



Sustaining wealth through a well defined shared family capital strategy

How generations ahead can benefit
from holistic planning today



It is not uncommon for enterprising families to end up making sub-optimal capital allocation decisions due to limited visibility into, and planning around, the entirety of their shared family assets. The lack of a holistic perspective encompassing assets and commitments can result in blindspots and decision-making that is not fully aligned with the family's purpose and objectives.

Think back to what it might have been like for the founders of your family business. Shared family capital was much more easily managed because the family capital was held primarily in a business the founders started. Family businesses often begin simply enough for leaders to see the full picture and control the moving parts, but that ease quickly goes away once growth begins and wealth is amassed. It all gets a little more complicated. As businesses diversify and the needs of the family become more complex, business or wealth owners often lose sight of that overarching view and therefore the alignment of the capital with the mission and values of the family—which is the glue that keeps it all together.

Why is gaining such a view important? When entities within the family enterprise aren't in communication, don't have access to the same shared information or don't have the ability to optimize capital allocation across the enterprise, inefficient decision-making occurs. To optimize the value of shared family capital, both the business and other entities or advisors, like family offices or outsourced family investment portfolio managers, must work in harmony.

In addition to complexity, **succession** is another integral reason for adopting a holistic strategy. While deciding who will be the next to run the operating company is familiar territory for most families, many have not considered succession planning at the enterprise level. A holistic view can help families consider not just who will be leading the company in the future, but which individuals will have responsibility and visibility across the entire enterprise. Developing a clear strategy for how assets will be managed and responsibility for funding cash needs, like shared family properties, philanthropy or estate planning, is crucial to protect against value destruction and conflict.

The Power of Purpose

When a company is founded, it's usually with intention and motive that family members can rally around. Revisit this intention and see how it might have changed based on what the family now hopes to achieve through their shared assets and how they use their capital, and then redefine it, if necessary. The purpose you define should go beyond a mission statement. It should stem from collective contribution, be unique and meaningful, authentic and relevant and filled with intention that cultivates action.

Of course, this is easier said than done. With many individuals making up a family, it can be difficult to find a collective purpose, but without it, harmony is lost. To help ensure all individuals are included, engage the members of your family to uncover what makes you all unique and united. Remember that your purpose may change as your enterprise grows and evolves across generations. It's good practice to return to this at regular intervals.

With purpose in hand, you can engage all individuals, align diverse interests and make even stronger capital allocation decisions.

