid family workers. Non-metropolitan women, the group with the highest rate overall, were 60% more likely than non-metropolitan men to be in this job class. A paired sample t-test showed there was a significant difference between men's and women's rates of participation as unpaid family workers in their respective counties ($t = 20.101$, sig. .000). Although it was beyond the scope of this project to determine the ownership of businesses, it seems possible that women may have been more likely to call themselves unpaid family workers while men may have preferred to classify themselves as self-employed when both are part of the same company. An analysis of owners' differing perceptions of ownership and participation in family businesses, and the effects of those various perceptions could be an interesting avenue for future research that could provide important insights into how family businesses operate.

CONCLUSIONS

It is estimated that approximately 40% to 60% of the United States GNP stems from family businesses, making it a significant portion of the economy (Neubauer & Lank, 1998). The results of this study showed that although only a small proportion of workers consider themselves unpaid family workers, a large number of people are in this category. It was not possible to determine from the data whether these people could also be categorized as self-employed.

The use of unpaid labor is one way in which family businesses are obviously different from other companies. This could naturally be an advantage in terms of resources, but in comparing the financial performance of family firms with non-family firms, family firms may be consuming additional labor without providing greater financial performance. In addition, the opportunity cost

of the unpaid family member not working in a paid position outside the family is another issue to be considered.

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AVOIDING THE HIGH COSTS OF LITIGATION

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ABSTRACT

Alternative Dispute Resolution (ADR), especially arbitration, has become an integral part of doing business as businesses consider the high costs of resolving legal disputes in court. While large corporations have embraced arbitration as a means to resolve disputes with less cost, both financial and otherwise, small business can also benefit from ADR. This paper discusses the costs of litigation and potential advantages of mediation and arbitration. The law regarding arbitration is examined to provide the business person with a working knowledge of this method of ADR. In addition, suggestions are made as to how to implement arbitration clauses into business contracts.

INTRODUCTION

Alternative Dispute Resolution (ADR) is a term most business people have heard. Most have heard of arbitration, too. For many though, these terms, and the choices they represent, may not have any practical application to their businesses, especially if the business is small. However, the advantages of ADR are available to all businesses, large and small. Arbitration, the most utilized form of ADR, has become a fixture in commercial contracts and a common method of dispute resolution for large corporations. Its application makes sense in small businesses where the costs of litigation are often not budgeted and resources can be strained by a legal dispute. For many small business owners, the concern over potential lawsuits is not acknowledged as part of doing business, but it should be.

THE HIGH COSTS OF LITIGATION

Most think of the cost of attorneys as the highest cost of litigation and that certainly can be the case. Most often in defense work, attorneys charge by the hour. The lawyer may also maintain an hourly billing statement for legal assistants working on the case. Time sheets are kept noting the time spent on each case. The hourly rate of attorneys engaged in defense work can vary tremendously depending on geographic and population factors. The lawyer's hourly rate could be anywhere from hundreds of dollars to thousands of dollars. Over time, this is going to add up. Every phone call, every meeting, every stage of discovery, every court appearance, every hour of research is added to the time sheet. The cost of representation will be high, but there are other costs as well.

Any court action includes costs and fees in addition to the lawyer's. Court costs are assessed by the court at the close of a case. One stage of civil litigation, referred to as discovery, "probably accounts for 80 percent of all commercial litigation costs" (Saunders, 1984, p. 105). Moreover, during a trial, expert witnesses are often needed to establish trade practices or professional standards and their fees are high. Other witness fees may be assessed for those you need to testify to defend your case. Photocopying, couriers, investigators and travel costs are all potential litigation expenses.

The process of bringing a dispute to trial will also involve time. Meetings with lawyers, compiling documents, locating witnesses and the court proceedings will force a businessperson away from his or her business. Whether your business is providing services or products, the demand on your time and attention will impact your customers.

Other costs are not counted immediately in terms of dollars, although there could be such an impact on a business. The legal system thrives on openness as the means to obtain truth and that

openness is illustrated by not only the public display of a trial but by the accessibility each party in a civil action has to information held by others. Records filed with court throughout a civil action, including those involved and the nature of the dispute are public record. Prior to the trial, a major stage in litigation, called discovery, requires all relevant data to be available for review by all engaged in the dispute. Information deemed confidential in your work environment will not remain so if it sheds light on the conflict between the parties or can lead to other information that will. It can be disconcerting to have your businesses financial records, tax returns, ledgers, bank statements, and cancelled checks handed over for inspection to an attorney, your opponent and other persons who can assist in the interpretation of such information. Privileged information, those forms of information not allowed to be compelled during discovery, are narrow in scope and rarely deal with financial records. Employment policies, handbooks, internal memorandums, notes, minutes from meetings can all become part of the litigation process. Once uncovered during the discovery process, confidential business information may become evidence during the trial. In this case, the information will be open to all present during the court proceeding, even the local newspaper reporter.

