

TEST QUESTIONS
Chapter 2 Family-Owned Businesses

Multiple Choice Questions

1. According to the Family Firm Institute of Boston, family-owned businesses have a high mortality rate primarily because:

- a) there is little personal satisfaction.
- b) they are too large.
- c) family members lose interest.
- d) the estate taxes are high.

Answer: d

Page: 35

Difficulty: Easy

2. According to the Family Firm Institute of Boston:

- a) family-owned businesses in the U.S. are predominantly small.
- b) a majority of family-owned businesses in the U.S. flourish.
- c) family-owned businesses in the U.S. must hire college graduates.
- d) emotions and business do not mix in a family-owned business.

Answer: a

Page: 35

Difficulty: Easy

3. A characteristic of family-owned businesses in the U.S. is that they:

- a) have less potential financial risks.
- b) can be a source of unresolved family conflicts.
- c) have little disagreement among members on how to meet business goals.
- d) rarely have family members with differing value systems.

Answer: b

Page: 35

Difficulty: Medium

4. In order to cope with the daily challenges of a family-owned business, the family should:

- a) hire more relatives to work in the business.
- b) keep children out of the decision-making process.
- c) reduce time spent on home activities.
- d) develop an appropriate family mission statement.

Answer: d

Page: 36

Difficulty: Medium

5. A developing trend in family businesses is that young people:

- a) offer an executive position to their parents in their company in return for funding.
- b) show disinterest in continuing the work of their parents.

- c) prefer to look for jobs in major corporations rather than focus on the business.
- d) are not interested in gaining experience by working part-time.

Answer: a

Page: 36

Difficulty: Medium

6. _____ refer(s) to family-owned businesses run by husband-and-wife teams.

- a) Angel investors
- b) Intrapreneurs
- c) Copreneurs
- d) Strategic alliances

Answer: c

Page: 37

Difficulty: Easy

7. Which of the following situations should copreneurs avoid?

- a) Agreeing to disagree on several business issues
- b) Ignoring business conflicts in an attempt to save the relationship
- c) Setting aside time for the family and sticking to it
- d) Defining each person's role and accentuating each other's talents

Answer: b

Page: 37

Difficulty: Medium

8. How can copreneurs efficiently manage their family-owned business?

- a) Keep personal issues aside while holding business arguments.
- b) Let one spouse work for the other as an employee.
- c) Make major decisions independently, without having to consult the other,
- d) Spend more time tending to the business and less time in personal matters.

Answer: a

Page: 37

Difficulty: Medium

9. Conflicts are likely to arise in a small family-owned business when:

- a) each family member has a different perspective, leading to dissension.
- b) a family member is clearly in command, at least in a given area of management.
- c) the role of each family member is distinct, based on sound business practices.
- d) family members agree to disagree and set ground rules.

Answer: a

Page: 39

Difficulty: Medium

10. A way to deal with incompetent family members in a family-owned business is to:

- a) allow them to take special privileges.
- b) tolerate them when they avoid unpleasant tasks.
- c) place them in responsible positions to encourage them to work.

d) assign jobs to them that allow minimal contact with other employees.

Answer: d

Page: 39

Difficulty: Medium

11. Which of the following steps should a family-owned business take to compensate family members?

- a) Every relative who wishes to work for the business should be hired.
- b) Family members should be financially rewarded on the basis of their position in the family.
- c) A managerial title should be offered to motivate a productive family member.
- d) Relatives should be offered positions according to their status in the family.

Answer: c

Page: 40

Difficulty: Medium

12. A limitation of a small family-owned business is that a family manager may:

- a) refuse to hire family members who want to enter the business.
- b) lack general management skills, being proficient in a specific activity.
- c) ignore top family members when a matter needs to be cleared.
- d) guard against letting past successes lead to trying to maintain the status quo.

