ENGAGED OWNERSHIP

A Guide for **Owners** of **Family Businesses**

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WILEY

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Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

Library of Congress Cataloging-in-Publication Data:

Names: Renkert-Thomas, Amelia, 1962-
Title: Engaged ownership : a guide for owners of family businesses / Amelia Renkert-Thomas ; foreword by Kenneth McCracken.
Description: Hoboken : Wiley, 2015. | Includes index.
Identifiers: LCCN 2015036765 (print) | LCCN 2015041896 (ebook) | ISBN 9781119171133 (hardback) | ISBN 9781119171171 (ePDF) | ISBN 9781119171157 (ePub) | ISBN 9781119171171 (pdf) | ISBN 9781119171157 (epub)
Subjects: LCSH: Family-owned business enterprises. | Small business—Management. | BISAC: BUSINESS & ECONOMICS / Small Business.
Classification: LCC HD62.25 .R46 2015 (print) | LCC HD62.25 (ebook) | DDC 658.02/2—dc23
LC record available at http://lccn.loc.gov/2015036765

Cover Design: Wiley
Cover Image: © 751/iStockphoto

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

Foreword

The genesis of this book was Amelia's characteristically practical way of expressing the question that every enterprising family needs to answer at some point: What do the owners value about their enterprise?

Note that this question is not the same as *How* do the owners value their enterprise? When the question is framed that way discussion tends to focus on just the financial value and provokes a debate about which valuation method should be used. However, as every enterprising family and those who work with them know, a financial valuation provides only a partial answer to the question. So that is not good enough.

This is because one of the distinguishing features of family enterprises is that the owners attribute value to nonfinancial objectives. What they struggle with is how to identify, discuss, and enumerate these types of capital so that they can agree how to value them.

This book gives owners of a family enterprise a new way of dealing with these issues. It is based on what Amelia and I have learned from working together with family enterprises in different parts of the world over many years, but it is also of personal interest to Amelia as one of the owners of a fifth-generation family business. Using this extensive professional and personal experience, Amelia has been able to describe the different types of capital that a family could have invested in their enterprise, and for this she has coined the immensely useful term, *core capital*.

One of the refreshing aspects of this work is the way it highlights the important role of owners. Often ignored and even maligned as a problem in family enterprises, it is in fact their responsibility to become engaged and to enumerate the core capital of the enterprise. They also need to establish the forums and policies that will bring this all to life, which might include a new balance of power between owners and management that is very different from other types of business.

The concepts of engaged ownership and core capital will make immense good sense to family enterprises and their advisors. Unfortunately, it is unlikely to make as much sense to those who think that family businesses should all become more like public companies. In those companies, owners provide financial capital and power is concentrated in the hands of management. Short-term shareholder value remains the paramount goal no matter how much effort is made to fit in other types of return. This simply serves to illustrate that the reality of ownership in a family enterprise is fundamentally different from the public company model.

The importance of core capital and engaged ownership is ever present, but both will naturally come to the fore at critical junctures in the life of a family enterprise, such as during succession.

For example, when the original entrepreneur or wealth creator is passing on the product of their life's work, the notion of core capital will help the family to value the overall meaning of this inheritance. In later generations, the owners' ability to become engaged owners who can discuss and evaluate their core capital in a calm and rational manner will be vital to the continued success of the family and their enterprise. Even slight, unresolved differences of opinion among relatives could cause the type of rancorous conflict that destroys everything that a family has invested in their enterprise, meaning their relationships and reputations as much as their money.

These realities highlight the importance of understanding inherited ownership. Passing on ownership matters more in family businesses than other types of business because, to use Amelia's term, the inheritance represents the core capital that the family has already invested in their business as well as their hopes for the future.

It is important, as Amelia has done, to look at the effect of different types of ownership and not treat owners of a family enterprise as a homogeneous group. For example, how does a family ensure that a trust that holds shares will be aligned with their overall understanding of core capital and that the trustees will be effective as engaged owners?

