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Florence W. Kaslow

For information about the editor, see the biographical information page within the book.

International Business Press®

An Imprint of The Haworth Press, Inc.
10 Alice Street, Binghamton, NY 13904-1580
www.HaworthPress.com

ISBN-13: 978-0-7890-2777-1

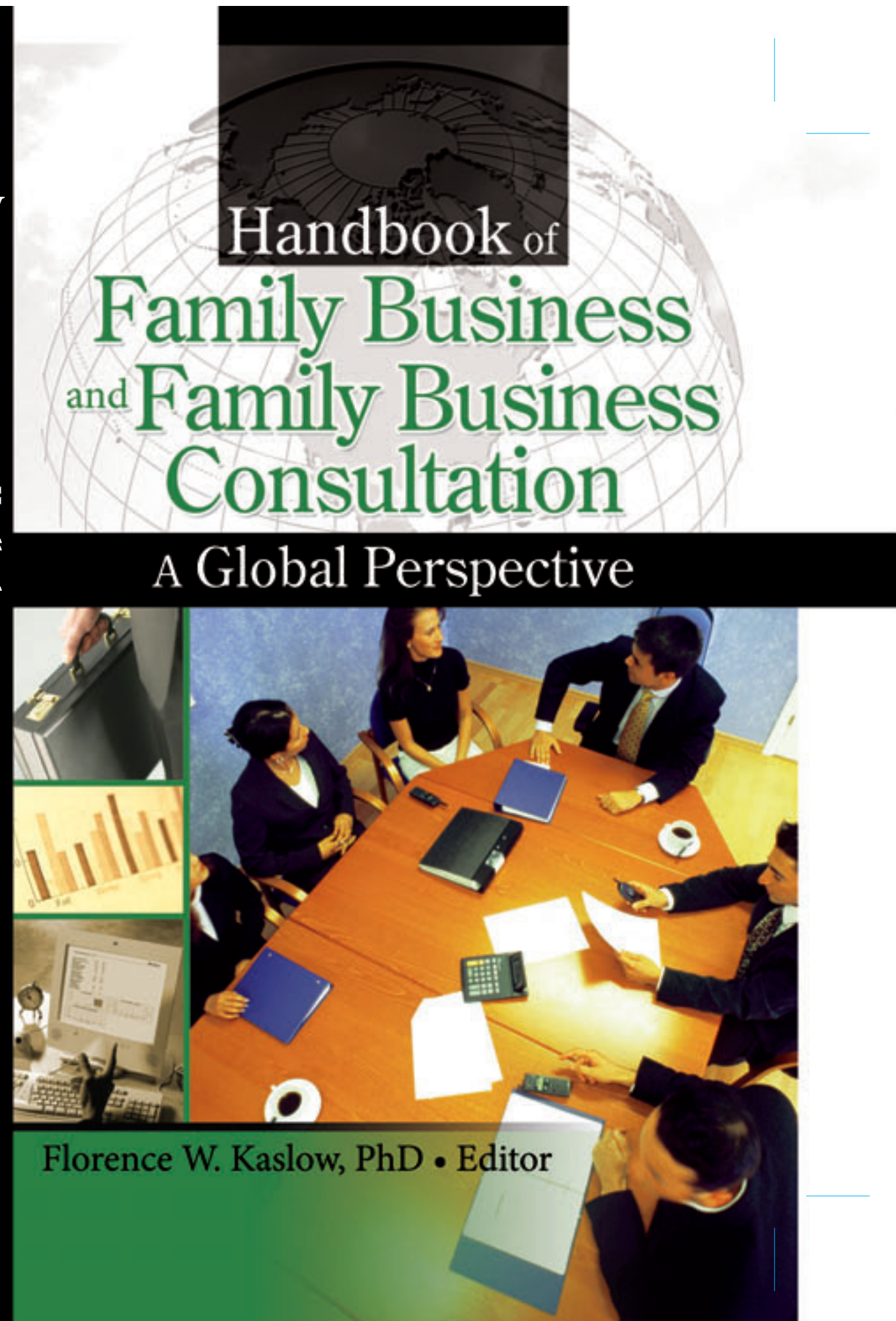
ISBN 0-7890-2777-1



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Kaslow

Handbook of
Family Business
and Family Business
Consultation



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A Global Perspective

Florence W. Kaslow, PhD, ABPP
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An Imprint of The Haworth Press, Inc.
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or (607) 722-5857 outside the United States and Canada

or contact orders@HaworthPress.com

Published by

International Business Press®, an imprint of The Haworth Press, Inc., 10 Alice Street, Binghamton,
NY 13904-1580.

