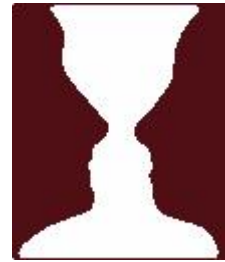


MIKE HENNING'S

“ALL IN THE FAMILY” COLUMN

With Stock Ownership Comes Confusion



It is easy for a non-active shareholder of a privately-owned company to become confused regarding privileges and responsibilities of ownership. I recently experienced this confusion with two of my clients. It would be advisable for active owners to help non-active owners develop an understanding about their obligations to the company. In preventing or solving potential problems, it is essential to have a basic understanding of your position in the company structure.

Shareholders

Let's examine the many attributes and characteristics of stock in a closely-held company.

1. **Power to Vote.** Since shareholders are at the top of the corporate structure, they alone vote to elect the board of directors, who will then elect the president and other corporate officers. This voting privilege is significant as the officers usually are the people who run day-to-day operations of the company.

An “S” corporation can only have common stock-but you can have two kinds of common, voting and non-voting. A “C” corporation may have two or more classes of stock, common and preferred. It is customary for one class to have voting rights and the other not, although both classes could have voting rights.

2. **Distributions/dividends.** If the board of directors elects to pay the accumulated profits of the corporation to the shareholders, this will become a privilege of ownership. Additionally, dividends could be paid to owners of one class of stock and preclude the others.
3. **Liquidation, sale of company, and mergers.** For example, when a company is liquidated or dissolved, each shareholder participates in the liquidation value only after all debts to creditors have been settled. Naturally, each shareholder's distributive share is proportionate to their share of ownership.
4. **Financial Statements.** Each shareholder has the right to a copy of the company's financial statement and an explanation that clarifies the reasons behind the numbers.
5. **Gift or Sale of Stock.** According to the corporate bylaws and minutes, each shareholder has the right to sell or transfer stock.

Directors

Buy/Sell Agreements entered into by shareholders of a private company are often designed to keep stock in the shareholder's hands and the company's control.

As is clear, shareholders impact the company through their choice of directors, not by involving themselves in day-to-day operations or in formulating policy. Their rights and privileges do not include working for the company or receiving benefits or direct compensation.

Since the duties of the shareholder and director in a small closely-held company can become confused, let's look briefly at the responsibilities of the director.

1. **Shareholder interest.** Represent the interest of the shareholder as a group.
2. **Corporate and financial strategy.** Approve investment strategies, distributions and retirement plans.
3. **Policy making.** Look beyond day-to-day issues and formulate policy that will last for years to come.
4. **Forming and maintaining the management team.** Boards approve the duties for the president and managers as well as their compensation.
5. **Elect corporate officers.** Boards dismiss and elect officers and determine their compensation.
6. **Corporate controls.** Review company performance.
7. **Employee and community relations.** Since some company decisions can affect officers personally in the community, generally boards deal with such issues.
8. **Vote.** A typical vote of the board would come on issues dealing with mergers, major debt, property acquisition or large sales.

Company officers are responsible to the board for implementing policy through day-to-day management of the operations. It is common that key personnel will make reports concerning their area of responsibility to the board at a meeting.

Common Issues

Confusion. Family members find themselves involved in playing many different roles, and if they are unaware of the responsibilities associated with each role, confusion is often the result. For example, a family member and owner of company stock who happens to be sales manager and board member, commonly turns conversation at the board meeting into day-to-day sales.

Control. Too often the senior generation retains majority control of company stock. The result is usually one of suppressing the enthusiasm of the junior generation for the routines and traditions of the past.

Cohesion. Small groups of shareholders form who have the majority vote and then stack the board with those who favor their position. For example, they elect themselves as officers, determine their own salaries and rarely consider dividends.

In some cases, they fail to provide shareholders and other minority shareholders with proper financial information. Frustration is the clear result because these minority shareholders have no

place to sell their stock, except to the majority shareholders who are not interested, and they have little knowledge of the company; the only alternative is to become involved day-to-day. Naturally, the majority group calls “harassment.”

Wearing the Proper Hat

Having multiple roles for family members running privately-held companies is here to stay. The “key” to long term success for these families is to reduce the emphasis on the rights associated with their position and focus on the responsibilities of each role. Many family members are very successful at wearing the different hats associated with multiple roles, others need to introduce outside help - for example, inviting outsiders or “key” managers from within the company to sit on the board.

This article appeared in Mike Henning’s Family Firm Advisor newsletter, for more information about receiving one free copy of our newsletter, visit us at our web site: www.mikehenning.com, e-mail: hfbc@mikehenning.com or call -- 217-342-3728. Mike Henning is a nationally and internationally respected consultant and speaker on family business issues.

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