Changing perspective, external investors in a family enterprise should seek to understand the core capital of the family owners and the ways in which they operate as engaged owners rather than make the error of trying to fit the family enterprise into another model of business, whether that be the public company or any other type.

This book is a significant and timely contribution to family enterprise knowledge and practice. It is an enjoyable read that will benefit families and advisors who are able to embrace new ideas in pursuit of improving their understanding of the fascinating and complex world of family enterprises.

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August 5, 2015

Preface

This book came about because I kept hearing a half-truth about family business succession presented as a best practice. More than one family business consultant opined that it is a bad idea for control to pass to owners who aren't "in the business." Lawyers recommended estate planning strategies that concentrated control in the hands of those managing the business, not only for tax mitigation but also to "reduce the risk of conflict." Bankers and wealth advisors laughed that "all business-owning families are dysfunctional."

Certainly, no family business—or family, for that matter—is without conflict. Conflict is endemic when people with different perspectives—owners, directors, managers, family—have different needs, perspectives, and priorities. And issues of control can be some of the most vexing problems family businesses can face.

But to suggest that consolidating control of a family business in the hands of management is a good way to avoid conflict—worse yet, a "best practice"—sells owners short. In our consulting practice I have met and worked with too many multigenerational owner groups where owners play a productive, active, and accepted role in business decision making to believe the half-truth so many advisors are perpetrating.

The challenge is: How can owners become engaged in business decision making in a way that sustains and builds the capital that has been created?

Owners who don't work in the business can be an asset, not a liability. They bring a different, but critical, viewpoint. They often possess skills, talents, experience, and perspective that can help shape the vision and strategic direction of the business. They, of all participants in the family business system, are best situated to think beyond "What's the best decision for the business?" to "What's the best decision for our family and our core capital?" Core capital—the unique blend of financial, human, and enterprise capital that make up the assets of a business-owning family—includes the business itself but goes far beyond it, and includes the savvy in the family's lineage and the entrepreneurial knowledge and drive developed over generations. For a business-owning family, there is so much more at stake than money. When owners think broadly about how all the forms of the family's capital are invested inside and outside the business—not just the financial capital—they are more likely to deploy their capital wisely.

This book is written for family business owners and the advisors who help them. It lays out a time-tested process for building engagement among all owners, managing and non-managing. My business partner and close colleague, Ken McCracken, and I, and the consultants who work with us, have used this process with families across the world over many years. We have found that engaged owners experience less conflict and bring important contributions to the business and the core capital. They have spent time together articulating a shared purpose—the answer to the question, "Why do we want to be owners of this business together, if at all?"—and laying out a common vision for the future. They have worked with board, management, and family to allocate responsibility for making decisions around critical issues such as capital investment, acquisitions and divestitures, dividends, strategic planning, corporate branding, and relocation, and have laid out policies to provide additional guidance. For family owners who undertake the work of engagement, there is a new energy around business and capital discussions. With engaged owners at the helm, board and management alike find they have a strategic partner and a far clearer vision for the future.

The process and challenges of achieving engaged ownership are illustrated throughout the book by the story of the Owen family, second- and third-generation owners of Owen Products, Ltd., a terracotta manufacturing company. The four Owen children—Mike, Martha, Amanda, and Christopher—find themselves as third-generation owners following the unexpected death of their father, Charlie. The Owens are entirely fictitious, but their story is pieced together from those of many family businesses, and it demonstrates how managing and non-managing owners can come together to make decisions about the future of the business and core capital.

Engaged Ownership contains four parts.

Part I: Engaged Ownership: An Introduction

Part I introduces the concept of *engaged ownership*—a different paradigm for family business owners. Engaged owners bring a deep understanding of their core capital and a vision for the future.