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from the publisher. Printed in the United States of America.

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Cover design by Lora Wiggins.

Library of Congress Cataloging-in-Publication Data

Handbook of family business and family business consultation : a global perspective / Florence W.
Kaslow, editor.

p. cm.

Includes bibliographical references and index.

ISBN-13: 978-0-7890-2776-4 (alk. paper)

ISBN-10: 0-7890-2776-3 (alk. paper)

ISBN-13: 978-0-7890-2777-1 (soft : alk. paper)

ISBN-10: 0-7890-2777-1 (soft : alk. paper)

1. Family-owned business enterprises—Handbooks, manuals, etc. I. Kaslow, Florence
Whiteman.

HD62.25.H35 2006
658'.045—dc22

2006006666

Chapter 20

Managing Wealth, Liquidity, and Growth in the Global Family Business

François M. de Visscher

It is no mystery that the Western world is experiencing one of the most dramatic transitions of business leadership and family wealth in history.

The massive wealth created in the economic expansion years of the post–World War II era is now shifting to the most populous generation of all time—the baby boom generation. Many old family companies have already disappeared in that transition, victims of fierce forces of destruction from inside and outside. Yet many have survived. For those who have endured, a certain sense of relief and complacency tends to settle in once they get through their transition. However, the handing down of power and money is not an end point. “*Ces nouveaux héritiers qui doivent inventer l’avenir*,” as the French newspaper *Le Figaro* calls them—these new heirs who must invent the future—have a whole new set of challenges.

In Europe, expanding a family business entails facing unparalleled competition from well-capitalized nonfamily enterprises, which are taking advantage of the continuing opening of the European Economic Community (EEC). The new members of the EEC have become great safe-havens to relocate to and to compensate for the increasing social cost of businesses in “Old Europe.” In Latin America, the opening of trade zones has forced many family businesses to transition from operating as monopolies in their own country to competing in much larger open markets. In the United States, the vast majority of family businesses are becoming “niche players” with high value added and a need to accelerate their growth to defend their position in the economy. So, it is no mystery that today’s globalization requires vast amounts of capital for businesses to survive and to navigate the global waters.

While family businesses have vast “capital needs” to global competition, family ownership and generation succession creates large “liquidity needs” among an expanded shareholder base. Companies that want to maintain family control and ensure survival of proper business and family governance must balance the capital needs of the business and liquidity needs of the shareholders. Balancing capital needs, liquidity needs and family control is essential to the survival of family companies and is depicted in the triangle in Figure 20.1.

These three issues—capital, liquidity, and control—often conflict as shareholders view their role as managers who want to grow the business, as owners who are looking for return and liquidity, and as family members who want to maintain the family heritage, tradition, and stewardship of the business beyond their current generation. The difficulty of balancing control, liquidity, and growth capital is further exacerbated by the many transitions that family businesses face when exposed to global economic and global family factors.

LIQUIDITY NEEDS OF THE FAMILY SHAREHOLDERS

As a family company transitions from one generation to the next, it embraces more numerous and increasingly diverse shareholders, each with their own lifestyle, needs, and liquidity demands. At each generation, the business has its own challenges of balancing capital, liquidity, and control.

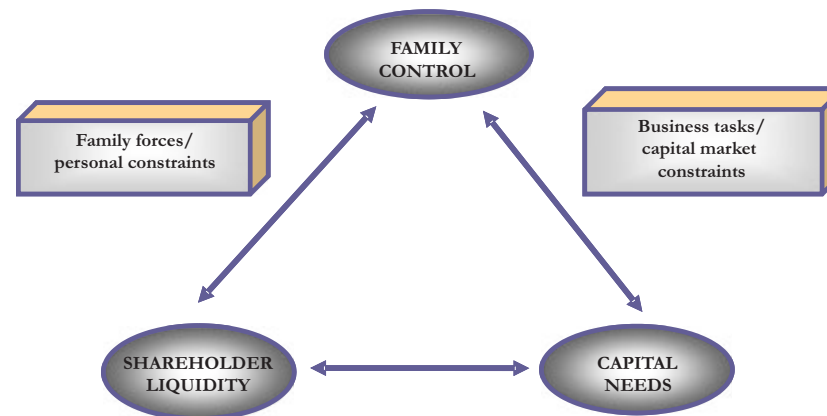


FIGURE 20.1. The Family Business Triangle. *Source:* Trademarked by de Visser & Co. LLC.

