Achieving Ownership Alignment on Financial Goals

By: Lisa Morel and Joshua Nacht, Ph.D, The Family Business Consulting Group

The meeting with the non-family CEO and 14-person family-ownership team had started off tenuously but was developing good momentum. They were meeting together to help develop a mutual understanding of the financial goals of the company. The vague statements of the family to “give us a profitable return” were no longer sufficient to help the CEO in his strategic planning. He used a sports analogy to help drive the conversation: “I need to know where the sidelines and end zone are — then I can run the plays. I need to know your goals in a way that are tangible and actionable.”

The family realized they had some work to do because they had never quantified their financial goals. If they could agree on a “dashboard” of key indicators management would understand what was expected and owners, even those with relatively little financial literacy, could track company performance.

Key Indicators for Owner Alignment

One of the most important responsibilities of owners of a family-owned business is to contribute to the long-term success of both the business and the family. They must do so in a variety of ways, including having good governance, effective communication, and clear financial goals. Those financial goals include what we refer to as GRPL: growth, risk, profitability and liquidity. Ownership families who go through the valuable process of defining what these goals are find the project rewarding and highly useful for the guidance that it gives to the Board and business leaders, as well as for the alignment it gives as an ownership group.

Defining GRPL in the earlier stage of a business is something that usually emerges from the small family management team as part of their strategic business planning. But as the business and ownership group grows into a second, third or fourth generation ownership group, GRPL is something that needs to be revisited and re-defined by those owners. However, many ownership groups do not necessarily have the skills or qualifications to define these goals in a way that is useful to the business. Furthermore, managers will likely be very uncomfortable with a group of family owners telling them what their goals should be. This is why we advocate for a collaborative process in pursuit of defining GRPL.

A Southwestern manufacturing family had grown significantly over the years — as a business and as a family. The ownership group now numbers over 30 people, and the business continues to grow at a healthy rate. But when the business hit difficult times because of the pandemic, they were not able to pay the same dividend that owners has grown accustomed to. For some, this was a minor issue, but for others it was a significant hardship. Tensions began to build as some owners requested more detailed metrics around expected rates of return, business growth, and dividend formulas.

The family council realized that they did not have shareholder alignment around their financial goals, and this lack of alignment was causing several challenges that could prove problematic if not addressed. After a series of thoughtful meetings, the family council embarked on a comprehensive initiative that sought to define the owner’s financial goals. With the help of a facilitator, they began to explore the various aspects of what GRPL means to them.

Growth

Owners define growth in a variety of ways. When establishing key indicators, many owners first take into consideration the nature of their business. For example, in asset or property-oriented companies, growth may focus on growing property value. In other industries, it

could mean measuring growth via top line revenue. As owners, you might ask other important questions such as: do we want to grow in our same line of business, do we want to expand geographically, or do we want to diversify our portfolio of products and services?

When owners discuss creating an aligned dashboard for growth indicators, it is as much an exercise of defining how they would like the company to be "driving" the growth, as well as about establishing speed limits and roads (avenues). Owners who speak in one voice to the Board and Management about what type of growth they expect to see from the business helps communicate clear mandates that will be incorporated into strategic planning.

Some examples of growth parameters defined by owners are:

- Sales growth in X percentage
- Increased market share
- Increased client customer satisfaction score
- Increased client retention rates
- Increased value of the assets
- Increased number of employees
- Geographical growth- i.e. opening a new division, factory, office.

One aspect to consider is how owners will support that growth; whether organically, or by highly leveraged operation or through mergers and acquisitions. Many family-owned enterprises have grown organically through consistent reinvestment over the years. Nonetheless, organic growth usually hinders high growth rates. As family enterprises transition, some owners might have different needs and expectations about the speed of growth. Faster growth will most likely require a sacrifice in liquidity or profitability. Alignment on how, where and how fast owners would like the company to grow is a key component for an aligned ownership vision.

Risk

When analyzing risks, owners first identify what types of risks their business is exposed to internally, externally and even through its own ownership group. Examples of diverse risk considerations include shareholders who will likely want to exit ownership in the near future, political instability in the countries they operate, how much debt to take on and ESG practices.

After identifying the types of risks, the next task is to define as owners how you believe these risks should be managed (for example through an audit and risk committee on the Board), and then creating a unified risk statement.

This was the case for the Bennett Family, a third-generation cousin consortium who owned a large real estate company in the Seattle area. At their ownership meeting working through GRPL, the family CEO was passionately convincing his cousins: "Guys, we are grossly underleveraged. The average for our industry is 40% and we are at 8%." Their independent Board had suggested increasing leverage to continue to add to their portfolio. But what were the owners comfortable with?

Through this exercise the ownership group established the following parameters: low risk meant below 20% debt leverage, median risk from 20-30%, high risk from 30-50%. They polled the group and the results were pretty uniform that the family would accept a median risk profile, which gave the Board and management clearer guidelines for how to manage debt and risk.

Profitability

Profitability in a business is one measurement of value. For family-owned enterprises, it is what drives wealth creation in the business and for the family. Sustainable profits are often central to the reason a family is in business together. If not, family enterprises would be non-for-profit organizations.

A thoughtful discussion around profitability explores the fundamental question: What return are we seeking on our investment at this moment in time? Different industries have different parameters for return on investment, and what constitutes high quality profitability. Oftentimes, higher profitability demands will impact the company's speed of growth and tolerance for risk exposure.

Take the case of the Lee family. As a family, they had successfully owned and operated resorts for many years and as a result, also grew a substantial real estate portfolio. The business allowed the family to be able to provide a lifestyle and financial security they all valued. As the family grew and transitioned to the 4th

generation, the new ownership group was faced with the dilemma of how to continue to provide the lifestyle they were accustomed to and still maintain a healthy company. They discussed how the profitability goals of the business needed to change in order to meet the evolving needs of the family.

With the input of management, Board and financial advisors, they established new profitability metrics that led to the company gradually restructuring the business in order to be able to yield more returns. While previous generations were focused on growth and heavy reinvestments, at this stage, their investment strategy changed to a less growth centered approach, but one that allowed for more profitable returns and liquidity.

Liquidity

Establishing a clear metric for expected liquidity can be a tricky subject as ownership configuration changes over time. Different owners will likely have different needs at different moments in time. At this stage, the ownership group seeks to align themselves on the following: How do we value the trade-off between investments and providing liquidity to the shareholders? How do we value predictability of dividends vs. the opportunity for potentially inconsistent but higher dividends?

In revisiting the Southwestern manufacturing family, all felt that the company should always provide some form of annual liquidity to shareholders, as it had in the past. They valued growth but many were dependent on their yearly dividends and had college expenses coming up. They worked with a team of stakeholders from the ownership group, management team and board members to establish a 10% minimum dividend policy which gave shareholders a consistent return and was manageable for the business. The collaborative process to arrive at those liquidity metrics was additive and effective because it was a team effort with the goal of team success.

Conclusion

Taking a strategic look at GRPL as a team allows for a cohesive ownership group that provides the Board and management with the right information for a balanced plan of attack. They are the “marching orders” that can help build alignment and accountability throughout the system. Keep in mind, it is not just the end result that matters, but the process of arriving at agreement on the elements of GRPL that perhaps matters most. Investing the time in a collaborative process that integrates the perspectives of all stakeholders will result in alignment of financial goals to support the continuity of the business and family.

Lisa Morel and Joshua Nacht are consultants with The Family Business Consulting Group.

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