Three issues for the presidents of family businesses

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Family businesses are often praised for their performance and their success in combining short-term results with a long-term vision. This is usually true. However, it is often forgotten that family businesses must balance three specific and potentially conflicting issues: the company's strategy, the family's wealth strategy and the governance.

1. The strategy of the different activities of the company

The role of the president is to define and implement a growth strategy which is relevant for the company. It must choose the segments on which to operate, develop a competitive and differentiated model, achieve leadership positions, balance activities in terms of cash generation and investment, and contain the level of risk. It has to go beyond the vision of its management.

The time spent managing the existing company, even if very profitable, does not create value. It simply maintains it. Creating value therefore requires a profound and regular change in the trajectory, profitability or mix of activities, or the ability to get on and stay in strong, long and profitable growth waves.

In the current environment, speed becomes as important a strategic variable as the ultimate goal. Given the increasingly rapid evolution of the technology markets, ways of accessing customers, a "good" strategy is only good in a given time frame. Too late, too soon, too long are issues which are as important in allocating resources as too much, not enough or not in the right place. This requires an articulate and precise link between vision, ambition, positions to be reached and actions to be taken to achieve them. That is the role of the President.

2. The family wealth strategy and the nature of the Group

Beyond the strategy of the various components, the President must define the wealth strategy.

For a family shareholder, it basically depends on 4 criteria:

- The desired level of profitability for the shareholder including the value of the shares (whether they be listed or not) and the distribution of the dividends;
- Volatility, that is, the level of risk associated with holding an asset in the portfolio;
- The liquidity of assets and thus the ability to sell assets at different time horizons or to profit from the value through the distribution of dividends;
- The role that the family wants to play in the business's conduct and the independence of management from the family holding company, in the implementation of the already defined strategy, in the management of day-to-day operations and in investment decisions.

There are two types of family holding companies:

- A portfolio holding company where the business portfolio diversified away from the original activity; this diversification can take different forms: real estate, investment funds, minority holdings in listed or non-quoted companies, liquid securities...

This is the case, for example, of Dassault, whose original activity accounts for only about 35% of the assets managed by the family, the remainder being distributed among different types of investments with various levels of risk and volatility. The challenge is to balance the risk of the portfolio with low-volatility and profitability assets.

- Industrial holdings where all (or at least the vast majority) of investments are made in well-controlled and potentially value-creating industrial activities.

For a president of a family company, the stake is to define both the type of holding company and also the role that this holding company will play in relation to investments.

What is the deep nature of the group and its ability to make its scope evolve? A company specializing in one business line (in a broad sense) benefiting from long and geographically scalable growth? A diversified group regularly changing its portfolio according to value-creation waves? A financial holding company without an active management of its business portfolio, nor an implementation of synergies between its various activities? Is the leadership's representation of the core nature of their business and its modes of value creation compatible with a growth strategy?

3. Governance

The role of each of the parties (shareholders, board, management) must be clearly defined so that all family shareholders may be aligned on:

- The ambition of the company;
- The level of risk taken;
- The methods of decisions and impact concerning the company.

Often, there is a significant difference between the different family shareholders of the 3rd generation or later. Their perception of the company's role, what it should generate in terms of value creation in relation to the distribution of dividends, the impact they must have on the company's strategy, its role in its home country or region...