Founding Generation

The founding generation usually owns all the shares. Although they can certainly cash in on the value of the company at any point, most founders would never dream of doing so. They are, after all, in the mode of building a company and its value, not milking it. As an owner/operator, the founder(s) is more interested in supporting the growth plans of the business—for a potential exit down the road—rather than distributing liquidity. Achieving liquidity through dividends or capital realization is secondary to the desire for economic wealth and social status. This is not to say that founders do not have any liquidity aspirations, but these are part of an overall wealth and estate plan of the owner, which includes his or her legacy, philanthropy, and wealth diversification.

Partnership Generation

The next generation—the “partnership generation”—may have several siblings and cousins owning shares. Some will work in the company, but others are not active in the management of business. Shareholders involved in the management of the family company are compensated as employees, collecting salaries and other incentive compensations. These “management shareholders” are instinctively more interested in reinvesting cash flow to continue to build the business, as their professional achievements will be a function of this growth. On the other hand, shareholders not active in management of the company see dividends and shareholder distributions as an important, if not essential, financial benefit of owning the inherited shares in the family company. The “nonmanagement shareholders” will inevitably have a bias toward a larger distribution of profits in the form of dividends or redemptions. Geographic distances may further exacerbate the dichotomy between active and passive, between management and nonmanagement shareholders because they further diminish the attachment to the roots of the business and the place of the family in the local community. Reconciling the liquidity objectives of the nonmanagement shareholder with the goals of management shareholders to conserve cash in the business for growth investment is the fundamental financial challenge of family businesses at the partnership generation.

Coalition Generation

If the company is fortunate enough to transition to a third or fourth generation, a “coalition” of owners will now exercise control over the business.

During this “coalition generation,” the number of shareholders will have grown, as will the proportion of shareholders not active in the business. Those who work in the business represent a small number compared to “nonactive” shareholders. The disparity among the owners group will increase along with the increased number of active and inactive shareholders, of different ages and even different generations, geographically disbursed throughout the world, and living in different social environments. In most cases, nonmanagement shareholders no longer depend on the revenues of the business to live and will seek outside professional income. Each member of this coalition generation owns relatively small interests in the company, and their need for liquidity from the family business will evolve. The few shareholders involved in the management of the business will be compensated as most executives are with salaries, perks, and incentive compensation packages. Their ownership in the family business is comparable to stock or stock options owned by management of large public companies. The large majority of nonmanagement shareholders, with relatively small ownership interests in the family business, evaluate their ownership in investment terms, bringing in the notion of risk and return, appreciation value, and liquidity flexibility. Hence it is no surprise that the liquidity challenges of coalition generation family businesses center around two fundamental issues: return on investment and liquidity flexibility.

In most successful coalition generation family businesses, we observe close collaboration between family members involved in management and those who are not. The management shareholders depend on stable “patient capital” of the entire shareholder group to support future business growth.

Stewardship Generation

In Western economies the family business “stewardship generation” is beginning to evolve. When the management resources of the family have been exhausted and the family seeks outside management to take over the family business, the role of the family is to steward the patient capital for future generations. The family is now guided by investment principles and stewardship objectives of the patient capital for the generations to come.

Table 20.1 illustrates the unique financial and liquidity challenges of each generation in the development of a family business (Aronoff, Ward, & de Visscher, 1995).

The current generation transition underway adds complexity to the shareholder liquidity challenges of the family because of the generational conflicts they create between the senior generation and the younger baby-boom generation. Older members tend to approach growth and investment

TABLE 20.1. The stages of family business financial evolution and revolution.

Stages	Conflicts/issues	Liquidity/capital sources
1. Founder Generation (Owner/operator)	Balancing personal cash flow with business capital needs Ownership transfer	Business cash flow
2. Partnership Generation (Sibling/partnership)	Increasing liquidity needs of shareholders, especially inactive shareholders Providing financial incentives for active shareholders Meeting strategic capital needs of the business	Business cash flow External debt or equity financing Internal recapitalization
3. Coalition Generation (Cousins/collaborative)	Expanding capital needs of the family business Liquidity flexibility needs of multiple minority shareholders Transitioning from family ownership to family control	Ongoing liquidity programs Internal recapitalization Outside capital from Public and private equity sources Business alliances Joint ventures Disposing of assets
4. Stewardship Generation	Corporate strategic development Wealth diversification Long-term family strategy Philanthropy Management of shareholder expectations Professional asset management services	All of the above plus a family office for Internal liquidity Stewardship of patient capital Diversification of family wealth

Source: de Visscher & Co. LLC.

initiatives with excessive prudence, being primarily concerned about liquidity and estate planning. The younger generation tends to be more interested in the growth of the family business.

