Challenge "liquidity event" – From family business to family office

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Selling the family business probably still represents one of the most difficult decisions in the life of an entrepreneur. The business has up until now not only provided for the family, but also played an essential role in regard to the education and career paths of family members as well as in keeping the family together. Entrepreneurs, respectively business families, identify themselves to a great extent with their company, and this not only in the founding generation, even though in most cases only very few family members are actually actively involved in the operational business. Important business decisions are taken during family get-togethers and the next generation is – in an ideal case early – introduced, not only to entrepreneurship itself, but also to the respective values and accustomed with family and business strategies.

Planning and preparation

If an entrepreneur decides to sell the business – be it due to a lack of candidates for succession or for conflict prevention in respect to succeeding generations, preparation and planning are equally important; not only regarding the transaction itself, which is commonly handled professionally and well prepared, but also and especially with respect to the development of new strategies on the asset management as well as the family side. In the majority of cases, family members withdraw for multiple reasons very fast from the operative business following a sale. The company, as central element of the family, no longer exists; the common shareholding, which is often pooled in the family-owned holding company, dissolves, and keeping the family together becomes a challenge in itself.

While families where the family business is sold only after several generations are usually very well aware of such changes and obstacles, entrepreneurs of the first and second generation sometimes underestimate the consequences of a sale, not only for themselves, but especially for succeeding generations.

New family strategies

While with the sale of the company, the original source of the common fortune dissolves and the topic of wealth preservation becomes eminent, the question for new growth strategies also emerges.

In addition, with the now missing common financial stronghold, family members are given, more or less overnight, the ability to act entirely independently and are therefore, often for the very first time, able to express their individuality. At such a point, family members are often torn between staying together and following their own paths. The definition of a family strategy accommodating these two diverging elements becomes critical. What is the common family goal? Should the family stay together and is investing together feasible?

Once the business is sold, it is a challenge to keep the family together purely on the basis of liquid wealth. However, at the same time, extraordinary opportunities are arising as a result of the substantial pool of assets. In addition, not only families exceeding the first generation recognize the critical role of entrepreneurship per se, but also the founders, who seek to transfer the "entrepreneurial spirit" to their children. Strategies fostering the latter have priority – be it on the basis of common strategic shareholdings, which, over the years, often amount to a substantial part of the overall family wealth, or simply by the transfer of values from the founding generation to the next.

The role of the family office

It is often the founding generation acting quite conservatively when it comes to financial investments following the sale of the family business, while next generations often adapt a higher risk profile. A healthy balance is critical, whereby the "drive" especially of the young generation, if wisely built into the overall strategic asset allocation, may not only be an advantage, but even become the new "engine" for future growth. Similar to family businesses, where expansion, respectively diversification to other industries or regions is often brought about by the transition to a next generation, thereby not only safeguarding, but enabling business growth in the first place, such a principle may be applied to investment structures as well. While the focus following a sale may well rest on wealth preservation with the core portfolios structured accordingly, growth cannot only be generated by satellite portfolios such as private equity or real estate, but also by strategic shareholdings.

The family office offers here not only the professional platform, but acts in particular as the independent strategic advisor, which is, with a growing number of family members and therefore a variety of diverse expectations and characters, not always an easy task. Mastering the challenge to define a value proposition appealing to all family members as well as to service the different risk and return profiles often proves to be complex. The obvious advantages of asset pooling, as, for instance, access to best-in-class managers, cost sharing and greater bargaining power, are often insufficient arguments for a common family office, where all family members join in as "clients".

Factors for success

There are a number of factors playing a key role for the long-term success of the family, respectively the family office, following a liquidity event, whereby a few critical aspects can be highlighted as follows:

Flexibility – The family office has to be able to adjust to investment as well as liquidity requirements of individual family members. Umbrella-fund structures are only one option to manage assets as a pool, while at the same time safeguarding individual risk and return profiles. In addition, family members need to be given possibilities for exit and liquidation.

Ownership structures – While a family office in the first generation usually operates under a direct reporting line to the entrepreneur himself or herself, respectively the family, families already several generations ahead decide more and more in favor of partnership models, addressing therewith, at the same time, the important question of motivation and performance. In addition, conflict potentials on the family side arising due to unequal ownership structures may thereby be reduced, and family members as family office "clients" gain a professional strategic partner at their side.

Discretion – Clear information barriers for individual family members are essential, especially following the sale of the family business. Was the company so far in the hands of and led by a single entrepreneur or a few family members, such control, which is especially strong in relation to the directly succeeding generation and often transcends onto the investment side, is difficult to give up. The preservation of the overall wealth therefore requires first and foremost discretion, as family members will always have a tendency to invest independently in order to avoid such control.

Family office and entrepreneurship

Families constantly developing over generations are also those, who successfully transfer entrepreneurship and therefore the values and the spirit of the founders from generation to generation – even though the exit from the original family business may have already taken place a long time ago. Families in several generations are often not only known by their former businesses, but rather by a variety of activities – philanthropy being just one such example.

The family office itself plays a particular role hereby, which in most cases reaches beyond classical asset management. Accordingly, it is often the family office which is responsible for the management of the strategic portfolio, including multiple shareholdings. This is the entrepreneurial aspect, the "entrepreneurial spirit" per se, which is recognized as being essential and is safeguarded for more than simply the generation of returns. In this way, a number of family offices are also responsible for the selection, coordination and execution of private-equity projects of the next generation, thereby not only fostering future entrepreneurship, but also "growth engines" for the family wealth.

Also so-called "next-generation funds" are set up by family offices and are growing in importance. These are in many cases structured as sub-funds to the already mentioned umbrella funds and are managed under separate investment committees composed of members of the next generation.

Equality in representation and shareholdings for individual family branches, clear investment guidelines and selection criteria for young family members as well as asset managers are deciding factors for success. While in earlier years there had been a tendency to foster competition amongst the young generation, today keeping the family together has priority. This way, the next generation is not only educated in financial matters, but further learns how to handle responsibility as well as to take decisions as a family. At this point, in an ideal case, the circle closes itself again with the return and continuity of entrepreneurship.

Selling the family business is an exciting time, resulting in plenty of changes for the entrepreneur and the family, but also sometimes triggering a number of conflicts within the family. In order to master this life-changing event successfully, not only good planning is required, but especially strong family strategies as well. The latter pave the way for future generations enabling the long-term success as a family or a "dynasty".

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