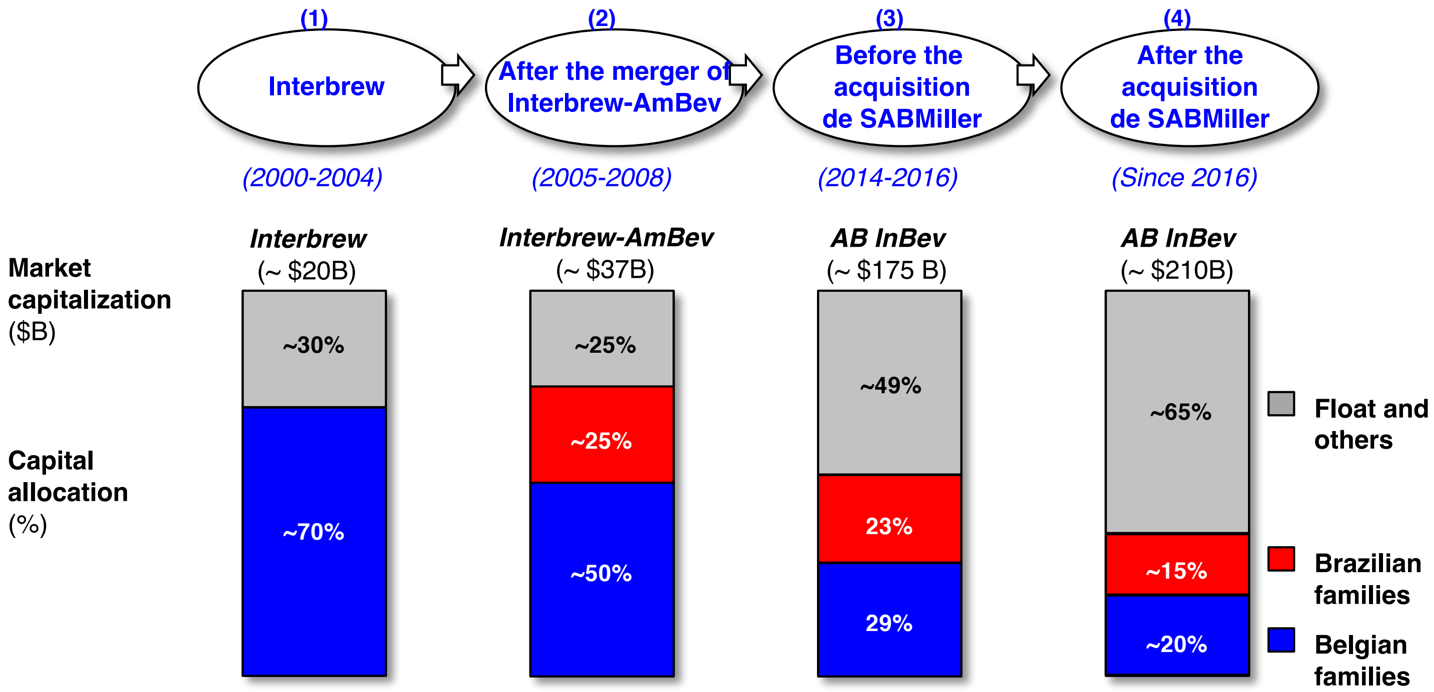
For first-generation entrepreneurs, management is not an issue as there is a strong link between strategy, wealth and governance issues.

For 3rd generation or later shareholders, the perception may be different. The bond to the company and its activities is not the same. The interest in reinvesting cash flows (and therefore getting a smaller dividend distribution) is different. Maintaining a cohesion is necessary to manage a strategy. Only a clear strategy and good governance make it possible.

The risk of mismanaging this governance because the project is unclear or because a significant number of shareholders do not adhere to it can paralyze the company. However, the speed of realization is critical for a company.

The Belgian shareholders of Stella Artois (Interbrew) have managed to carry out such a coherent strategy in the long term. They decided to consolidate the industry and accept a dilution of their share of capital to carry out this strategy. In 2008, the company generated a revenue of $5 billion for a value of $20 billion. Today, AB InBev generates $80 billion of revenue and is worth $210 billion. The original Belgian shareholders have 20% of the capital and have 4 out of 15 seats on the board of directors. They created the world's largest brewer and managed to maintain a cohesive approach to this project (see table).

Interbrew's historic shareholders have agreed to gradually dilute their ownership to create the world's leading industry in 15 years, while remaining the reference shareholding group



Sources: Estin & Co analysis and estimates

What to conclude?

At the beginning of any company, there is a brilliant vision, often born out of the intuition of an entrepreneur to do something differently through innovation, cost competitiveness, increased risk of investment, development of attractive pockets of growth in the market which are poorly addressed by existing players... This vision is brilliantly implemented.

The entrepreneur naturally succeeds in maintaining coherence between strategic, wealth and governance issues. Over the years, there is a risk of seeing a lack of alignment between the 3 dimensions.

However, these 3 dimensions cannot be dissociated. They link back to one another:

- The strategy sets a course and an ambition. It requires financial resources;
- The wealth orientation may or may not allow for this strategy. It gives constraints and sets the possible framework for the strategy. If it is too "restrictive", it does not create much value for the shareholder in that investment. If it is too "imprecise", it may frustrate some shareholders;
- To remain the primary shareholder, the family shareholder must define a governance that allows the implementation of the right strategy. If a leadership strategy is not possible without equity dilution, it must be decided what to do: give up leadership with the risk of losing competitiveness and creating little value or developing leadership but reducing the share of the family shareholder to fund the strategy.

Value creation results from a time allocation of the management of a company and choices made in this area. It requires aligning corporate strategies, wealth strategies and governance to enable the strategy to be rolled out at the right pace. Time is accelerating. Alignment is necessary. This is the role of the President.

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Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists the management of major European, North American and Asian groups in their growth strategies, as well as private equity funds in the analysis and valuation of their investments.

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