

Add Capital Planning to Your Family Business Toolkit

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Eventually, every family enterprise reaches a moment when the needs of the business and the needs of the family pull in opposite directions. Growth demands reinvestment, while owners seek liquidity. Without a plan, tensions can erode trust, stall opportunity, and even jeopardize the family enterprise. That's why thoughtful capital planning belongs in every family business toolkit to help leaders anticipate needs, mitigate conflicts, and synthesize the owning family's vision with the strategic goals of the business.



Families who want to continue business ownership into future generations will benefit from understanding the origins of competition for capital, recognizing family owners' evolving needs, and finding agreement on an ownership strategy to shape the capital planning decisions. This article also introduces the value of clear roles for management, boards, and owners involved in capital planning.

The Forces that Create Capital Competition in Family Enterprises

The long-term investment of family capital enables a business to flourish and persist through good times and bad. When the business is growing and has attractive investment opportunities, leaders retain earnings for reinvestment to increase business value. When there are headwinds brought on by the emergence of disruptive new technology or price shocks in the supply chain, for example, leaders prefer liquidity in the business to enable agile moves that mitigate risk.

At the same time, family owners deserve a return on their capital, as all investors do. Unlike the public equity markets, family owners cannot transact their ownership without involving the business, constraining the ability of individuals to capture the value of share growth. Over time, current returns in the form of dividends or distributions may not be sufficient to support family owners who have become financially dependent on the business or owners who want to diversify their capital into other investment opportunities.

Transitions like an owner's retirement, divorce, death, generational transfers, or ownership consolidation create time-sensitive demands for business liquidity to pay estate taxes, gift taxes, or fund owner buyouts. Conflict emerges when the timing and amount of owners' liquidity requirements impinge on the business's ability to invest in growth and weather challenges.

How Family Owners' Liquidity Needs Change Over Time

Owner demands for liquidity are influenced by both their role in the business and by their age and stage in life. Operating owners often prefer to minimize distributions in order to keep their options open. They access

liquidity through their compensation package more often than through dividends. When their liquidity needs exceed their employee compensation, they may arrange loans through the business rather than redeeming shares or paying dividends. While this approach keeps the family capital invested in the business, conflicts about fairness can emerge as the owner group grows more varied.

By the 3rd or 4th generation, diversity is a defining attribute of family business owner groups. Owners' ages may span generations, and the family may be more geographically dispersed. Ownership may be held in trust for beneficial owners. Many do not work in the business and may differ in their appetite for risk as compared to those leading the business. Owners who are closer to retirement may prefer generous dividends to investments in growing enterprise value. Others may be willing to forgo current cash returns in favor of greater total returns in the future, preferring growth-oriented investments that can carry more risk.

At this stage, family leaders must consider how they want to retain the patient, long-term equity capital held by a growing group of family owners, some of whom may feel distantly related to the business. A profitable business with healthy cash flow and prospects for growth goes a long way in encouraging family owners to stay invested, but it is not the only ingredient in the mix.

Owners deserve a return on their investment and, in our experience, are more likely to stay invested when they also have consistent options to access liquidity through share redemptions. Completing the formula is a secret ingredient: the intangible, emotional benefits that accrue to family members who find meaning and purpose through collective ownership.

Why Ownership Purpose Matters in Capital Planning

Effective capital planning is rooted in the owning family's well-defined vision for the future of their enterprise. Successful families develop an ownership strategy to align on financial preferences and articulate their meaningful purpose for continued family ownership. Ownership purpose is an application and expression of the family's culture and core values. Purpose is the glue that keeps the family together and committed to a common cause.



Ownership financial strategy consists of agreed-upon parameters for enterprise growth, risk, profitability, and liquidity. Business leaders provide data, market perspective, and education with scenarios that illustrate the relationship among these parameters. Owners gain insight into the value that their long-term capital brings, and see the implications of their projected liquidity requirements.