Chapter 1: More at Stake than Money

Chapter 1 introduces the concept of engaged ownership for family business. Family owners are regularly presented as the villains in media presentations of family businesses, but they can be a core strength of the business. Achieving engaged ownership requires owners and advisors alike to think differently about the roles and responsibilities of family owners, their shared purpose, and their collective vision for the future. To see owners in this new light, the discussion around business succession planning needs to change from *Who's going to run the company?* to *What is the best use of the core capital?* Core capital consists of financial capital, human capital, and enterprise capital. Chapter 1 also introduces three ownership constellations that make engaged ownership more difficult to achieve: the managing owner, the trust, and the non-family investor.

Chapter 2: Achieving Engaged Ownership

Chapter 2 provides an overview of how owners achieve engaged ownership. Owners must organize and lead the work to achieve engagement—it is not a process that the board or management can orchestrate. Owners will want to undertake the work of developing engagement when circumstances have changed and the natural governance system—"the way we do things around here"—no longer keeps the business in a comfortable equilibrium. This chapter discusses when owners should undertake the process of engagement and emphasizes the importance of undertaking engagement in connection with a significant transition. This chapter provides an overview of the engagement process: enumerating core capital and articulating shared purpose and vision.

Chapter 3: Engaged Ownership: Hallmarks and Impediments

Chapter 3 discusses the four hallmarks of engaged ownership: interest, understanding, ability, and longsightedness/broadsightedness. Engaged owners look beyond dividends to ask: What is our core capital? What is our shared purpose: Why do we choose to be owners of this business and its core capital together? What is our vision? This chapter also considers some of the impediments to engaged ownership: public company governance, conventional wisdom favoring controlling owners, focusing succession narrowly on the business rather than core capital, and denigration of inherited ownership.

Part II: Getting Organized

Part II provides a foundation for family business owners seeking to increase engagement.

Chapter 4: Family Business Roles and Relationships

Chapter 4 discusses four distinct roles in family businesses: owners, board, management/employees, and family. Each participant will occupy at least one role; some may occupy more than one or even all four. Each role has a distinct perspective:

- *Owners*—Owners hold the ultimate power to determine whether to keep, sell, expand, or contract the business. They may delegate decision-making power to other roles.
- *Board*—The board's primary role is as the chief overseer of the enterprise. The owners typically delegate to the board the responsibility for setting/approving strategy for the enterprise, hiring senior management, and monitoring performance.
- *Management and employees*—Management and employees operate the business in accordance with the strategic plan approved by the board.
- *Family*—The family is the source of the entrepreneurial spirit and values that lie at the core of business culture.

Each group will have its own focus and views about how the core capital should be deployed.

Chapter 5: The Legacy of the Past: Natural Governance, Family History, and Culture

Chapter 5 discusses how the decision-making system of a family business has evolved over its history.

Many family businesses from their first days evolve a form of natural governance that is largely based on assumptions, expectations, and understandings, rather than the tangible structures and policies of a formal decision-making system. This natural governance system might be called "how we do things around here." Natural governance is particularly apparent when a family business is run by a controlling owner. Natural governance can be adaptable and resilient, but as complexity increases, more formal decision-making processes may be necessary.

The business may come to be seen as a favored family member. However, engaged owners must have an ongoing conversation with board and family about how the core capital is being deployed, what risks and opportunities exist, and whether core capital should be redeployed in other ways, even if that might mean downsizing the existing business or exiting it altogether. A hallmark of engaged ownership is the ability to have difficult conversations about the future of the core capital, and, when necessary, to challenge long-held attitudes and assumptions.

Chapter 6: Enumerating Core Capital

Chapter 6 explains core capital: financial capital, human capital, and enterprise capital.

Profitability and positive cash flow will need to be achieved and sustained if the core capital in all its forms is to be sustained. A failing business will slowly destroy other forms of core capital as it consumes financial capital, while a successful business will sustain and grow financial and other forms of core capital.

Human capital is the total of the family's and the business's individual and collective human potential. Human capital includes social capital: relationships and connections; influence and values; goodwill and reputation.

Enterprise capital is all the unique knowhow embodied within the business and family; it is the array of one-of-a-kind combinations of capital that generate a return greater than what the separate elements would generate individually. Enterprise capital is the end result of human capital that has been coupled with financial capital to accomplish a specific endeavor.