This complex combination of constantly changing forces impacts the nature of ownership and control that the family is able to exercise. Because control is different at each stage of evolution, liquidity needs and business capital needs must be addressed differently from one stage to the next (Gersick, Davis, Hampton, & Lansberg, 1997).

**GROWTH CAPITAL NEEDS
OF THE FAMILY BUSINESS**

Just like any other business, family businesses need capital to grow. More than ever in today’s global economic landscape, size and scale are critical components of shareholder value creation. Therefore, growth is no longer a choice for a business but a necessity for its survival. “Be number one, two, or three in your product or market or else,” according to the global economic mode. Fortunately for family businesses, size in the global information age is defined by market reach and not just by physical assets. So a family business with strong brands, a loyal and dedicated employee base, and a long-term investment orientation can actually compete very effectively with the multinational giants. Globalization and the information age are windfalls for family businesses, not handicaps.

The global growth of a business is defined in its four components in Figure 20.2. The growth in existing markets with existing products (Organic growth on Figure 20.2) is often referred to as the “defensive growth strategy” against large, often well-capitalized, global competitors. Internal cash flow will most likely finance defense of one’s markets or products, as it is difficult to raise outside capital on the premise of a defensive growth strategy.

Taking existing products into new markets (Product expansion on Figure 20.2) extends the family business core competencies into new territo-

Existing market	Organic growth Internal cash	Product innovation R&D financing Venture capital
	Product expansion Local financing Mezzanine debt Private equity	Company reinvention Joint ventures Spinoffs Corporate reorganizations
New market		
	Existing products	New products

FIGURE 20.2. Four components of global growth and financing. *Source:* de Visscher & Co. LLC.

ries, new countries, and new economic regions. This growth strategy will require two engines to succeed: communication technology and a strong local or regional distribution and marketing network to sell and bridge the cultural differences of entering new regions of the world. Capital sources are amply available in global capital markets to finance product expansion because the product has a track record or brand in its existing markets of origin. In some cases, new plants or acquiring physical assets in new markets can find successful financing by local sources, banks, or private investors/partners.

New products in existing markets (Product innovation on Figure 20.2) require strong research and development efforts and commitment of the family company. Investing in technology is a critical component of growth in a global market. Development of new products and new technologies and protecting one's intellectual property require increasing outside investments. Venture capitalists and other technology investors would be the most likely financing sources for such projects.

Finally, family companies also can orient their growth toward new markets with new products (Company reinvention on Figure 20.2). This is often the riskiest of the four strategies because of the unproven status of the new products and the cultural novelty of the new markets. New products also require significant investments for either an acquisition, green-field marketing, or construction investments. Because of the risks involved in those investments, a family business would be well advised to share the risk of this strategy with an outside investor or new partner from the new market.

Growing a family business in global markets will inevitably invite two new types of owners outside of the family. Outside equity or quasi-equity investors, who have invested growth capital in the family business, have their own liquidity and control expectations. Competing in a global economy will also require the company to attract top-quality outside management, who will also expect to enjoy participating in ownership through stock options or other incentives programs. Suddenly the family business must embrace three types of owners with different expectations and liquidity horizons.

Capital needs are bound to start competing with liquidity needs of this diverse group of owners. Family owners, who represent patient capital, have the longest time horizon but still require some ongoing liquidity. Management equity, which increases based on performance, expects medium-term liquidity. Outside investor equity, which provides transitional capital, insists on relatively short-term liquidity.

FAMILY CONTROL IN THE FAMILY BUSINESS

Family control and governance structures in this competing environment for capital and liquidity become increasingly important yet complex cornerstones of family business stability. The family must create a strong control structure that can unify the family yet ally it to outside sources of capital. The family control structure can also facilitate liquidity measures for family shareholders and reinforce the family heritage, an intangible but integral part of shareholder value.

The role played by these family control and governance structures evolves over time from a mostly financial and estate-planning tool to a family-management tool. Management shareholders should welcome the establishment of family structures that will take care of the business of the family and allow the management to focus on business growth. A family council is often a vehicle that can represent all factions of the family and handle issues such as family events, shareholder communication, and family liquidity issues. The family council is not a second Board of Directors. Delineation of responsibilities between the Family Council and the Board is a critical task. For instance, the Family Council may be in charge of studying and promoting liquidity programs for the shareholders, while the Board of Directors may take charge of aligning liquidity desires or recommendations with the capital needs of the business.

