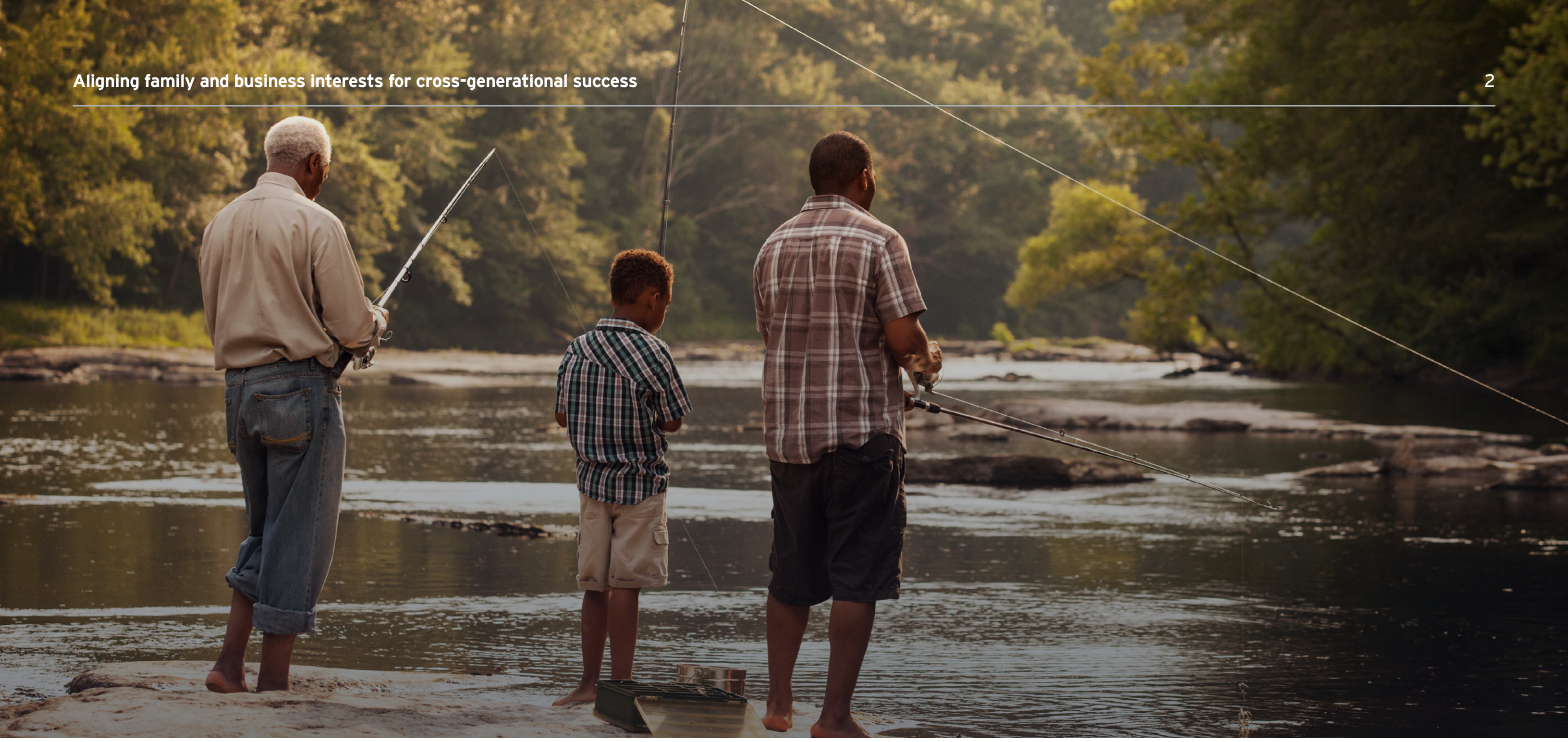
Aligning family and business interests for cross-generational success

Building a better working world



What family businesses need to grow and compete

Every family business faces its own unique factors that impact business planning today. From disruptive new technologies to inflationary monetary policy and talent management challenges, that's just the start. Potential regulatory changes could make it harder to compete in a redefined market. Add to that, potential disruptions due to business transition planning — or a lack thereof — and it's clear that family businesses need to adapt and expand their planning approach.

Business and family are inextricably connected. For enterprising families who aim to grow their company and make it more valuable to last for generations to come, we've identified four strategic priorities that should be included in future planning:

01.

Business growth strategy to manage and protect the wealth engine

02.

A capitalization strategy to fund the growth plan

03.

A shareholder liquidity strategy

04.