Enumerating core capital is the exercise of thinking about all that has been invested in the business and the family over time—all the assets, in all forms, that make up their legacy and their future opportunity set.

Chapter 7: Shared Purpose

Chapter 7 describes how a group of owners can articulate their shared purpose. Shared purpose is the answer to the question: Why do we want to be owners of this business together, if at all?

For some owners, there is indeed an undeniable shared purpose and sense of collective focus and effort. For others, shared purpose can be more difficult to articulate, or even nonexistent. When there is a lack of shared purpose, it can be impossible to generate the energy and focus necessary to sustain engagement, particularly when an owner cannot reach consensus with other owners. Owners who feel bound together against their will run the risk of damaging the business. In such circumstances, facing up to the reality of the situation with honesty can help clarify the path forward.

Every owner will have a different perspective; the point is to see common threads and then work to articulate them clearly. A facilitator with family business experience can help to guide the work and keep discussion on track. Shared purpose can reunite and reenergize siblings and cousins who otherwise might not have reason to come together, and can foster a new sense of collaboration and consensus.

Chapter 8: Vision and Mission

Chapter 8 discusses how engaged owners articulate their vision for the future of the business and the core capital, and how they determine their mission for the coming two to five years.

Vision is the owners' collective vision of the future of the core capital and the business. It is the answer to the question: Now that we can articulate our shared purpose, what is our destination? What future do we see?

A clear and well-articulated vision animates the shared purpose: the owners can see the future and focus their efforts on achieving it. And while the shared purpose belongs to the owners as a group, the vision becomes the vision for the entire business and the core capital. It becomes the animating driver of the business. The owners' vision frames the board's discussion of strategy. It creates the direction and boundaries for management's deployment of resources. It gives family members an understanding of the purpose and direction of the business.

The goal of the mission exercise is to develop a list of steps that need to be undertaken over the next two to five years to achieve the vision in keeping with the shared purpose.

Chapter 9: Is it "Good Enough"?

Chapter 9 presents the *good-enough standard* for evaluating a given decision and determining whether consensus has been reached. Consensus requires an affirmative answer to four questions:

1. Is it right for me individually?
2. Is it right for the owner group and the family?
3. Will it work for the business and for the core capital as a whole?
4. Is it feasible in the real world?

The good-enough standard helps participants to analyze a given decision from multiple perspectives, and can help them pinpoint areas of concern that merit further discussion.

Chapter 10: Alternatives to Engaged Ownership

Chapter 10 discusses alternatives to engaged ownership. Not all owners will want to be engaged owners. They may be unable to reach consensus on shared purpose or vision for the future. If the majority of the group is willing, interested, and able to take on the work of engagement, but some are not, then there are two options that would enable the group to move forward: exit or delegation. If a larger part of the group is unwilling or unable to take on the work of developing consensus around shared purpose and vision, or the work itself generates disagreement that the group feels is insurmountable, then they will need to consider a different set of options. These include pruning the tree, dividing into silos, dividing the business through spinoff, splitoff, or splitup, or sale of the business.

Part III: Practicing Engaged Ownership

Part III lays out the practice of engaged ownership, and how owners do the work of developing and maintaining engagement.

Chapter 11: Forums

Chapter 11 discusses the purpose and benefits of creating forums for decision making. Each of the groups—family, owners, board, and management—has its own objectives and perspective. One of the responsibilities of the owners as the ultimate owners of the core capital is to create opportunities for each group's voice to be heard. Decision making for the business and core capital will be more effective if each group has a forum in which to come together to discuss the particular topics and issues that concern them.

Chapter 12: Allocating Power among Owners, Board, and Management

Chapter 12 discusses the challenge of allocating decision-making power among owners, board, and management, and in some cases the wider family.