Answer: b

Page: 40

Difficulty: Medium

13. Which of the following is an advantage of hiring professional managers to run family-owned businesses?

- a) More employment opportunities for family members
- b) Retained “personal touch”
- c) Fair treatment of employees
- d) Concentration of power in small cliques

Answer: c

Page: 40

Difficulty: Medium

14. A disadvantage of organizing a family business into a corporation and hiring professional managers is the:

- a) concentration of power in small cliques.
- b) unfair treatment of employees.
- c) loss of family time for other purposes.
- d) increasing friction between family members.

Answer: a

Page: 40

Difficulty: Medium

15. A home-based business is an attractive option for working mothers because:

- a) most corporations encourage telecommuting.
- b) there has been a decrease in job sharing.
- c) many companies are adopting flextime.
- d) daycare services are relatively inexpensive.

Answer: b

Page: 42

Difficulty: Medium

16. Expansion for small family-owned businesses may be limited by:

- a) the size of the family.
- b) low motivation level of employees.
- c) the amount of family assets available.
- d) the retirement age of the owner.

Answer: c

Page: 42

Difficulty: Medium

17. How can children be prepared to enter the family-owned business?

- a) Allow them to work in senior management positions and make important decisions.
- b) Give them a permanent leadership position in the business.
- c) Promote them rapidly in the business out of turn.
- d) Let them work for another company to gain experience.

Answer: d

Page: 43

Difficulty: Medium

18. Why is management succession a problem for family-owned businesses?

- a) Employees may dislike the chosen successor.
- b) Children may choose their own successor.
- c) Potential candidates may be groomed too early.
- d) There is a defined hierarchy for decision-making.

Answer: a

Page: 44

Difficulty: Medium

19. A number of entrepreneurs are turning to formal succession plans for their family-owned businesses to:

- a) ensure they get proper returns on their investment.
- b) allow themselves to go on a short leave.
- c) prevent endless disputes over ownership between their heirs.
- d) devote time to face-to-face teaching and training.

Answer: c

Page: 45

Difficulty: Medium

20. A(n) _____ is a document that contains instructions about what should be done with the family-owned business if the owner suddenly dies or becomes incapacitated.

- a) bequest
- b) will
- c) instrument
- d) claim

Answer: b

Page: 45

Difficulty: Easy

21. If a family-owned business is a corporation, replacement of ownership is decided by:

- a) the spouse of the former owner.
- b) a court-appointed attorney.
- c) the board of directors.
- d) family law.

Answer: c

Page: 45-46

Difficulty: Easy

22. Which of the following is an advantage of selling a family-owned business to family members?

- a) Fewer family members are hired in the business.
- b) The former owner has to take some responsibility toward the business.
- c) Family bonds are strengthened and additional friction is reduced.
- d) The former owner still owns the business until retirement.

Answer: c

Page: 47

Difficulty: Medium

23. An advantage of selling a family-owned business to outsiders is that:

- a) the former owner receives an assured income.
- b) it provides a constant source of income to all the family members.
- c) the stature of the family is maintained.
- d) the owner assumes more responsibility with resultant happiness.

Answer: a

Page: 47

Difficulty: Medium

24. The transition of a family-owned business to a successor can be made easier for the former owner by:

- a) devoting lesser time to hobbies and other outside activities.
- b) keeping the owner engaged in a top management position.
- c) narrowing his/her skills to focus on a single task.
- d) handing over to the successor in phases.

Answer: d

Page: 48

Difficulty: Medium

25. What is estate planning?

- a) Planning for a new buyer of a family-owned business that is up for sale
- b) Compensating the owner of a family-owned business when the family wants to sell it
- c) Preparing for the orderly transfer of the owner's equity when death occurs
- d) Assessing the real-estate value of a family-owned business before it is sold

Answer: c

Page: 48

Difficulty: Medium

26. A family limited partnership allows business owners to:

- a) choose people who could be considered owners of the business in their absence.
- b) remain part of the ownership group when the business is sold.
- c) pass assets to heirs with a minimum of income and estate tax costs while retaining control of assets during their lifetime.
- d) name a family member as the successor when the business is up for sale.