When the family reaches the coalition or stewardship generations, the objectives of the family governance structures expand from communication and liquidity planning to family wealth planning. This is often the time when a family will establish a family office to address the overall wealth-planning needs of the family. The family office becomes a helpful tool to reinforce the ownership of the family, plan for continuity of family wealth, including its liquidity needs, and serve as a catalyst for intra-family communications.

PATIENT CAPITAL IN THE FAMILY BUSINESS

What becomes of family companies that fail to address the growth capital of the business, the liquidity needs of the shareholders, and family control objectives?

One example, XYZ Company, provided liquidity to one branch in the family by incurring excessive leverage to buy out some existing shareholders. As a result, the company's cash flow was largely dedicated to repayment of the debt, and hence not available for growth investments. The overly leveraged company became limited in its ability to compete globally.

This resulted in loss of value, a loss of confidence by the remaining shareholders, and the ultimate distress sale of the company.

On the other hand, the secret of those companies that have survived generations is simply that they managed their patient capital by properly balancing liquidity, capital, and control.

What Is Patient Capital?

In accounting terms, patient capital is simply shareholders' equity and retained earnings. But in the family business context, patient capital has more than an accounting meaning. It incorporates all the capital that the family owners, generation after generation, have invested in the family business; it is more than the tangible value of the equity. It also includes the heritage, the association to the family business, the human capital, and the attachment to the business on the part of owners, generation after generation. This intangible value of patient capital is exactly what allows family shareholders to make long-term investment decisions, promote sound employee relations, and let go of short-term gains and short-term liquidity for long-term and sustainable rewards.

Successful family companies maintain this patient capital generation after generation by

- creating value for shareholders.
- providing liquidity programs for shareholders, allowing them adequate return, freedom of choice of their investment in the family company, and assessment of value. In other words, patient capital is not trapped capital.
- investing in the family effect, in order to reinforce the values, commitment, and family heritage.

CREATING VALUE IN THE GLOBAL FAMILY BUSINESS

Creating value in a global family business requires four separate steps: the establishment of a family vision and a business vision; the development of a strategic plan for executing those visions and the implementation of liquidity plans for shareholders to access income and value gains. Once the family, management, and Board have agreed on strategic and liquidity plans, measurements have to be instituted to gauge progress relative to the plans. The strategic and liquidity plans will determine the outside capital requirements of the family business to achieve its growth objectives and provide the desired liquidity to the shareholders.

Tools for Maximizing Growth Across the Globe

While family businesses in various cultures have their own sets of strategic issues, they have one aspect in common: the need to grow to survive. The pursuit of a sustainable profitable growth strategy is the only avenue toward long-term viability of any family company.

The strategic need for growth requires outside capital. What sources of outside capital are available to family-owned businesses? How are those sources unique for family businesses and from continent to continent? And how do the objectives of those outside capital sources compete with or complement the objectives of the family owners? A family company has three different sources for financing its growth: debt solutions, equity solutions, and strategic solutions.

Debt solutions available to the family company include lines of credit, term debt, leasing of assets, subordinated debt, and private placements. It is not in the scope of this chapter to outline all the forms of debt to the family company. However, I will point out that in a global economic environment there are three key elements in judging a debt solution: the overall interest rate cost (after fees), the covenants attached to the debt instrument, and the currency exposure. The latter consideration is often neglected by uninformed or overzealous bankers (see Table 20.2).

Take the example of a European family company that three years ago decided to finance an expansion in the United States by way of an unhedged borrowing in euro currency at its local bank. With the recent 30 percent depreciation of the dollar vis-à-vis the euro, this family company is faced with servicing a loan in high-value euros while receiving cash flow from its investment in the United States in a highly depreciated dollar. Many hedging techniques are available today to match the currency of the debt with the currency of the underlying asset, generating the cash flow to service that

TABLE 20.2. Investment criteria of three equity investors.

Investment criterion	Venture capital	Institutional private equity	Family business investors
Family involvement	Family = negative	Neutral	Family = positive
Investors' control	Majority	Mostly majority	Minority
Target returns	>30 percent	20-30 percent	<20 percent
Timing of exit	1-2 years	3-5 years	>5 years

Source: de Visscher & Co. LLC.

debt. Natural hedging and currency swaps are just two examples of those techniques.