All decision-making power within a corporation initially belongs to the owners. Statutes and codes governing business entities provide a default allocation of decision-making power, but also offer opportunities for very different allocations and thereby permit customized structures for reallocating decision-making power in ways that might better suit the needs of a particular family and business. At one end of the spectrum, the owners can retain all powers and control all decisions, which is the model seen in very small one-person businesses. Founder-run or controlling-owner businesses typically exhibit some degree of delegation to a board and management, but retain considerable power in the hands of the controlling owner. At the other end of the spectrum, owners can delegate most powers and choose to be relatively passive.

For engaged owners who have articulated a shared purpose and vision, and have begun the work of creating forums for family, business, and ownership discussion and decision making, the task is to allocate decision-making power in a way that gives the owners a voice in the highest level of strategic decision making, and the family a voice in issues that affect them, while still giving the board and management leeway to operate the business.

This chapter then presents a method for creating an allocation grid to permit the owners to allocate decision-making power among the groups and/or their forums.

Chapter 13: Working with Other Forums

Chapter 13 discusses the benefits and challenges of inter-forum meetings and decision making. Engaged owners don't operate in a vacuum. Their work is intended to guide the work of the board and management and to take into account the needs and wishes of the wider family.

An active and inviting Family Assembly can be a tremendous asset for a family and for engaged owners of a family business, because it can achieve respect as the voice of the family. When the Owners Council needs information and guidance about the family's wishes and needs, a strong Family Assembly with respected leadership will be trusted by the family to represent its interests promptly and accurately.

While the Family Assembly may be an entirely new forum, the business most likely already has a Board of Directors with well-established practices and a working relationship with management. The task, then, for the Owners Council is to introduce itself, the shared purpose, and the vision in a way that promotes dialog and collaboration with the board.

Chapter 14: Meetings

Chapter 14 describes how forum meetings can be scheduled, organized, and conducted to ensure that decision making is timely, thoughtful, and well-considered. The quality of forum decision making depends on the quality of the meetings that precede the decision.

Frequency: Meetings should be held often enough for the group to build the rapport, knowledge, and decision-making skills to do the forum's work effectively.

Meeting guidelines: A well-run meeting is scheduled well in advance and has a clear agenda. Materials are sent out in advance. Participants accept and adhere to a code of conduct.

Quorum and proxies: The group may choose to require a quorum for decision making and may or may not permit proxies.

Agendas: An agenda sets boundaries and manages participant expectations for the meeting. The chair of the forum may want to consider establishing an agenda cycle at least for the first several years of the forum's existence to ensure that the forum's members are educated on relevant topics and prepared to make the decisions for which they are responsible.

Participation: A forum may operate on a members-only basis or it may choose to invite presenters, participants, and/or observers.

Chapter 15: Policies

Chapter 15 discusses policies. A policy sets forth a decision agreed upon by two or more of the forums or provides the parameters within which a decision will be made, thereby providing guidance and helping to manage expectations of the groups vis-a-vis each other. Policies encourage a degree of consistency in decision making and promote investment by groups in long-range thinking and planning. When a policy is under development, it can be helpful for the participating forums to establish a joint task force to develop a draft of the policy.

Policies are living agreements. It is important to review policies from time to time to ensure that they continue to serve the purposes for which they were established. Major changes in circumstances all warrant prompt review of existing policies to ensure that they remain appropriate and effective.

Part IV: Three Challenges: Hats, Trusts, and Outside Investors

Part IV discusses three common situations that can challenge owners' efforts at developing engagement.

Chapter 16: When an Owner Also Runs the Enterprise

Chapter 16 discusses the challenges that can arise when an owner also runs the business. A managing owner's multiple roles may make it more difficult to reach consensus around shared purpose and vision with other owners and the risk of conflict among them may increase. A founder not only builds a business, he creates a culture and an established pattern of decision making around business issues. A child who succeeds the founder in running the business can find it difficult to make decisions together with other family members who own shares but don't work in the business, because these non-managing owners don't have the same level of information about the business or even a common vocabulary. Furthermore, joint decision making around ownership issues often simply isn't part of the culture of the business. To bring a managing owner into conversation with non-managing owners, it can help to begin with a group discussion. Issues that may be particularly challenging include: articulating a shared purpose and vision, allocating decision-making power in a new way, determining compensation and dividends, and redeploying core capital outside the business. The process of building owner engagement can help a managing owner develop a better understanding of and appreciation for the challenges of ownership, which are substantively different from the challenges of business management.