Answer: c

Page: 49

Difficulty: Medium

27. A _____ provides for a corporation to repurchase a shareholder's stock when he/she leaves the company.

- a) living trust
- b) buy-sell agreement
- c) family limited partnership
- d) recovery fund

Answer: b

Page: 49

Difficulty: Easy

28. In the context of family-owned businesses, which of the following can be used to minimize estate taxes?

- a) Buy-sell agreement
- b) Family limited partnership
- c) Formal succession planning
- d) Selling stock to outsiders

Answer: b

Page: 50

Difficulty: Medium

29. A(n) _____ resembles a will, but, in addition to providing for distributing personal assets on the maker's death, it also contains instructions for managing those assets, should a person become disabled.

- a) living trust
- b) promissory note

c) white paper

d) attestation

Answer: a

Page: 51

Difficulty: Easy

30. In the context of a family-owned business, which of the following is a disadvantage of a living trust?

a) The business goes to the designated heirs without going through probate court.

b) Property can be put into the trust while the owner is alive.

c) The ownership still remains with the owner after transferring the title to the trust.

d) The title on real estate and securities must be changed to the name of the trust.

Answer: d

Page: 51

Difficulty: Medium

True/False Questions

31. According to the Family Firm Institute of Boston, a majority of family-owned businesses close down due to high estate taxes.

Answer: True

Page: 35

Difficulty: Easy

32. Most people-related challenges faced by family-owned businesses result from interactions of business necessity with family values and relationships.

Answer: True

Page: 35

Difficulty: Easy

33. Family-owned businesses need an appropriate mission statement to cope with the demands of business operation.

Answer: True

Page: 36

Difficulty: Easy

34. Due to their inexperience, children must be excluded when making important decisions and setting goals for a family-owned business.

Answer: False

Page: 36

Difficulty: Medium

35. Family-owned businesses run so smoothly that there is rarely any conflict among family members.

Answer: False

Page: 36

Difficulty: Easy

36. A recent trend in the operation of a family business is that of retired parents wanting to buy their children's business.

Answer: False

Page: 36

Difficulty: Easy

37. Family-owned businesses run by husband-and-wife teams are referred to as copreneurs.

Answer: True

Page: 37

Difficulty: Easy

38. In family-owned businesses run by copreneurs, both partners have equal roles in all management areas.

Answer: False

Page: 38

Difficulty: Medium

39. The involvement of relatives in a family-owned business should always be based on the family status of the person.

Answer: False

Page: 38

Difficulty: Easy

40. Daughters interested in leading the family business should gain experience by working outside.

Answer: True

Page: 38

Difficulty: Easy

41. Incompetent family members working in a family-owned business may be handled by placing them in jobs which involve frequent interaction with other employees.

Answer: False

Page: 39

Difficulty: Medium

42. The attitudes of incompetent relatives working in a family-owned business can be changed by formal or informal education.

Answer: True

Page: 39

Difficulty: Easy

43. The high turnover rate of top-notch nonfamily managers and employees may be due to incompetent family members.

Answer: True

Page: 39

Difficulty: Easy

44. Deferred profit-sharing plans may be used to placate dissatisfied family members in a family-owned business—if deserved.

Answer: True

Page: 40

Difficulty: Easy

45. When success leads a family-owned business into the second generation, younger relatives begin to lose interest in job titles.

Answer: False

Page: 40

Difficulty: Easy

46. Family-owned business entrepreneurs usually make good general managers.

Answer: False

Page: 40

Difficulty: Medium

47. A person's age must determine the lines of authority in a family-owned business.

Answer: False

Page: 40

Difficulty: Easy

48. Managers of family-owned businesses must agree to hire any family member who wants to join the business.

Answer: False

Page: 40

Difficulty: Easy

49. As the leader of a family-owned business grows older, he/she must guard against depending on past successes.

Answer: True

Page: 40

Difficulty: Easy

50. Employees find themselves treated less fairly in a family-owned business that is organized into a corporation.

Answer: False

Page: 40

Difficulty: Medium

51. Pre-nuptial agreements pose a problem when a couple running a family-owned business gets divorced.

Answer: False

Page: 41

Difficulty: Medium

52. The borrowing power of a family-owned business is limited by the amount of family assets.

Answer: True

Page: 42

Difficulty: Easy

53. In order to prepare children to take over the family-owned business, it is essential to hire them for higher-level positions in the business.