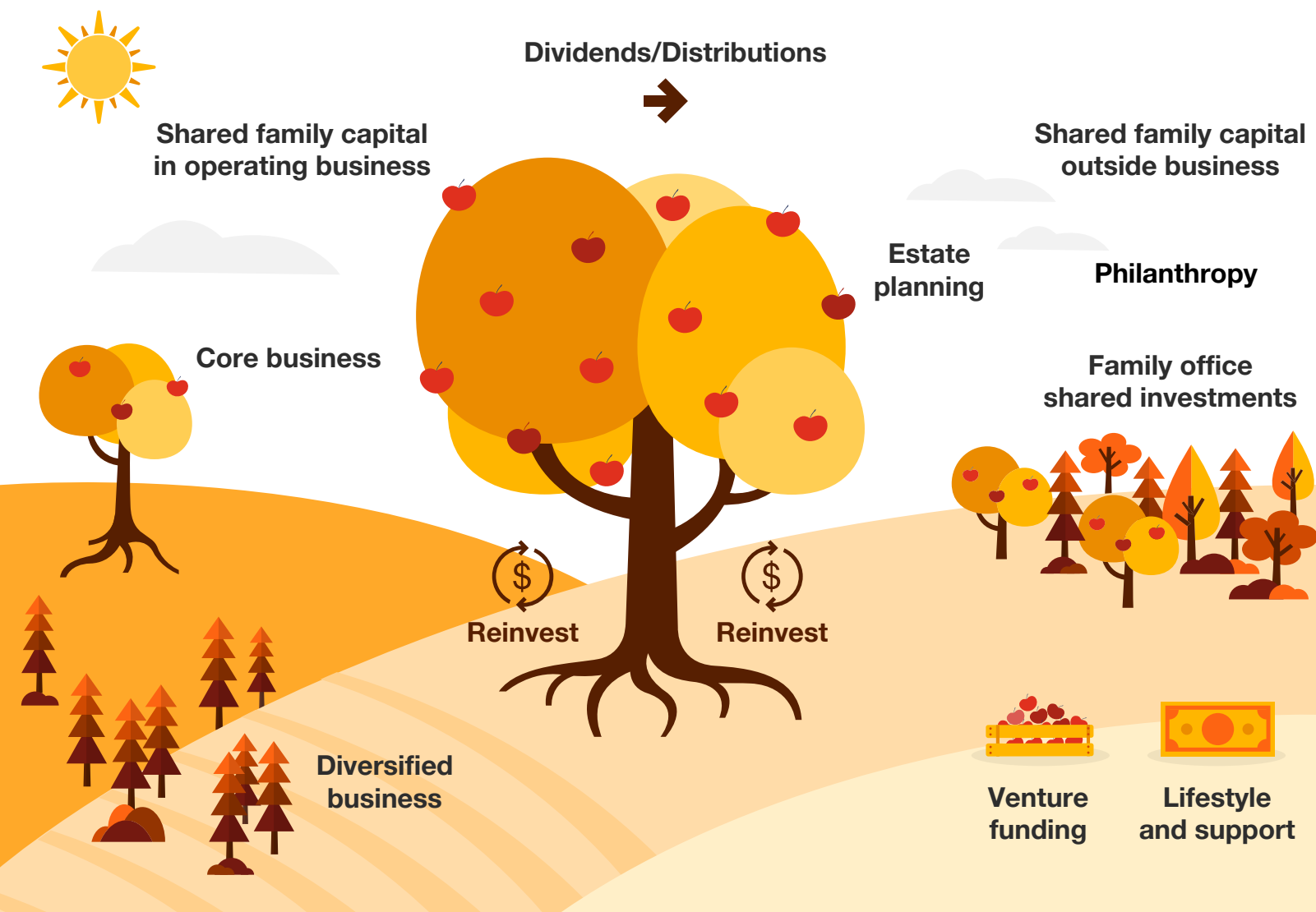


Framework Fundamentals

Before organizing holistically to make assets work optimally, you need to take inventory of what the assets are. It's helpful to look at your shared family capital through the following framework. This may involve some teamwork and multiple iterations since many families don't have a complete picture of all assets. Oftentimes, assets are held in different places, under different structures or controlled by different people.

Think of your shared family capital as a tree with multiple branches and components. Your core business begins at the roots, grows and stabilizes through the trunk and flourishes with the fruit. On the left side is the business related capital, and the many components on the right side represent more diversified sources and uses of capital outside the business.

Figure 1. Inventory of shared family capital



It's important that your inventory be comprehensive of everything that is shared by the family, also acknowledging what is not shared and lies outside of the framework. A comprehensive view is essential, because even if things are simple and under control now, they will become more complex with growth. And remember that any asset can be both a source and a use of capital. For example, your family might have money set aside for family gatherings or charitable intent (a use of capital). But if the company requires additional cashflow to keep employees on the payroll during an economic recession, the money reserved for a family reunion or philanthropy can be reallocated and become a source of capital for the operating company.