Generational transition plan

01.

Business growth strategy

Developing, implementing and monitoring long-term strategies and initiatives to enhance performance

Sustainable business growth needs deliberate strategy development, target setting, monitoring and analysis, with adjustments as needed. Long-term value creation is anchored in purpose and is achieved through effective strategy and business model execution. Value creation can be measured in terms of financial, human, consumer and societal value.

For family enterprise next-gen leaders, there is often a challenge with defining purpose. The first-generation founder started the business, and while they may not have always had a clear "why," there was a purpose — doing whatever it takes to build against tough circumstances and overcome obstacles to support the family.

The next generation often sees the business for what it is, what it does, the activities it engages in. Sometimes that business inspires, other times it doesn't. Where there is a lack of clarity on purpose, or differing views of the next generation, it becomes harder to determine long-term strategy and value creation.

Developing a business growth strategy is becoming more challenging in the current environment given ongoing economic and geopolitical disruptions, rapid technological change, accelerating interest in sustainability, inflated past deal multiples, and evolving expectations for the consumer experience.

When considering strategic choices, businesses may ask themselves:

- What is our winning aspiration?
- Where will we play?
- How will we win where we have chosen to play?
- What capabilities must be in place to win?
- What management systems are required to ensure the capabilities are in place?

Making strategy choices is never easy because it means doing some things at the expense of others. This could mean an acquisition or divestiture of assets to better align with short- and long-term goals.

Conventional strategic planning based on historic patterns and assumptions will no longer suffice as family businesses seek a competitive advantage in this new environment. CEOs are resetting their risk radar and reframing their investment strategy for growth in a new environment.

02.

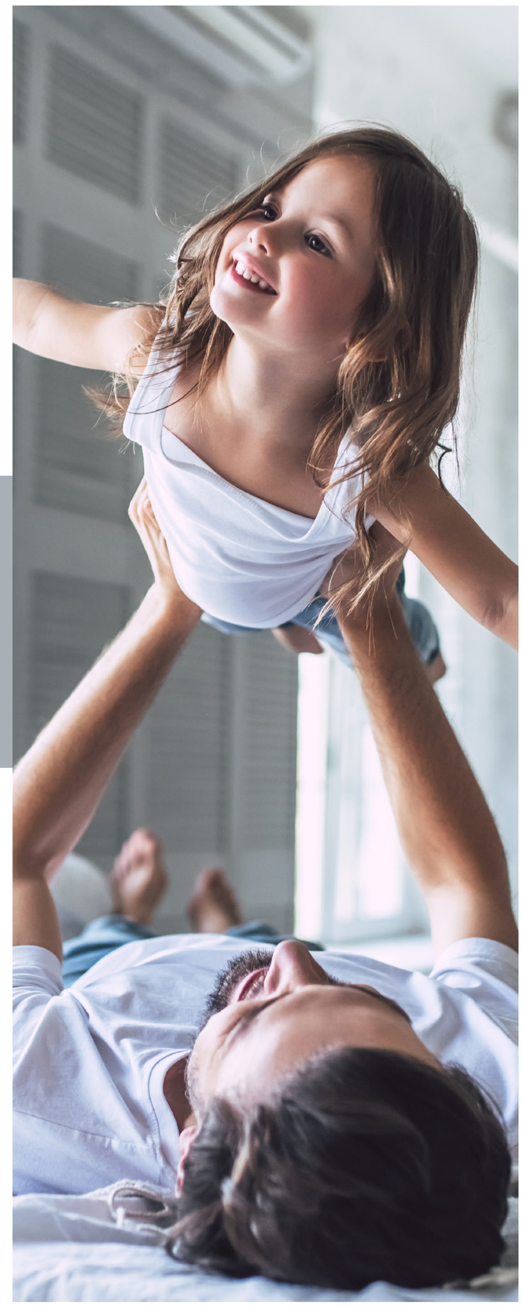
Company capitalization strategy

> Evaluating capitalization alternatives to fund business growth and shareholder liquidity needs while respecting family control

Funding business growth requires a long-term company capitalization strategy. But sourcing and managing capital to fuel business growth can be challenging, particularly if you want to keep the family in control of ownership.

There is an abundance of capital in North America and debt markets are active. However, rising interest rates and capital costs have caused lenders to become more selective in their investments over the past year; instead, they have focused their diligence on business resilience and health.

These conditions have made it more difficult for borrowers to access traditional debt financing at reasonable rates, and some borrowers are exploring alternative sources of funding.