Answer: False

Page: 43

Difficulty: Easy

54. In a small family business, management succession planning can start late.

Answer: False

Page: 43

Difficulty: Medium

55. Working for another company to broaden their training and background helps justify moving family members into the family business at a higher level.

Answer: True

Page: 43

Difficulty: Medium

56. In order to learn to manage a family-owned business, a family member should be given true responsibility.

Answer: True

Page: 43

Difficulty: Medium

57. When the choice of replacements is limited in a family-owned business, the owner may broaden a manager's job specification in order to utilize him/her effectively.

Answer: True

Page: 44

Difficulty: Easy

58. Estate planning involves preparing for the orderly transfer of the owner's equity in the business when death occurs.

Answer: True

Page: 48

Difficulty: Easy

59. A buy-sell agreement provides for the corporation to buy back a shareholder's stock when he/she leaves the company.

Answer: True

Page: 49

Difficulty: Easy

60. A family limited partnership resembles a will and contains instructions for managing personal assets.

Answer: False

Page: 49

Difficulty: Easy

Short Essay Questions

61. What causes conflicts in a family-owned business?

Answer: Family businesses are the backbone of America, but they can also be a source of unresolved family tensions and conflicts, which can create obstacles to achieving even the most basic business goals. When close relatives work together, emotions often interfere with business decisions. Also, unique problems, such as the departure of the founder-owner, develop in family-owned firms. When more than one family member is involved, emotions and differing value systems can cause conflicts between members. In fact, most people-related challenges faced by family businesses—small or large—result from the interactions of business necessity with family values and relationships.

Page: 35

Difficulty: Medium

62. Explain how a small family business owner must deal with incompetent family members working in the business.

Answer: Some family members want to become the head of the business but do not have the talents or training needed. Others may have the talents, but because of their youth or inexperience, these talents may not be recognized by other family members. Family members with little ability to contribute to the firm can be placed in jobs in which they do not disturb other employees. Sometimes, though, relatives can demoralize the business by their dealings with other employees or customers or by loafing on the job, avoiding unpleasant tasks, or taking special privileges. They may be responsible for the high turnover rate of top-notch nonfamily managers and employees. Such relatives should be assigned to jobs allowing minimal contact with other employees. In some cases, attitudes may be changed by formal or informal education.

Page: 39

Difficulty: Hard

63. How can family members working in a family-owned business be compensated?

Answer: Compensating family members and dividing profits among them can be difficult because some of them may feel they contribute more to the success of the firm than others. Compensation should be based on job performance, not family position. Fringe benefits can be useful as financial rewards, but they must conform to those given to

nonfamily employees. Stock can be established as part of the compensation plan. Deferred profit-sharing plans, pension plans, insurance programs, and stock purchase programs can all be effective in placating disgruntled family members, as can a managerial title—if deserved. When success leads a company into the second generation, titles start to matter to the younger relatives. A title is perceived as a confirmation of a job well done and also tends to serve as a motivator. This technique must be used carefully, however, to avoid counterproductive behavior in the future.

Page: 39–40

Difficulty: Hard

64. What are the limitations faced by a family-owned business?

Answer: Entrepreneurs tend to be specialists in an activity such as marketing, production, or finance, so they usually do not make good general managers. Another problem is that family managers may feel it is necessary to clear routine matters with the top family member, regardless of his/her position or ability. Also, bottlenecks that work against efficient operations can be caused by personality clashes and emotional reactions. The number of competent family members from whom to choose the managers of the company is usually limited.