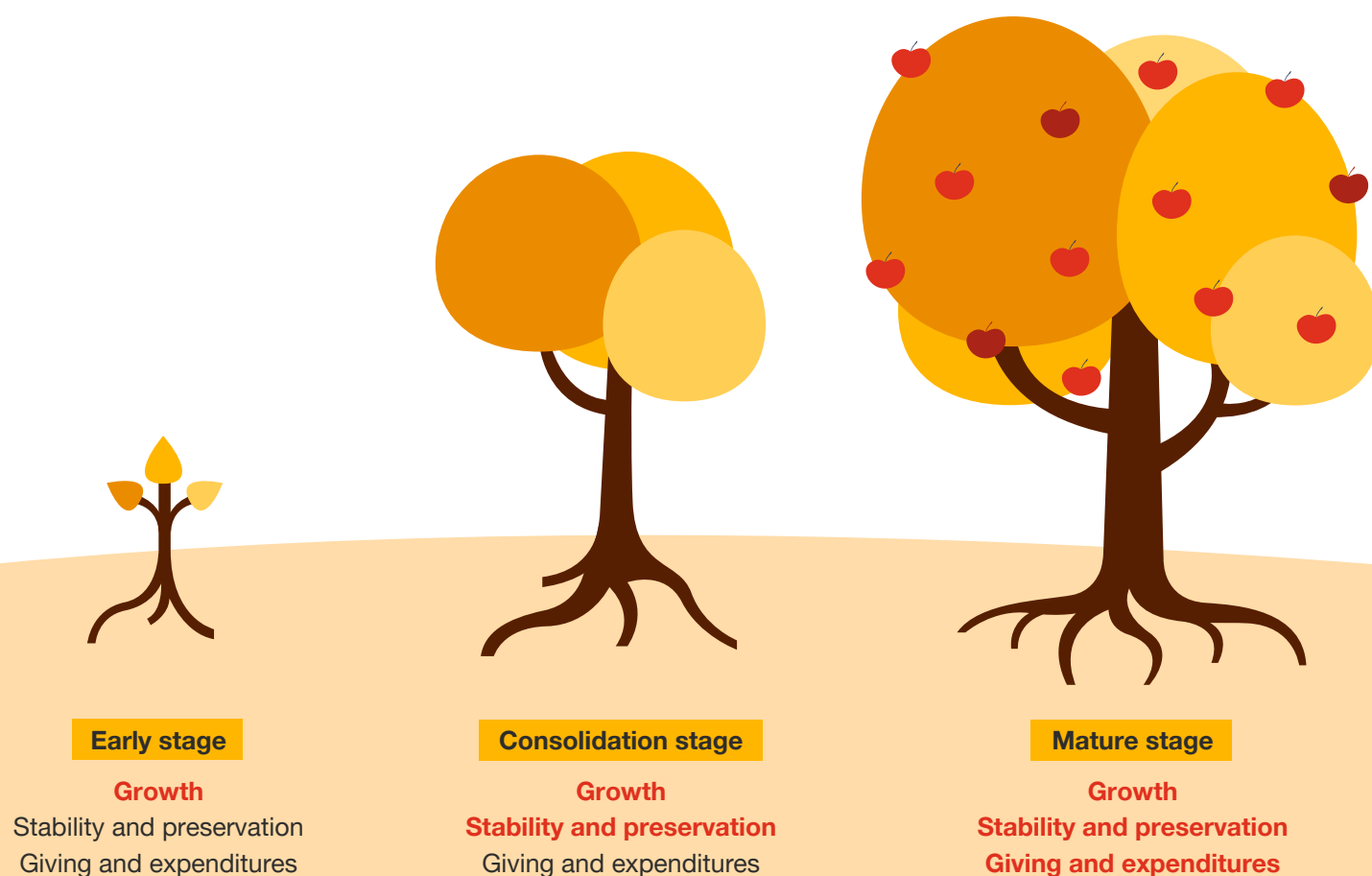
What are the fruits of your labor? Use the framework to assess and organize your shared family capital.

Figure 2. Shared family capital framework



Although these buckets could correlate to the various stages of maturity for your company, it's best to think of them independently of company maturity because families make values-based decisions throughout the life of their enterprise [see Figure 3]. For example, some families might decide to prioritize charitable giving during the early stages of their business. The important thing is to understand the various sources and uses of capital and plan for how you want to allocate your family's assets, both now and in the future.

Figure 3. The different family enterprises stages




Items in red are common areas of focus in each stage



Growing and sustaining a multitude of varied assets is complex, and this is where many business leaders struggle to make optimal decisions because they are making them without the complete picture. In addition, family business leaders might also be making decisions in the limited mindset of the current assets they have instead of thinking more broadly about how they could evolve to meet their shared goal or purpose. An all-encompassing view is required to optimize decision-making, promote family unity and prepare for the road ahead.