When it comes to equity solutions, private and public equity continue to be the most common sources of equity for family companies. Over the past several years, however, many family companies have shied away from the public-equity market. There are several reasons for this. First, in most major markets in the United States and in Europe, mutual funds and other large financial institutions have continuously increased their overall share of the volume of the stock markets. The interest of those institutions to treat large volumes has reduced liquidity in the market for smaller family company stock positions. The other reason is the trend in the markets worldwide toward greater regulation of corporate communications and corporate governance. Those regulations not only add to the cost of operating as a public family company, but also make it, in many cases, almost impossible to operate as a family-owned company in the public arena.

Because of the shortfalls of the public-equity markets for family-controlled families, many business-owning families have tapped into a growing private equity market to fund their business capital needs. Private equity is one of the fastest growing segments of the capital market. The amount of capital raised by private equity funds grew from \$11 billion in 2002 to \$42 billion in 2004. Over the same time period, private equity deal volume grew from \$41 billion to \$137 billion. The private equity market consists of many segments. The most common segments today are venture capital, institutional private equity, and individual or family offices, often called FBIs or family business investors.

- *Venture capital* has traditionally been used to fund high-growth investments or companies in the technology sector (broadly defined to include computers, information, and health care). Venture capitalists typically demand a high return on their investment with a rapid realization (exit) by way of an initial public offering or recapitalization or even sale of the company.
- *Institutional private equity funds* of corporate or financial institutions could take many forms (private equity, mezzanine investors, turn-around funds). These institutional private equity funds demand significantly less control and lower returns than venture capitalists. They tend to be more family friendly because they are not looking to make a quick exit: They are happy to stick with an investment for three to five years, compared with venture capitalists' one- to two-year horizons. Their biggest investors are insurance companies, pension funds, and other large institutions that must maintain broad asset allocations (including family companies) in their portfolios. They do not necessarily

target family businesses, but they do not rule them out or require family owners to step aside, as venture capital funds often do. Like venture capital, institutional private equity is becoming a worldwide market. Some of the largest U.S. funds have now raised significant money targeted for the European market to compete with the local European funds. Similarly in Latin America, funds specifically dedicated to make investments in Latin American companies have been growing exponentially.

- *Family business investors* are mainly private individuals or family offices who have pooled their money into funds to invest in family companies. Because FBIs have a family business background, they perceive the “family effect” not just as neutral but as a positive criterion they seek in all of their investments. FBIs are much more patient than venture capitalists or even institutional private equity funds, sometimes investing for ten years or more. They truly search for a financial and strategic partnership with the family to create long-term value for themselves and for the business-owning family. Obviously, at some point FBIs will want to exit their investment and return money to their own investors/families. Our experience tells us, however, that the form and nature of their exit is much more flexible than exits by venture capitalists or private funds. In one case of which I am aware, the family agreed to pay all excess cash flow over a certain threshold to the FBI and provide the FBI with an exit over seven years.

When searching for an investment partner, one needs to consider the partner’s parameters for exit, control, return, and family friendliness. In addition, one needs to factor in the size of the investment fund, whether it is venture capital, private equity, or FBI. The size of the fund determines the amount of capital the fund is looking to invest in individual companies to maintain a diversified portfolio. A \$20 million private equity fund might make five to seven investments of \$3 million to \$5 million. A \$1 billion fund may make ten investments of \$100 million or more.

The first step in a company’s search is to clearly define *why* it needs a financial partner. Is it to provide growth capital to the business or to allow some shareholders to exit the business? Or both? Is it to provide long-term capital over the long haul or just for a one-time liquidity need?

The intended use of proceeds will often dictate the type of financial partner one needs. Is it a pure short-term financial partner, or one who can also provide some strategic input? Is a partner with international experience and know-how what is needed?

Good financial partners can provide not only financial capital but also strategic advice, human capital, and networking contacts. After all, they are

creating value for themselves, too. In that sense, their interests are aligned with those of the borrowing company.

Tools for Maximizing Liquidity to the Global Business-Owning Family

The second critical element of patient capital in the global family business is efficiently addressing the liquidity needs of the shareholders, which is just as important as developing a strategic plan for the business. Family shareholders generally have three types of liquidity needs: the need for income; for liquidity flexibility; and for exit or sudden liquidity.

The need for income in the form of dividends or other current income depends much on the generation of ownership and the tax jurisdiction of the business and/or shareholders. As family businesses evolve across generations, the structure of dividends should evolve from “pay what you can” to a formal dividend policy based on objective market criteria that are found in many coalition-generation family businesses.