Page: 40

Difficulty: Medium

65. What are the advantages and disadvantages of organizing a family-owned business into a corporation?

Answer: Some families organize their businesses into corporations and hire professional managers to run them when no family members are in a position to manage, or no agreement can be reached on who should run the company. This solution has the advantages of using professional management, freeing family time for other purposes, reducing friction, and having employees treated more fairly.

The disadvantages of this arrangement, however, may be reduced family employment, lower income, concentration of power in small cliques, difficulties in finding and keeping a good management team, and loss of the “personal touch.”

Page: 40

Difficulty: Medium

66. If you were a working mother, why would you prefer to establish a home-based business instead of looking for a corporate position?

Answer: In our “family-friendly” business environment many businesses are cutting back on flextime, job sharing, and paid family leave in order to continue to be profitable. This is a major reason mothers are quitting their current jobs and positions. One study of 400 employers indicates that job sharing, four-day workweeks, and telecommuting are decreasing. This creates an incentive for working mothers to establish a home-based business.

Page: 42

Difficulty: Medium

67. How can family business owners prepare their children to manage the business?

Answer: Often, children raised in a small business become bored or uninterested, or simply lack the drive and desire to succeed that had motivated their parents. The two primary reasons children follow in their parents business are to make money and because they like the business. One way to prepare children to take over the family business is to let them work on simple jobs, or on a part-time basis, which provides insights that may influence them into—or away from—the company. Children can also prepare by working for another company in order to broaden their training. Such experience helps justify moving a family member into the family business at a higher level. It is not a good policy for a son or daughter to work in senior management until they have worked for someone else for at least two years. Children should be rotated in varying positions within the business. Finally, if the newcomer is ready to learn the business, true responsibility must be given.

Page: 42-43

Difficulty: Hard

68. Describe how a family-owned business may prepare for management succession in case the owner departs suddenly.

Answer: A successful business must continue to operate even when the owner-manager leaves. If the owner leaves on vacation, plans can be easily made because few decisions need to be made and the vacationer is available, if required. When the owner takes a vacation, a form of on-the-job training is provided for those left in charge. Those persons can take over temporarily under those circumstances. The sudden death of the owner can be very disruptive if not adequately provided for. If the owner has left no will or instructions on what to do, family members will probably have conflicting opinions about what should be done. For this reason, an owner should make a will and keep it current, including instructions about what should be done in—or with—the business. The firm can take out life insurance on the owners, the proceeds from which will go to the company in case of death. This money can be used to help the business operate until it recovers from the loss of its owner-manager.

Page: 45

Difficulty: Hard

69. What are the benefits of selling a family business to family members and the benefits of selling the business to outsiders?

Answer: Selling to family members: Business stays in the family, provides a source of employment for family members, the family's stature is maintained, the former owner is free to relax or travel, there is pleasure when the successor is successful, it can strengthen family bonds, and finally, it can be sold to outsiders and later be repurchased by one or family members.

Selling to outsiders: Owner is assured income, does not have to worry as to what happens with the business, owner has a possibility to consult, release of family tension, and further release from further responsibility; however, selling to someone outside the family can hurt the family since it marks the loss of something the founder built.

Page: 47-48

Difficulty: Hard

70. Discuss the different ways in which estate taxes can be minimized.

Answer: Estate taxes can be minimized using family gifts, family partnerships, stock sales to family members, and living trusts.

Family gifts: Parts of the estate may be given as gifts to family members as soon as feasible. The gifts must be of “present interest” such as direct cash gift, rather than “future interest” such as gifts of cash that can go into a trust fund for later distribution.

Family partnerships: A family limited partnership allows one to take money out of the business at lower tax rates. It must be a passive partnership that owns some type of property but does not operate the business.

Stock sales to family members: This method is complicated because family members must have a source of income to make nondeductible payments to the owner for the stock. Also, the owner must pay capital gains tax on the stock he/she sells.

Living trusts: A living trust resembles a will, but, in addition to providing for distributing personal assets on the maker’s death, it also contains instructions for managing those assets should the person become disabled.

Page: 50–51

Difficulty: Medium