Why a shared family capital framework matters:

- **Organization and optimization**
 - Provides clear visibility into an **accurate and comprehensive** inventory of shared family capital
 - Enables you to **optimize your shared family capital allocation** and effectively oversee your consolidated income or sources of capital
- **Family harmony**
 - Aligns shared family capital to a **shared purpose**
 - Encourages **family discourse** around the uses of shared family capital and ensures that lack of alignment is addressed with appropriate policies and governance (See Figure 4 for an example table of contents for a family capital allocation policy)
 - Provides a framework to revisit shared family capital in the context of **evolving generational needs and preferences**
 - Allows for the possibility of **individual strategies and pursuits** such that family members don't feel constrained
- **Future proofing**
 - Prepares you for **unexpected circumstances** or **opportunities** (including knowing all the options and lowest cost alternatives to access emergency capital)
 - Enables more holistic, **long-term** decision-making for how shared assets are managed
 - Supports the ability to evolve your capital allocation to meet the needs of changing and growing family

**Figure 4. Sample table of contents
for a family capital allocation policy**

Leverage existing documents and materials as appropriate

Why?	What?	How?
I. Preamble: Why this framework and charter was created II. Family mission and vision	III. Capital allocation <ul style="list-style-type: none"> - Overall philosophy - Role of operating company - Diversification guidelines - Liquidity and income requirements for spending levels - Growth guidelines 	IV. Governance <ul style="list-style-type: none"> - Structures and authority - Responsible parties and delegations - Risk appetite - Guidelines for formal investment policy statements V. Operations <ul style="list-style-type: none"> - Systems - Reporting and monitoring - Role and requirements of advisors VI. Guidelines for amending VII. Appendices



Case in point

It helps to see it all in action. The following **case study** serves as a real-world example of the applications of this framework:

A well-established, highly successful, family company had a vision to sustain business for years to come, but even though the company was in the mature stage of development, a disproportionate amount of focus was still being spent on the operating company. Instead, the family ownership group needed to allot attention toward family decision-making related to establishing a strategy to support stability and preservation for the operating company and the current family wealth while establishing a foundation for future growth.

This assessment wasn't just made overnight. The issue surfaced after an owner leading the operating company, the CEO, noted that the business maintained significant cash reserves, well beyond what they envisioned needing. This begged the question: could cash reserves be more effectively deployed? This starting point led to a larger discussion about how capital was allocated across the enterprise.

Beginning with a bottom-up approach, the family, in collaboration with the operating company management team, first assessed and agreed upon the capital and reserve requirements of the operating business. "Paying the business first" ensured that the family protected the very foundation of their shared family capital.

They then analyzed how excess capital could be effectively allocated/invested for the benefit of the family, including future opportunities for the operating company and potential business ventures balancing the concurrent objectives of maintaining a defined level of wealth while pursuing opportunities for growth.

Lastly they worked their way up to the top of the tree, where they assessed spending and lifestyle commitments of family members to see how these might be affected if changes were implemented. (This can be a difficult step, as each family unit is comprised of individuals with different lifestyle expectations. Some are spenders. Some are more frugal. Families need to return to their purpose and decide what the business objective of funding the family might be.)

After these assessments, goals and priorities were defined and agreed upon. The resulting strategy prioritizes the health and competitive positioning of the primary operating company and preserves an agreed upon standard of wealth for current and future family members through a diversified shared investment approach.



Case study results


- **Organization and optimization**
 - Agreed to fund a shared investment vehicle with proceeds from the operating company and excess liquidity.
 - Created a family office to support oversight of shared investments
 - Structured a pooled investment vehicle to manage shared assets effectively (some family members actually chose to contribute more to the pooled investment, demonstrating how the framework fostered a more engaged family unit)
 - Revised governance structure to provide holistic oversight of the operating company and financial investments, collectively as a family enterprise
 - Hired one senior-level executive with an investment management background to oversee the advisors and service providers and manage the day-to-day operations for the family
- **Family harmony and flexibility**
 - Decided against creating a family foundation, instead agreeing to pursue charitable inclinations at the individual level to maintain independence while contributing toward shared goal, and allow family members the flexibility to opt in or out
 - Updated dividend policy to allow for a greater range of investment options by allocating a portion to owners for personal expenses, a portion to the shared investment vehicle and a portion to newly created growth pool to deploy back to the operating company or to other financial investments (the business had previously paid cash dividends to shareholders who then invested or spent at their own discretion)
- **Future proofing**
 - Established a reserve within the family investment vehicle to support unexpected family or operating needs

To make these policy changes, this family stuck to the framework. They returned back to basics, assessed and strategized to invest in their long term sustainability and success for generations to come.

