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How Family Business Owners Can Step Up During A Crisis

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In uncertain times, businesses need to adapt. Their owners may have to as well.

BY

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More than six months after the declaration of a global pandemic, management teams are turning from crisis response to future planning. They're evaluating long-term shifts in consumer preferences, reconsidering existing strategies—if not their entire business model—and identifying the talent to deliver on new strategies.

Yet this planning is taking place in an uncertain and rapidly changing environment, where the near- and medium-term outlooks for most businesses are still highly unpredictable. It is clear that success will require agility and flexibility.

In a meaningful sense, multigenerational family enterprises are at an advantage. By their very existence, they have demonstrated the ability to evolve to meet changing demands—often while honoring legacy and maintaining the family's values. Many large 100+ year-old family-owned enterprises have reinvented themselves multiple times over.

Take industrial manufacturer Milliken & Company with its long history of innovation, from the invention of Agilon fiber used in nylons in the 1950s, to the first polymer-bound chemical in the 1960s, to reusable protective fabrics ideal for PPE today. Or take the J. M. Huber Corporation, which evolved from a manufacturer of pigments in 1883 to a supplier for a wide range of consumer and industrial products. These days, as their website puts it, "We keep the wind and rain out of your house, the chocolate suspended in your milk, the components of your electronics cool."

Still, future success for such family-owned enterprises is by no means a given. In addition to reacting to rapidly changing market expectations, families must also continue to evaluate how the business is meeting their needs and how they themselves might adapt to meet the needs of the business.

Fit for a Family

Even in good times, as families grow and evolve, owners may choose to adapt the business to address their own changing needs.

Take the case of an agricultural family that had grown accustomed to riding the ups and downs of the commodity markets, as well as the weather. As they moved from third to fourth generation, the ownership profile evolved from most owners working in the business (and benefiting through salary and bonuses) to most owners not working in the business (and benefiting through dividends). This new generation of non-employed owners was less comfortable with the ups and downs of the business. So they reevaluated the portfolio of the company's assets, liquidating some farmland to reinvest in commercial properties that would generate a stable return.

Over time, families also adapt their business portfolio to align with their social values or their interest in spurring next-generation entrepreneurship. For instance, the Rockefeller Brothers Fund, a family foundation funded by the Rockefeller oil-refining dynasty, pledged to divest of fossil-fuel assets at the behest of the younger generation. Other families may make assets available to fund next-generation investment ideas.

In the wake of a crisis such as COVID-19, families might need to speed up these kinds of changes, to ensure that their business continues to work for them.

For instance, a family heavily invested in commercial real estate—typically a fairly low-risk investment—might have been completely comfortable with the risk profile of its assets in February. But by October, it might need to restructure its portfolio drastically to maintain its desired risk profile as it assesses long-term work-from-home trends.

Other families that might have been considering making a shift in order to follow the entrepreneurial pursuits of a new generation, or support a social cause, may also find themselves speeding up their timetable, as new opportunities emerge or social needs grow more urgent.

How Families Can Adapt to Uncertainty and Change

These examples demonstrate how families can evolve their assets to meet the needs of the family. But families also need to adapt their own practices in order to serve as a productive ownership group. Oftentimes, families think about innovation as belonging solely to the domain of the business, but it is equally important in the domain of family and ownership.

What does this mean? Families need to ensure that their decision-making practices and structures function effectively in times of uncertainty and change. This may require a new form of governance, perhaps in the form of an active board of directors with skilled and involved independent board members.

Even families that already have an independent board of directors may find it helpful to expand the pool and upgrade the qualifications of their independent directors—possibly reducing the number of board seats held by family members to make room for additional talent.

Family management may also find it is time to cede more control to nonfamily leaders. Family leaders have an inherent tie to legacy operations and business practices that have served them well through history. But the current moment could call for talent with exposure to different industries and practices. (For the same reason, ceding more control to younger, next-generation family members with new perspectives and skillsets, either in operating or board roles, could also be useful.)

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Even when the owners embrace nonfamily leadership, they often keep a close eye on operations and retain control of key decisions. In an environment where there are no certainties, and change occurs on a daily basis, owners will benefit from moving to a "nose in, fingers out" philosophy, where they stay informed but avoid second-guessing management. With managers' time consumed by developing contingencies to adapt to evolving future outlooks, owners should take a disciplined approach to asking questions, inquiring only to benefit the business rather than to satisfy their own curiosity or fears. After all, families should remember that they want their management team spending time on what matters.

But perhaps the biggest challenge for many multigenerational family enterprises is changing capital allocations. Even in the best of times, there are competing needs for capital. Should returns be reinvested in a core business, used to diversify, or returned to owners in the form of dividends or buyback of shares?

Because most business sectors have benefited from a strong economic environment in recent years, many owners have gotten used to a routine and increasing dividend flow, even if their management teams preach that owners should

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not rely on dividends. But when times are tough, owners may need to be the first to take a pay cut. Yes, many family owners willingly agreed to suspend dividends last spring. But as the crisis rolls on, will owners stay so accommodating? One family enterprise addressed this challenge by deferring rather than suspending distributions to owners, and planning to pay back the deferral to older family members, who count on distributions to support them in retirement, before catching up younger owners.

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Others families have struggled with the challenge of how to compensate managers at a time when they are working extremely long hours and may be putting themselves at physical risk of exposure to COVID. With profits down, many boards are advocating that discretionary bonuses should be paid to employees, reallocating capital from the owners to the business. At times like these, families' values are tested. It is one thing to say that employees come first, but another to give up a financial return to pay associates.

Finally, it is important to point out that this is not an exhaustive list of considerations. All families and businesses are different, and will have a different path forward through the current crisis. But all families can and should think carefully about what they have to contribute: to their management team, to their employees, and to their communities.

For example, family members of a hospitality business that had to furlough 75 percent of its employees contributed to an employee relief fund that is typically funded by the business itself. In this case, individual family members opened their pocket books to support employees in need.

Another popular option for families is donor-advised funds—think of an investment savings account, but for charitable causes—managed out of community foundations. Family wealth is one of the leading categories of funding within community foundations, which have reportedly raised over $1B in the U.S. to support COVID relief.

So yes, there are many paths forward through the current moment. But many successful multigenerational family businesses, with their long-term or possibly even infinite investment horizon, are recognizing that it is wise to put other stakeholders at the front of the line.