Family Business
THE GUIDE FOR FAMILY COMPANIES

Acting like a business owner rather than just an investor

The recent downturn has taught us that the pursuit of short-term gain can have dire long-term consequences.

How will the history books describe the first decade of the 21st century? Will it be known as the decade of the great financial boom and bust? The decade of the global financial crisis? The decade of the great financial scandals?

I believe the 2000s will be referred to as the decade of greed, self-interest and pursuit of financial rewards at the expense of long-term stewardship. To me, the most important financial lesson of the past decade's economic roller coaster is that it underscored the merits of being an owner and not just an investor.

A client of mine remembers that when he was a child, his grandfather brought him, along with several siblings and cousins, down to the plant floor of their family's business and told them, "You see all those people working here? One day, they will be your responsibility."

Contrast that to the more common message that family business owners have traditionally passed along to their future successors: "Someday this will all be yours." Therein lies what I believe to be the difference between investors and owners.

An investor, in the purest sense of the term, is motivated solely by the profits he or she makes on an investment at the expense of any other short- or long-term considerations. An investment is a binary concept: There is a "buyer" and a "seller"; one party makes a profit and the other does not. The gratification from making a short-term profit leads to the pursuit of self-interest and, ultimately, greed, without any regard for long-term consequences.

A responsible owner, on the other hand, acts in the long-term interest of all involved. What counts for an owner is not just the profit that is made, but also the legacy that is left behind. Ownership leads to stewardship, and stewardship leads to a long-term legacy.

In the 2000s, it seemed that many individuals and institutions—from consumers to family business shareholders to commercial and investment bankers—lost their sense of ownership and its associated responsibilities. In the process, while trying to maximize short-term gains, they sacrificed their future well-being and the security of their legacy.

Owners' long-term interest lies in fulfilling their responsibilities not just to themselves, but also to other stakeholders.

The economic meltdown that followed the investment banking excesses and irresponsible borrowing and lending practices of the past decade can largely be traced to confusion about the roles and responsibilities of investors vs. owners.

Family businesses were not immune to those excesses. The corporate meltdowns of Parmalat in Italy and Adelphia Communications in the U.S. are just two examples. It's not surprising that in 2005 the Family Business Network choose "Responsible Ownership" as the theme of its annual summit.

Enlightened self-interest

Investment and ownership are not incompatible. In fact, the concept of "enlightened self-interest" was first introduced by French political thinker and historian Alexis de Tocqueville in his 1835 book, *Democracy in America.* According to this concept, by serving one's own selfish interests, one could ultimately do good. As de Tocqueville noted: "The Americans … are fond of explaining almost all of the actions of their lives by the principle of interest rightly understood; they show with complacency how an enlightened regard for themselves constantly prompts them to assist each other, and inclines them willingly to sacrifice a portion of their time and property to the welfare of the state."

Yet our recent economic woes illustrate what happens when we forget about the "enlightened" aspect of self-interest. The result is a descent into plain old greed.

Owners, by contrast, are like farmers. They are concerned not just about maximizing this year's harvest, but also about balancing this year's output with the need to maintain the land for generations to come. Owners

realize their long-term interest lies in fulfilling their responsibilities to the other stakeholders: employees, vendors, customers and shareholders. As the African proverb states, "If you want to go fast, go alone. If you want to go far, go together."

Founders of family businesses naturally understand the notion of ownership. They sacrifice long hours and often forgo personal financial rewards to help launch and nurture their company. This is known as "the family effect," and it translates into patient capital that allows the company to expand and support a growing family's financial needs. But when a business passes to later generations, the family effect dissipates; often greed takes over and erodes the family's ownership mentality.

The pursuit of short-term profit usually undermines future security. I believe that responsible ownership implies a sense of stewardship, which acknowledges that we are mortal and should pass on assets in the best possible shape for the next generation. This is what Samuel C. Johnson from S.C. Johnson meant when he talked about making decisions today to provide opportunities for future generations to do the same. It is also akin to the Native Americans' belief that all generations are connected, and that one therefore must consider the impact of every decision on the seventh generation.

As today's businesses evolve and family systems become more complex and global, family business leaders must balance the multiple interests of owners, managers, partners and employees. This is particularly difficult when the business passes into the next generation and the ownership becomes diluted. Family owners with smaller stakes in the business tend to think of themselves as investors in the family firm.

The role of family governance, whether it be a family council, a family office or another organizational structure, is to allow the owners to reinforce the family effect and make responsible decisions that take into account the interests of all parties involved. This will create an environment in which the family business system can continue to flourish for many generations to come. A shareowner, as opposed to an investor, will be more likely to:

- Consider the interests of all stakeholders.
- Make long-term stewardship a priority.
- Resist temptations to go after short-term profits that could risk long-term success.
- Run the business as a business and the family as a family.
- Ensure a smooth ownership transition from one generation to the next.
- Balance the capital needs of the business with the liquidity needs of the family.
- Operate transparent governance systems.
- Invest in educating the next generation of owners and leaders.
- Respect and learn from the differences among individual family members and allow for individual financial and career choices.

Don't neglect the short term

A family business owner must embrace some qualities of an investor, as de Tocqueville noted. You must, for instance, respond to short-term opportunities as they arise. After all, your business won't get to the long term unless you pay attention to the short term.

Dangers arise when a business owner becomes complacent about the present. The trick is to manage the short term with a long-term view. FB

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