Equipped with this knowledge, owners make agreements on a preferred strategy designed to provide the liquidity they seek at an acceptable level of risk to their business. This

discernment process produces a valuable byproduct when owners learn to communicate their strategy with "one voice" to business leaders and their board of directors.

Role Clarity for Effective Capital Planning

Capital planning is most effective when it is part of a recurring process that integrates the priorities of management, the board, and owners. Management plays a central role in developing and maintaining

projections of the business's sources and uses of cash. The use of projection should reflect both the business and the owners' strategy. The sources side of the equation should clearly indicate where management sees a need to access external debt or equity to implement the approved strategy.

Owners enable effective capital planning by communicating their strategy, maintaining a comprehensive projection of planned ownership transitions, and establishing protocols that limit uncontrolled transfers of ownership in cases of divorce, death, or bankruptcy. Buy/sell or shareholder agreements define rules for owners who wish to exit or transfer shares. These agreements mitigate the negative effects of untimely demands on business capital by specifying the terms for payments to departing owners.

The board of directors' role is to manage the tension between owners' capital requirements and those of the enterprise. Directors who have gained a detailed understanding of the family owners' strategy and vision are better equipped to make decisions that synthesize competing requirements. Family directors must be vigilant about their role and their responsibility to represent the interests of all owners, not only their personal or branch interests.

If your family enterprise has yet to form a board of directors, your capital planning process should begin by distinguishing the owners' role from management's. Different and sometimes conflicting priorities for capital planning emerge from the perspective of each of these roles: management, ownership, and family. Role awareness and clarity help family members who "wear multiple hats."

For example, a third-generation business leader who inherited ownership and is a parent to two future owners. As a manager, she knows that increased cash returns to owners could reduce the business's reinvestment rate, affecting her division's plans for growth. As an owner, she may want a larger quarterly distribution to enhance her lifestyle. As a parent, she may want the business to remain family-owned so her children can enjoy the same opportunities she has known working in the strong team culture of business.

Well-defined business governance forums, such as an owners' council, make explicit the family members' role in discussing capital planning. With or without a board in place, an experienced family business advisor can help your family enterprise develop a fair process for capital planning decisions with clear roles and responsibilities and effective guiding agreements.

Decision Roles and Governance Documents in Capital Planning

Capital decisions become far easier when everyone knows their part. The following framework outlines how responsibilities are shared and which documents provide the structure for sound decision-making.

Significant Investments, Acquisitions, or Material Changes in Debt	
<ul style="list-style-type: none">• Decision Roles• Management: Proposes investments and implements once approved• Board of Directors: Decides, guided by the Ownership Strategy• Owners: Advise via the Ownership Strategy Statement	<ul style="list-style-type: none">• Guiding Documents• Business Strategic Plan• Capital Budgets• Ownership Strategy

Liquidity to Owners (Income or Diversification)	
Decision Roles <ul style="list-style-type: none"> • Management: Proposes investments and implements once approved • Board of Directors: Decides, guided by the Ownership Strategy • Owners: Advise via the Ownership Strategy Statement 	Guiding Documents <ul style="list-style-type: none"> • Business Strategic Plan • Capital Budgets • Ownership Strategy
Changes in Ownership (Buyouts or Generational Transfers)	
Decision Roles <ul style="list-style-type: none"> • Management: Advises on business capacity to support transactions • Board of Directors: Approves guiding documents and terms of share purchases • Owners: Decide whether to transact 	Guiding Documents <ul style="list-style-type: none"> • Capital Budgets • Shareholder Agreement (corporation) • Operating Agreement (LLC) • Estate Plans • Trust Documents • Owner Demographic Surveys

The Long-Term Rewards of Capital Planning

Family leaders convert potential conflict into continuity when they embrace an effective capital planning practice. The tool motivates the family to clarify and communicate ownership vision and goals, compels the business to synthesize owners' needs into its strategy and governance, and ensures that both, family and business, thrive across generations.