The publicity associated with a court case could also up the costs of litigation. While the old adage may be that bad publicity is better than no publicity, that doesn't apply well when the public impression of your business is tarnished by another's allegations that your business is not up to par. The goodwill a business has developed over time may diminish. Reputation and integrity are still qualities that will enhance a business and those can be damaged when disgruntled parties go to court.

Those disgruntled parties may also never be able to work together in the future, illustrating another high cost to adversarial litigation, the damage to business relationships (Harwell & Weinzierl, 1995). The legal system, by design, is confrontational and does not necessarily lend itself to amicable settlements if parties are unwilling. Certainly, it would seem that a less confrontational approach to a dispute could benefit all concerned and allow for continued relationships (Demery, 1996).

THE ALTERNATIVE TO LITIGATION

Is there a way to avoid the high costs of litigation? Perhaps not always, but there are alternatives available to business owners that can serve to, if not eliminate, severely reduce the negative and costly impact of legal disputes and civil litigation. These alternatives fall under the heading of Alternative Dispute Resolution (ADR) and can be incorporated into your business plan when planning for the worst. ADR encompasses several processes that serve to move a dispute from the court system and the public sector, to a less formal and private sector. Arbitration it the most utilized form of ADR.

Arbitration is not a new idea but is most definitely an idea whose time has come. Amid complaints of an overloaded and ever expensive court system, more and more businesses are looking for alternatives. The Federal Arbitration Act (FAA) was enacted in the 1940's as a means for the government to support the alternative means for the resolution of disputes. It created law regarding contractual arbitration provisions that has both federal and state application (Southland Corp. v. Keating, 1984). This law does not set up the method by which arbitration is to take place, but positions the state as the enforcer of contractual agreements to access arbitration as the means to resolve differences outside of the court. While this act provides for the court review of agreements to arbitrate and limited review of arbitration awards, its true purpose was to set the stage for the support of arbitration as a public policy issue. Reducing the litigation load in the courts and supporting the freedom to contract is in the public interest and as so, will be encouraged by law.

The resolution of a disagreement as to the validity of a contract is generally determined by state law and as such, can vary in state jurisdictions. However, the Federal Arbitration Act preempts all state law that would serve to restrict the enforcement of arbitration clauses (R.J. Palmer

Construction Company v. Witichta Band Instrument Co., 1982). As long as the contract containing the clause is enforceable, the arbitration requirement will be too. The FAA is applicable to the arbitration provisions only (Rickard v. Teynor's Homes Inc., 2003) and only when those provisions are in contracts engaged in interstate commerce (Shearson Hayden Stone, Inc. v. Liang, 1980). Otherwise, federal jurisdiction is limited to controversies involving federal law or involving diversity of citizen and high dollar amounts. The FAA does not confer federal court jurisdiction over disputes involving contractual provisions regarding arbitration but does allow those provisions to be enforced by state courts using the federal law (R.J. Palmer Construction Company v. Witichta Band Instrument Co., 1982).

One of the common disputes regarding arbitration provisions involves a determination as to whether the parties had fully agreed and freely entered into the contract. However, contract law is strict in enforcing contracts where the parties knew the nature of the agreement and acted with free will. Again, it is in the public interest to promote arbitration and contracts utilizing that process. Federal courts have set the policy that private arbitration agreements should be "rigorously" enforced (Peoples Sec. Life Ins. Co.v. Monumental Life Insurance Co., 1989, p. 812).

If the underlying contract containing the arbitration provisions is valid and enforceable, then the courts will compel the parties to arbitrate. Any court proceeding of a similar nature to the issues included in the agreement to arbitrate will be put on hold, or stayed, until the arbitration takes place (9 U.S.C.S. § 3 (1947)). However, the party seeking arbitration must more quickly. Unreasonable delay in seeking arbitration at this point could lead to a court decision that the party waived the right to arbitrate (Secrist v. Burns International Sec. Servs., 1997). Moreover, under the FAA a court is authorized to order parties to arbitration should one party to the dispute refuse to proceed to arbitration (Townsend v. Smith Barney Shearson, 1995). The court may even appoint an arbitrator if need be (9 U.S.C.S. § 5 (1947)).