Chapter 17: When an Owner Is Also a Trustee

Chapter 17 describes the challenges to engaged ownership when the owners include a trustee. When a trust owns shares in a family business, ownership decision making must accommodate a fiduciary perspective. A trustee of a trust that owns shares has obligations to the beneficiaries that circumscribe the trustee's ownership choices. To operate effectively, the structure, membership, goals, and tasks of the Owners Council will need to take into account the purpose of the trust and the roles of the trustee and beneficiaries. Understanding the purpose of the trust will help determine the membership as well as goals and tasks of the Owners Council. To fulfill fiduciary obligations, the trustee will need to understand the needs and interests of the beneficiaries so that the trustee can factor that information into ownership decision making. The Owners Council can be a useful forum for gathering and disseminating information and for building rapport and mutual understanding between the trustee and the beneficiaries.

Where ownership of the business includes individuals as well as trusts, or includes separate trusts for different branches of a large family, it may be useful to create one or more Beneficiaries Assemblies. A Beneficiaries Assembly is tasked with educating the beneficiaries about the trust and providing an ongoing forum for trustee–beneficiary discussion.

Chapter 18: Bringing in Outside Investors

Chapter 18 discusses the impact on the owners, the family, and the business of bringing in an outside investor. Whereas the family owners have a shared interest in the human capital of the business and the wider family and an appreciation of the human and enterprise capital that make up their shared legacy, an outside investor is primarily concerned about a financial investment. An outside investor will be motivated to make decisions that enhance that investment and will have less concern for nonfinancial interests. An outside investor will want extensive information about the business and its financial and strategic plans. Family owners who are focused on core capital rather than liquidity and return on equity may find it difficult to find common ground with an outside owner while family owners who are less engaged may find that the demands of outside owners disturb the peaceful balance of power that has existed heretofore. Engaged owners will want to have an open discussion with the board about the advantages and disadvantages before bringing in outside capital to fund expansion or acquisitions. The Owners Council will want to perform extensive due diligence regarding the investor beforehand. The Owners Council may choose to restructure to accommodate the participation of the investor in ownership decision making.

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Engaged Ownership offers family business owners a path to engagement with management, board, and family on the critical questions facing the business and the core capital. It also offers an alternative paradigm to more traditional models of family business governance. The process of engagement described here has enabled many family businesses to navigate ownership transitions over generations and to assess and deploy their core capital more thoughtfully. To family business owners reading this book, I hope that the ideas presented here will resonate with you and help you to articulate your vision and to invest every form of your core capital toward its highest and best use.

July 29, 2015

Acknowledgments

After starting my professional career as a lawyer, I have had the luck and privilege to learn my second and third professions, business management and consulting, on the job from two of the finest tutors possible: my father, J. S. Renkert, and Ken McCracken. With the rare privilege of a tutorial education comes a challenge: I do not always know the source of knowledge I gleaned. With apologies at the outset that I will omit many who deserve commendation for bringing clarity and nuance to the complex subject that is family business, my deep thanks to Ernesto Poza, Rob Kauer, Barbara Murray, Katherine McCarthy, Guy Renkert, Bill Cranshaw, Amy Malsin, Deidre O'Byrne, Edgar Schein, John Davis, John Ward, Craig Aronoff, Marion McCollom Hampton, Kelin Gersick, Ivan Lansberg, Dennis Jaffe, Don Opatrny, Bonnie Brown Hartley, Holly Isdale, Tom Davidow, F.C. Howland, Stuart Grodd, the entire team at Withers, attorneys for family held enterprises, and the Family Firm Institute, and to my most visionary teachers: our clients.