Private debt started in early 2000 and represents non-bank lenders that typically fund through:

- Institutional capital
- Pension funds
- Business development companies
- Hedge funds

Private debt has grown steadily over the years based on a reputation for being a more flexible and creative source of financing that can also move more quickly end to end than traditional banks. A significant number of commercial transactions now have some form of private debt. Global private debt is expected to remain robust and surpassed $1.6 trillion at the end of 2023.[1]

The capital stack generally shifts over time and economic cycles. Family-owned businesses should think about gearing their mix of debt and equity to support their short-term and longer-term needs.

Family enterprises should understand all available capitalization options and their alignment to the long-term capital agenda.

1. Globe & Mail, January 3, 2024

03.

Shareholder liquidity strategy

Assessing and designing internal and external liquidity alternatives that take into account future business plans and capital resources

One of the biggest disruptions to family-owned businesses is the lack of attention that is paid to shareholder liquidity needs and expectations. This is especially true after generational transitions, when the owner base becomes larger with each successive generation. In addition, the liquidity requirements of family members can be quite different for each generation participating in ownership.

It's not unusual that shareholder expectations don't match company needs. This is often the case where owners who aren't involved in the daily operations aren't aware of the capital requirements of a growth plan, declining revenues or the impact that increasing interest rates have on business operations.

Shareholder liquidity disputes can drive significant disruption, especially when there has been a history of receiving dividends and other distributions, but current business or economic events result in a reduction in distributions. For some family businesses, this may cause conflict due to unrealistic liquidity demands and, in some cases, may lead to a sale of the business assets and a breakdown of family relationships.

In other situations, shareholders may simply want to cash in their shares to follow a passion, start their own business, diversify investments or just exit family co-ownership. Even with a shareholders' agreement in place that details how to manage an exit, these requests may arise at an inopportune time.

Consider a business that wants to grow through strategic acquisitions, but some family owners don't agree with this approach and the extra risk it brings. This disruption arises just at a time when the business needs capital and owner alignment for the acquisition.

Understanding short- and long-term shareholder liquidity can help manage the needs of both the owners and the business. Management currently forecasts the company's balance sheet cash flow needs; incorporating the shareholders' cash flow needs into those forecasts will give management a clearer picture and aid in decision-making around the capital strategy. It will also open up the opportunity for shareholder discussions, which may avoid lengthy legal battles.

Some questions to be considered:

- What is the value of our business and what do we see in the next 5-10 years?
- What is the net projected cash flow from operations (after tax)?
- How do we currently address the liquidity need of our shareholders?
- What has the history of liquidity needs from shareholders been and what might it look like in the future?
- Have we regularly paid dividends? How might this change in the future?
- What does the family tree look like and can we anticipate future liquidity needs?
- How do we buy out a branch of the family?

04.

Generational transition strategy

Formulating and implementing generational transition processes to create long-term legacies

Transitioning a business from generation to generation is not an easy task. As families grow in size and complexity, there is often a misalignment of goals, priorities and expectations. This is most often seen when there are some family members who work in the business and some who do not. Common transition issues include the lack of a formal transition plan, lack of understanding of the plan and lack of communication of the plan to stakeholders.

Preparing future family leaders and owners involves business understanding, mentoring, building trust and understanding role boundaries. Families who own successful multigenerational enterprises have a strategy at the heart of their business that lays out parallel governance for both the family and the business. This helps provide for the cohesion, stewardship and competency needed to sustain a healthy business for generations.

The family governance portion of the strategy addresses preparing the next generation to be good stewards of operating the business and educating them on the roles and responsibilities of being affiliated with the business, whether actively working for the company or not. The family may establish governance policies and structures that encourage communication and collaboration and outline their decision-making process.

Meanwhile, the business governance activities address procedures for ensuring that well-qualified people are running the company by creating an effective fiduciary board of directors. The board then appoints qualified management, who are responsible for tasks such as transparently reporting on results and developing data analytics to better understand growth opportunities and risks.

The key success factor for a parallel governance strategy is to separate family planning from business planning while maintaining open communication and information sharing between the business and the family.

Final thoughts

Refocusing the traditional strategic planning process to emphasize business growth, the capital agenda, shareholder liquidity and generational transition can equip family enterprise leaders for the challenges that may lie ahead, helping their businesses endure and stay in the family for generations.

Authors

Tina Di Vito

Partner and Canadian Family Enterprise Leader – Tax

Manos Xenos

Partner
Strategy and Transactions

Barkin Sayiner

Partner
Strategy and Transactions

4440766

ey.com/en_ca/family-enterprise