The courts play a limited role after an arbitration award has been made since to provide otherwise would "frustrate basic purposes of arbitration" (Federal Commerce and Navigation Co. v. Kanematsu Gosho, Ltd., 1972).There are exceptions. First, either party may apply to the court to confirm the award and have the award entered as a judgment. This will require that the confirmation by court was part of the original contractual agreement of the parties. Moreover, the court may review and even modify an arbitration award should the final award have numeric miscalculations and "evident and material mistakes as to a person, thing or property referenced in the award" (U.S.C.C. 9 § 11(a) (1947)) or if the arbitrator has made a determination to a matter not submitted to arbitration (9 U.S.C.S. § 11(b) (1947)). Finally, the court can actually vacate an arbitration award under very restrictive circumstances. The Federal Arbitration Act specifically provides for vacating awards "procured by corruption, fraud or undue means," (9 U.S.C.S. § 10(a)(1) (1947)) situations where the arbitration's actions meet a standard of "misconduct," (9 U.S.C.S. § 10(a)(3) (2002)) or where arbitrators "exceed their powers" ((9 U.S.C.S. § 10(a)(4) (1947)).

Arbitrators, however, have considerable leeway in conducting hearings and reaching awards. The FAA does give an arbitrator some authority to summons witnesses and relevant documents in order to allow for the presentation of evidence at the arbitration hearing (9 U.S.C.S. § 7 (1947)). However, once the award is reached, the arbitrator is not required to enumerate her reasons for her decision and award (Sperry International Trade, Inc.v. Government of Israel, 1985). Legally, the arbitrator is required to give only a "fundamentally fair" hearing (Bell Aerospace Co. Div.of Textron, Inc. v. International Union, United Auto, etc., 1974).

The court has no power to vacate an award even in situations where the arbitrator misunderstood the law (Denver and Rio Grande W.R.R. v. Union Pac. R.R., 1997). For the court to intervene, the arbitrator has to engage in a "manifest disregard" for the law. An award must demonstrate an understanding of the law which is then intentionally disregarded to earn vacating by the court (Reynolds Secur., Inc.v. Macquown, 1978). Refusing to hold a hearing or to allow parties to submit evidence illustrates arbitrator misconduct that leads to the vacating of an award.

(Riko Enterprises, Inc. v. Seattle Supersonics, Corp., 1973). This authority extends to state courts, which, under the FAA, also have the jurisdiction to review and, if justified, vacate awards (National Railroad Passenger Corp. v. Blanchette, 1977).

However, the message is clear that courts will not become involved in review of arbitration hearings and awards except in the most extreme cases. While contracts are the essence of arbitration, the review of arbitration awards by the courts can not be expanded even should the parties agree to it (Koycera Corp. v. Prudential-Bache T Servs, 2003).

IMPLEMENTING ARBITRATION

To utilize arbitration to its fullest, parties can agree on the dynamics of the arbitration hearing. This would include the selection of the arbitrator or arbitrators, time frames and the information that both parties will have access to from the other. Since arbitration is based on contract, the abilities of the parties to agree on such elements are crucial. Selection of an arbitrator is of significance in that someone with expertise in the field, credentials and experience is much more likely to make appropriate awards. Arbitrators may be lawyers or retired judges, but can be experts in any profession (Hall, 2001). Many concerns of an arbitrator's bad faith can be eliminated to a great extent, by selection of an appropriate arbitrator.

Practical issues such as how to include arbitration clauses in contracts, how to find an arbitrator or how to schedule the hearing can impair access to arbitration. Many of those issues can be resolved by careful drafting of arbitration clauses in contracts. These clauses can be specific and outline the arbitration process including selection of arbitrators, access to information and the manner in which the arbitration hearing will be conducted. A simple contractual phrase stating disputes will be resolved by arbitration will suffice, but fails to identify all the issues involved in the process. The only requirement in law is that the agreement to arbitrate must be in writing (Ward Foods, Inc. v. Bakery & Confectionery Workers Union, 1973).

CONCLUSION

Businesses large and small can turn to alternative dispute resolution processes in many commercial, consumer and employment contracts. Courts have consistently enforced fair agreements and have expressed continued support for alternative means to resolve legal disputes. It is an important part of the business plan, even for small business, to consider the consequences of a legal dispute and to consider the most efficient and effective way to handle such issues. ADR is not just for large corporations, it can also well serve the small business providing significant advantages to civil litigation. Planning, seeking appropriate legal advice, and appropriate contract drafting can help a small business create an environment for dispute resolution that bypasses the courts. Decreasing the costs of litigation, from attorney's fees to damaged business relationships, should be an important consideration in all business plans.

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