Liquidity flexibility is a universal need of all family businesses and is often addressed by ongoing liquidity programs. When shareholders feel trapped in their investment in the family company with no way out, they are more likely to want to exit. By providing the opportunity for shareholders to sell stock on a periodic basis, the pressure is released. Our experience shows that in those cases, family shareholders do not sell stock at all or only very minimally. The other advantage of setting up ongoing liquidity programs is for shareholders to focus on the value of the stock and future value-creation opportunities, because ongoing liquidity programs are pegged to a consistent valuation of the stock year after year. That same valuation can also be used for management incentive programs, furthering the goal of allying the interest of management and shareholders.

Last, the need for exit or sudden liquidity is difficult to plan for family shareholders because it often results from unexpected family or personal exigencies such as death, disputes, divorce, or economic needs of shareholders. The one exit need that can be predicted is that of the outside investors, private equity, or others, and those in management reaching retirement age to the extent that they have been granted some stock ownership.

Family businesses would be wise to assess the liquidity needs of the various shareholder groups through interviews, questionnaires, or group meetings. Whatever the method, the company needs to collect information on the current income expectations of shareholders; whether and when those shareholders anticipate they will need or want to sell stock in the immediate future; and whether they want the flexibility to sell in the future and how of-

ten. This information is essential to formulating the appropriate liquidity program, including the dividend policy.

Liquidity Programs

Most liquidity programs in family companies start with the payment of dividends to shareholders. Although some drawbacks do accompany dividends, they remain an important tool in the context of other liquidity programs. For many family firms, the lack of a dividend policy is a serious omission at best, and a recipe for a shareholder-relations disaster—or a family feud—at worst. At the same time, a dividend policy formulated without consideration of other liquidity options and outside the context of the company's overall capital needs is also a serious mistake.

In its duty to maximize value for all shareholders, the Board of Directors often faces the challenge of reconciling diverging liquidity needs and demands. Unfortunately, many companies rely solely on dividends to provide some liquidity to shareholders because dividends provide tangible proof of the value of a shareholder's investment, and thus can provide a safety valve for the pent-up frustration of inactive shareholders eager for a return that can be banked. The board and family leaders often see such payments as a kind of "peace money" to keep inactive shareholders happy.

There are, however, four downsides to dividends for family firms: First, the regular payment of dividends can lead to unrealistic shareholder expectations. Once shareholders begin to depend on a stream of dividend income to support themselves, any decrease in dividends can have serious repercussions for the family business and for healthy family functioning. Shareholders may bring pressure on the company to maintain a level of dividend payments long after such dividends can be justified by the company's financial performance.

Second, increasing demands for dividends can strain cash flow and prevent the company from reinvesting profits in future growth, as well as making badly needed capital improvements. In terms of allocation of financial resources, dividends may not be the most productive way of meeting shareholders' return-on-equity objectives. If one dollar of cash flow reinvested in the business will reap a higher return on investment than the same dollar paid out as a dividend and reinvested outside the family business, why not give the shareholders the benefit of this higher return?

Third, dividends are a blunt instrument for rewarding shareholders with diverse liquidity needs. Every share of the class of dividend-paying stock receives the same return, whether shareholders need or desire liquidity or not. For example, members who are drawing salaries will receive the same

dividend per share as the inactive shareholders who may depend on dividends to meet their income needs. Although this nondiscriminatory policy honors the principle of equal rewards for equal ownership, it also makes dividends a less precise liquidity tool than other options.

Finally, in some jurisdictions such as the United States, dividends are a very tax-inefficient way of rewarding shareholders. Except in the case of S Corporations and other nontaxable entities, dividends are paid from after-tax earnings and then taxed again at the shareholder level.

Despite their limitations, dividends can and do play an important role in many family businesses. Companies find payments easy to implement, and shareholders find them easy to understand and appreciate—provided the firm has a clearly articulated dividend policy. Increasingly, companies are therefore articulating dividend policies in the broader context of other liquidity options available to shareholders.

Today's most common methods of providing targeted income to the shareholders and at the same time providing liquidity flexibility include multiple classes of stock, company clearinghouses, redemption programs, company-sponsored loan programs, family opportunity funds, and internal recapitalization.

Tools for Nourishing the Family Effect with Global Families

Companies that desire aggressive, global growth will need to expand shareholders' patient capital. A family CEO can manage shareholders by creating a written mission and values statement and performance goals that everyone can adhere to, and by veering away from chasing short-term gains and, instead, getting back on the track of long-term, sustainable growth (Hughes, 1997).

