FINANCING TRANSITIONS

Managing Capital and Liquidity in the Family Business

Francois M. de Visscher
Craig E. Aronoff
John L. Ward

A FAMILY BUSINESS PUBLICATION

Financing Transitions

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Family Business Publications are the combined efforts of the Family Business Consulting Group and Palgrave Macmillan. These books provide useful information on a broad range of topics that concern the family business enterprise, including succession planning, communication, strategy and growth, family leadership, and more. The books are written by experts with combined experiences of over a century in the field of family enterprise and who have consulted with thousands of enterprising families the world over, giving the reader practical, effective, and time-tested insights to everyone involved in a family business.

FBG, founded in 1994, is the leading business consultancy exclusively devoted to helping family enterprises prosper across generations.

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Preparing Successors for Leadership: Another Kind of Hero
Preparing Your Family Business for Strategic Change

All of the books were written by members of the Family Business Consulting Group and are based on both our experiences with thousands of client families as well as our empirical research at leading research universities the world over.

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Balancing Liquidity, Growth, and Control

Throughout the world and across the centuries, family businesses share a common set of challenges: liquidity for shareholders, capital for business growth, and responsiveness to shareholders' control objectives. Let's consider the case of Carwood, a U.S. family business:

> *Judging from their beautiful new headquarters on the outskirts of Cleveland, the future seems secure for Carwood, a third-generation automotive parts company. Founded in the 19th century, the company has sales of $250 million. Reflecting its strong cash flows, the company has historically paid generous dividends to shareholders.*
>
> *Behind this healthy image lies a company very much at risk. During the last five years, sales have begun to stagnate, mostly due to lack of industry growth and stronger competition from large and well-capitalized global companies. To keep its competitive position, Carwood has continued to invest in new equipment and production facilities, which will keep Carwood competitive in cost and productivity, but only if and when the industry begins to grow again.*
>
> *Three family branches own Carwood. At the last board meeting, one of the branches expressed their desire to sell their shares in the company—even if it meant selling the whole business to raise the cash. Members of that family branch feel detached from the business and the rest of the family. They live far from Cleveland and*

seldom show up for annual meetings, even though they hold seats on the board of directors. Global competition, they argued, requires continuous and massive investment, which eventually would reduce the company's ability to pay dividends and could even hurt future shareholder value.

Said one member of this group, "Let's sell before it's too late."

Another group, in which the chairman is one of 12 shareholders, has no interest in selling its shares, let alone the business. The third and most populous branch with more than 20 shareholders in four families is split over the issue—some are interested in selling, some are not, others waffle back and forth.

Two family members from each shareholder group serve on the board, along with two outside directors who are unwilling to take sides. The board's lack of cohesiveness results in unsatisfactory board meetings and prevents it from making strategic decisions.

Because none of the three family factions has enough votes to prevail, the board and management are at an impasse. They called in an investment banker to evaluate their options:

- *Sell, which may leave significant value on the table;*
- *Stay as is, which may be competitively risky;*
- *Find a partner to buy some shares, which may sacrifice significant control; or*
- *Recapitalize, which may require excessive debt to secure growth.*

In what we like to call "the cousin collaboration," none of the shareholders—multiple descendants of the founder—owns sufficient shares to control the company and its strategic decisions. While all shareholders have equal rights, they have very different needs. Balancing the financial needs of a growing business with the divergent liquidity needs of a growing family is one of the most critical issues Carwood shareholders—and other multigenerational companies—will face.

Family shareholders' expectations of the business evolve from generation to generation. Sometimes the evolution is peaceful and smooth, but it is not unusual for gradual shifts in the family and the business eventually to erupt into a liquidity crisis, threatening to destroy the business. Avoiding such crises requires that family shareholders understand and address the financial forces at work.

Depending on the attitude of the shareholders vis-à-vis control and the timing of its liquidity needs, Carwood may yet be able to cobble together a combination of solutions.

THE FAMILY BUSINESS TRIANGLE

Successfully balancing the evolving liquidity needs of a family with the growing capital needs of the business and the implication both those issues have for control of the company influence the long-term survival of the family business across generations.

The triangle portrays the tension intrinsic to the financial life of a family business as it passes from generation to generation. If family control is to be sustained at the top of the triangle, equilibrium between shareholder liquidity and the capital needs of the business must be achieved at its base.

When liquidity and capital needs drift apart for any reason, equilibrium dissipates. Any tendency of family business

EXHIBIT 1 **The Family Business Triangle™**
Balancing three needs in a family business system