Capital Planning in Action: A Family Business Case Study

This case study illustrates how effective governance and capital planning helped a family enterprise navigate competing demands for liquidity and growth, demonstrating the principles outlined in this article.

The Challenge: Competing Capital Demands

Three years into her role as Chief Financial Officer, Vivian faced a classic capital planning dilemma. Just one week after the board approved a significant investment in a new product line, she learned that her cousin Warren wanted to sell his shares.

The timing created immediate tension between the business's strategic needs and an owner's liquidity requirements. Redirecting capital for a buyout would delay the planned investment, potentially affecting the business's competitive position. The situation was further complicated by long-standing family tensions, making it critical to handle the request with both business prudence and family sensitivity.

Governance Structures Provide a Path Forward

Rather than attempting to resolve the situation alone, Vivian contacted the owners' council chair, activating the governance framework the family had recently established. Though the council was only a year old, it had already completed foundational work that proved essential in three areas:

1. The family had articulated a shared ownership purpose: to serve as an economic engine for their region and provide high-quality employment. This purpose provided context for ownership decisions beyond purely financial considerations.
2. An owners' task force had begun developing the family's financial strategy, establishing parameters for growth, risk, and liquidity that helped structure conversations about Warren's request.
3. The owners' council provided clear role definitions and a process for addressing owner needs.

Understanding the Real Need

When the council chair connected with Warren, the conversation moved beyond assumptions. Warren explained that a failed business venture had created urgent cash needs for his mortgage and children's education—a clear example of how life transitions create time-sensitive liquidity demands.

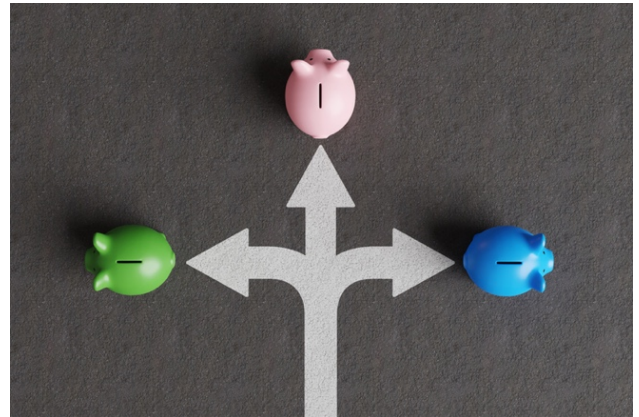
Warren also expressed feeling disconnected from both the business and the broader family ownership group, highlighting the importance of maintaining strong owner relationships as ownership diversifies across generations and geography.

A Solution that Serves Both Needs

Through collaborative discussions, the parties developed an agreement that:

- Provided Warren with needed liquidity by using a recently established share valuation, demonstrating the value of consistent, fair valuation practices.
- Protected the business's strategic investment capacity through payment terms that met Warren's immediate needs while spreading the financial impact over time.
- Maintained family relationships by creating a transparent process that acknowledged Warren's needs while honoring the business's strategic priorities.

Before presenting the proposal to the board, Vivian consulted with the CEO, who noted that Vivian's existing relationship with Warren likely prevented him from seeking liquidity through an outside sale. This potential outcome could have been far more disruptive to family ownership.



Lessons and Ongoing Work

This situation reinforced several critical elements of effective capital planning:

- Clear governance structures enabled a swift, appropriate response to an unexpected owner need
- Shared ownership purpose provided context beyond immediate financial considerations
- Role clarity helped distinguish between management, board, and ownership perspectives
- Existing relationships and trust facilitated difficult conversations

The experience also identified important next steps: formalizing the shareholder agreement to establish clear protocols for future ownership transitions, and developing more proactive communication with all owners about their individual goals and circumstances.

This case demonstrates how families convert potential conflict into continuity through effective capital planning practices. The resolution ensured that Warren's immediate liquidity needs were met while preserving the business's capacity for strategic investment, allowing both the family and the business to thrive across generations.

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