It's important to note that framework or not, these changes would not have been made had it not been for the leadership of the family member CEO. Because this family was close knit and communicated well with each other, a family member was able to lead this change. This may not be the case for all families, so sometimes an outside advisor is helpful.

Even though this family worked well together, they still held disparate viewpoints. The new policy solved for these by putting together an approach that everyone could agree upon. For example, the policy that is now in place gives individuals an exit strategy if their needs and priorities don't align with the shared capital strategy. This gave everyone the comfort they needed to move forward unanimously.





Components for successful framework implementation:

- 1. A framework that fits.** Does your business require a low- or high-complexity infrastructure? Larger family enterprises that have been in business for many years and have an intricate tree of assets require a more sophisticated infrastructure to support them, while smaller enterprises require a simpler frame to build from. No matter if low or high, as long as an effective infrastructure is in place, businesses can scale up proactively as complexity grows.
- 2. Family commitment to the process.** It's critical that your entire family understands the value of a holistic view and appreciates the need for family clarity on the purpose of their wealth. This can be achieved through group work to define purpose, processes and roles, and through consistent transparent reports throughout the process.
- 3. A leader of the charge.** The family CEO in the case study served as the individual who raised concerns and helped make plans for change, but for some families, this will not be the case. If not a CEO, family board chair or patriarch/matriarch, an outside advisor or non-family member who is independent of the personal and emotional considerations of family members has many advantages. In other cases, a group of family owners may identify the need for change through a family council or regular family meetings.
- 4. Governance and operating models.** It's important to have a structured governance model for the organization and oversight of your family policy. The governance model should designate decision-making authority and roles and responsibilities of all other members in a standard Responsible, Accountable, Consulted and Informed (RACI) structure. Similarly, best practices include the implementation of an operations model for the actual execution and monitoring of your policy. This includes the people involved, the process, including risk management and reporting, as well as technology capabilities and the data sources, validation and security [see Figure 5].