Family firms have a history of strong cultural values. They are close to the entrepreneurial mission of their founders. With a family company, the consultant does not have to create a whole "mission mind-set"; the message simply draws family and employees back to their roots.

The door to long-term, sustainable, profitable growth hinges on a strong family organizational structure, such as a family office, family council, or holding company, to be the steward of family values. This family organizational structure will be the focal point of discussions on family mission, family values, and wealth-related concerns, such as liquidity and diversification.

Depending on the jurisdiction and country of origin, the family office has taken many forms but is now recognized universally as the tool of choice

that can help strengthen patient capital and reconcile the needs of the business and those of its various constituent shareholders. Unlike a family council, which mainly addresses governance and communication issues, a family office focuses on structural and financial responsibilities.

Much has been said about the role of the family office in financial families. (See Chapter 19 for another relevant discussion on this topic.)

Conventional wisdom seems to focus on the family office as an investment vehicle and hence a tool reserved for financial families, but we believe that a family office is an equally important tool for families who still operate an active business. In that context, the family office can take many forms, such as a family trust, a family holding company, or a family investment company, depending upon the family and its country of origin.

A family trust or holding company owns shares of the operating company, concentrates control, and regroups the family's ownership of the business to allow the entry of outside investors in the business capital structure. A family investment company is a structure that parallels the family business and manages assets outside the family company, such as real estate or liquid assets.

In either form, the family office, when combined with an operating business, will fulfill four important roles for the family:

1. *Family as owners.* The family office can provide stewardship of the family's patient capital, which may include setting investment guidelines for the operating company. My family office, for instance, works with management and the Board of Directors to clarify shareholders' return expectations—both return on equity and return on assets. The family office can also decide which family members will fill available seats on the Board of Directors.

2. *Family as employees.* The family office can determine rules of entry for family members seeking to join the business, as well as what kinds of training and development programs the business should provide for relatives who have management aspirations.

3. *Family as family.* How will the family perpetrate its heritage, maintain communication and resolve conflicts? How, if at all, will it financially support family members, and under what circumstances? Some family offices create a fund to invest in relatives' ventures.

One other critical role the family office can play is sponsoring educational programs on topics such as the family's business, new developments in the industry, personal finance, technology, or career planning. It also can help connect disparate family members and keep them informed about business, family wealth, and other issues.

4. *Family as part of community.* A family office can decide how and where the family wants to direct its philanthropic giving. It can also identify

leadership opportunities, such as open board seats, at charitable, community, industry, and other nonprofit organizations in which the family may want to maintain a presence.

Especially during times of family and business transition, a family office can help educate relatives about various options, help the family articulate and live by its values, and strengthen patient capital. Without a family office, the only glue holding together a growing, dispersed family may be the business. So shareholders may cling to the business—in its current form—to preserve its identity and closeness, even if that means passing up opportunities to expand, evolve, or sell the business. By providing another organizational structure around which the family can unite, a family office enables the family to base decisions on business and financial factors, not emotions.

5. *Family as consumers.* Family offices often provide many services and products beyond investment management. Today they may navigate different products for the family, such as insurance, personal lines of credit, and business and family travel and legal services. Family offices can also harness the family's purchasing power, enabling it to negotiate much better prices and terms on these products and services than individuals could negotiate on their own. The professional staff at some family offices even reviews business plans developed by family members attempting to launch new business ventures.

The size of one's business is not the most relevant factor; it is the size of the family, and how dispersed the relatives are. For example, take a second-generation business with one parent and three children active in the company, plus two other inactive children. This family may be able to learn and make decisions effectively among themselves. But what will happen ten or fifteen years hence, in the next generation? That same business family may have expanded from six members to twenty, with only a handful of shareholders involved in day-to-day management. The rest of the relatives may have spread throughout the country, or even overseas. The company may have grown, stagnated, or even downsized in this time frame. Whatever its circumstances, it likely will benefit now more than before from a family office.

SUMMARY

So while family businesses in various cultures throughout the world have their own set of challenges and strategic issues, they also have one thing in common: the need to manage patient capital for their survival. The management of patient capital will require a sustainable profitable growth strategy of the business with the prospect of creating large value for the sharehold-

ers, efficient liquidity mechanisms to provide income and value realization for the shareholders, and, finally, strong family governance structures such as a family office to be the steward and the enhancer of the family effect.

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