START MANAGING YOUR FAMILY BUSINESS AS AN INVESTMENT

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While intentions are excellent, most families including "conservatively managed" multi-generational family businesses unwittingly destroy shareholder wealth every year! Unfortunately, the wealth evaporation doesn't show up as a line item on your company's financial statements, so it is both unrecognised and perpetuated for years in many family businesses.

Three issues need to be understood to detect and correct this common practice of destroying multi-generational family business wealth:

1. Family leaders need to look at the business as more than an "operating entity." It is a "financial investment", most often the family's largest one.
2. Leaders need to recognise the critical difference between company return on equity and shareholder realised returns on equity.
3. Leaders need to recognise that their history of "conservative" financial management typically results in poor stewardship of the family's wealth by exposing family members to unrecognised risks, lower long-term investment returns and diminished liquidity.

These flaws not only destroy multi-generational wealth but understandably create problematic family dynamics when the financial results don't meet business and family shareholder needs.

The solution requires changing your family's historical paradigms by reorienting company management and your board of directors to focus beyond solely "creating" shareholder value to include " realising" and "preserving" shareholder value.

Shareholder Wealth Evaporation

Shareholder wealth evaporates in privately held family businesses in many ways:

1. Time value of money – delay in distributing cash returns to shareholders; this reduces overall profits due to the time value of money and inflation.
2. Working capital management –failure to adequately finance and manage working capital; using family equity capital versus a 4% line of credit to finance receivables and inventories results in a 4% return on family equity capital! This misappropriation of equity capital also impacts the number of funds available for business reinvestment, thus hurting future growth.
3. Capital structure – the common aversion to a modest amount of business debt. Results in substandard shareholder returns due to the lack of financial leverage on the balance sheet.
4. Business management – a singular focus on profits; misses the important point of also focusing on cash generation, so funds are produced for re-investment and return to shareholders.
5. Risk management– excessive shareholder equity retained in the business is exposed to many tail-risks often not recognized by family leadership such as declining future business prospects; new competition/products; loss of key customers, suppliers or executives; new governmental regulation; product liability claims; and family ownership dysfunction.

Realizing Shareholder Returns

Since realising shareholder value requires cash or other asset distributions, private company CEOs and their boards need to implement strategies that generate current and future cash flow for their shareholders. There are three primary strategies to consider:

- Recurring cash distributions - from ongoing operating profits plus depreciation, less current or planned capital expenditures and tax distributions.
- One-time or periodic cash distributions – from improvements in working capital management, restructuring of the business' capital structure and efficient tax distributions of assets (for example, sale and leaseback of real estate used by the business).
- Cash distribution from the sale of the business - seldom a good choice when considering taxes and expected returns on remaining business sales proceeds; can be the right strategy if sale made for business strategic reasons.

Creating a Family Business Wealth Management Plan

A carefully crafted family business wealth management plan should have input from your family stakeholders and business leadership as well as from your team of business, tax, legal, and financial advisors. Remember, your plan needs to be crafted to meet both business and individual stakeholder short and longer-term needs.

The key steps are:

1. Business operational and financial review - evaluating the business' future cash flow generation capability, sustainability, volatility and capital needs.
2. A family needs assessment and wealth management review – understanding the individual and overall family's financial objectives, needs, and satisfaction.
3. Capital structure review – rationalising current working capital, overall business capital structures and existing shareholder distribution strategies.
4. Shareholder distributions and wealth management planning – preparing alternative 5-year financial plans for the business and for the family's wealth portfolio to identify the best go-forward strategy.
5. Wealth transfer and asset protection planning – projects of this nature often lead to a separate gift and estate planning; part of the plan should focus on wealth transfer opportunities for multi-generational businesses.

When completed properly, the plan should achieve the following family benefits:

- Increased shareholder returns and family member liquidity;
- Increased family wealth investment diversification;
- Improved family wealth asset protection;
- improved family stakeholder satisfaction and family dynamics;
- Better financial management disciplines in the business;
- Development of alternative investment entities to house individual family member distributions that better meet individual investment objectives and tolerance for risk; and;
- Tax efficient business wealth transfer and estate planning.

In summary, private companies have the benefit of longer time horizons for performance measurement than public companies. Public companies have a keen focus on realising shareholder value – easily generated by selling one's stock in the markets. Once private companies address protecting and delivering shareholder value with a longer-term focus, family businesses will have the best of both worlds!

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