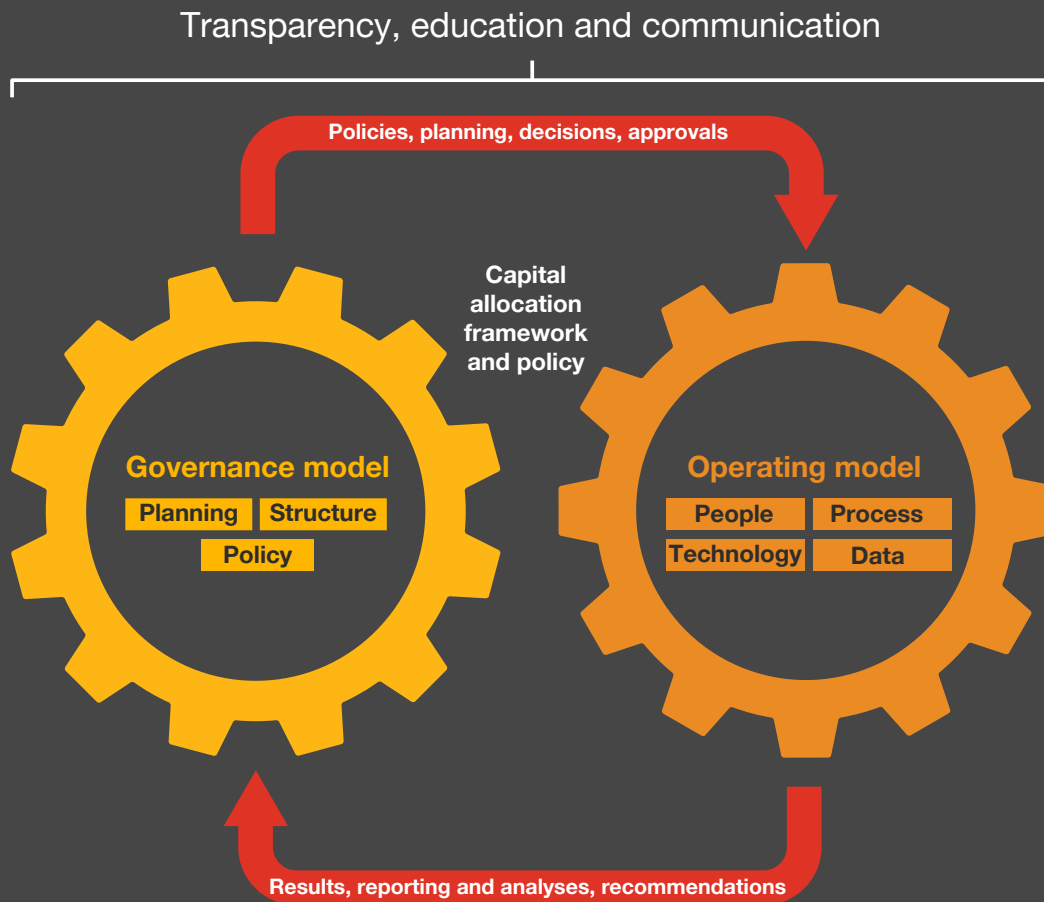
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5. **Decision-making authority.** There should be an enterprise-wide oversight entity for your shared family capital. Some entrust this in an individual (family or non-family), holding company board or owners committee, family office or trustee (family trust company). In addition, each operating business unit or family office within an enterprise may have its own governance entity responsible for implementing its own strategy. There is not a one size fits all. It depends on the needs of your family. No matter who takes on the job, roles and responsibilities must be defined. Clarifying will help manage people's expectations and keep the process on track.
 6. **Access to data.** Disparate sets of data housed in operating companies, investment portfolios, and/or entities holding real estate or other illiquid investments need to be looked at holistically, too, to avoid inconsistencies and manage consolidated risk exposures. While some families elect to use their financial advisors or custodian to aggregate data, other more complex family enterprises may require a specific technology solution and in-house expertise.
 7. **Monitoring and measuring.** After a strategy is implemented, operations experts and technology are required to monitor and report back on relevant data. In more complex structures, a chief investment officer is useful for overseeing the asset allocation and portfolio risk management, while a chief financial officer can help manage cash flow and finances. There are many cloud-based technologies that can operate in-house or can be outsourced to deliver KPIs and KRIs in an easily digestible format. An example is an allocation dashboard, which includes a visual representation of investment, operating and individual assets. Here you can view target, actuals and near-term forecasts of assets, and add exposures to tailor your strategy.
 8. **Flexibility.** The world is ever-changing and uncertain, so your family's policy should be built to be flexible and resilient. You can do this by leaving some capital available in the event of unforeseen issues, such as investment opportunities or to shore up at-risk operations.
 9. **Time and dedication.** Real, effective change takes time. The family from the case study achieved such successful results by returning to their shared purpose and deciding it was worth it to dedicate time and energy into their future success. And they took the time to gain the input of each family member to ensure individual interests were considered. In their case, it took a year and many iterations to see these results, but every family enterprise has different needs.

Figure 5. Governance and operations



There is no one-size-fits-all solution, and each family enterprise that employs this framework and approach can tailor their direction based on their unique needs. But no matter the path taken, the end result of a holistic perspective has both **strong family value and business value**. It has the power to create harmony and unite a family with a shared purpose, and the ability to enable more comprehensive, long-term decision-making and asset management for generations to come.



About the white paper

This white paper is the culmination of a virtual event series, Family Wealth Continuity Webinar Series, Family Capital Strategy: A Holistic View, which took place between August and December 2020. The webinar, hosted by The John L. Ward Center For Family Enterprises and in collaboration with Egon Zehnder, introduced the family capital strategy framework and how best to apply it to family enterprises.

Special thanks to German Herrera, Family Business Advisory Practice Global Co-leader at Egon Zehnder and Jennifer Pendergast, John L. Ward Clinical Professor of Family Enterprise and Executive Director of the John L. Ward Center for Family Enterprises.

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