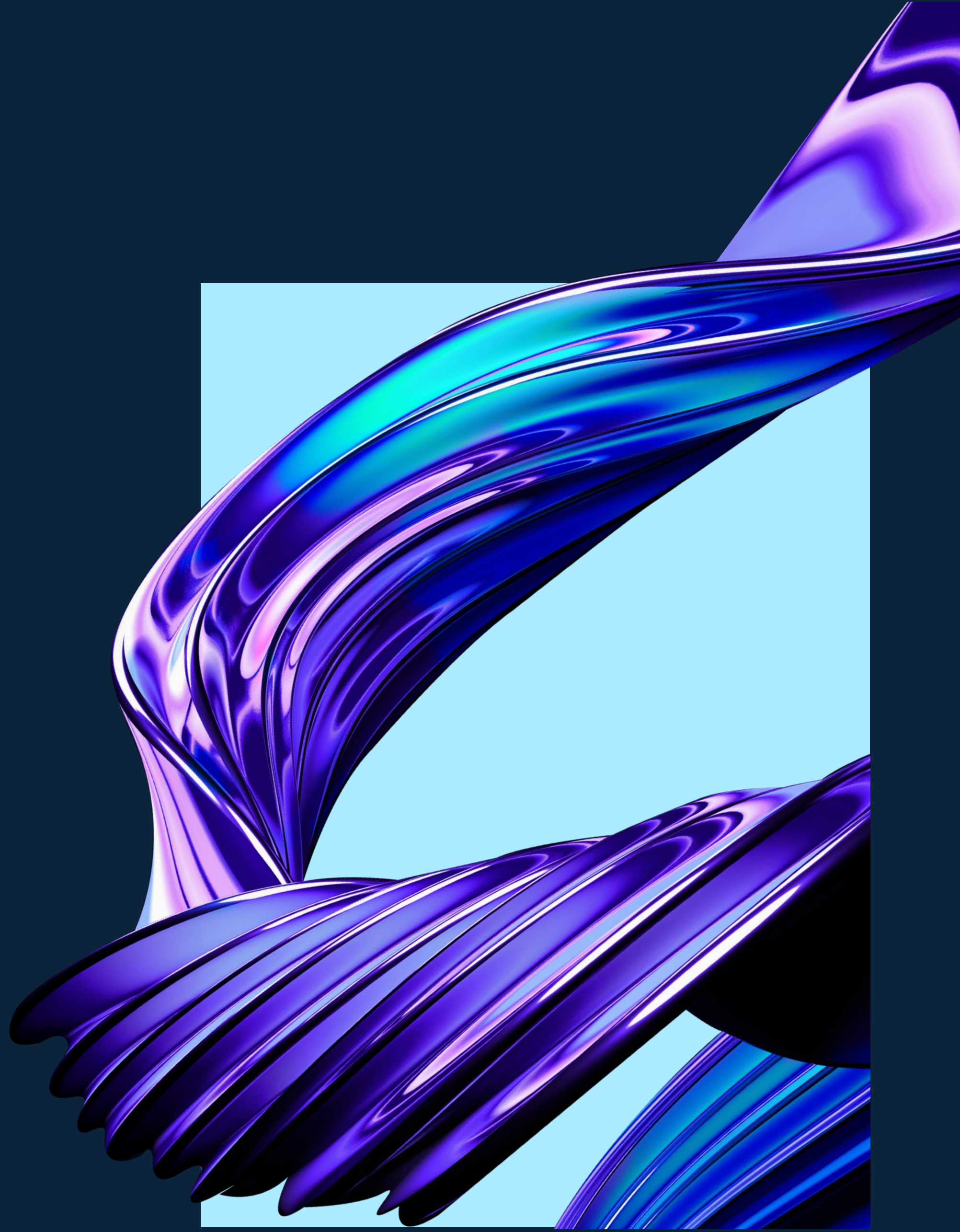
KPMG Private Enterprise

Redefining wealth in business families

The diversification of the family's financial, human and social capital



KPMG International

kpmg.com/privateenterprise

Foreword

Many business families are facing a new reality from a wealth creation and capital allocation perspective. After a lifetime of having the family wealth almost entirely bound up in their business, the need to de-risk and diversify their wealth is becoming apparent. And it is a key driver for families that are seeking more independent wealth — especially tech savvy next-generation family members who are eager to set out on their own entrepreneurial journeys.

Families in business are well known for their patient capital strategies with their focus on long-term value creation, not the continuous hunt for short-term results. The very concept of 'capital' and how it is allocated is evolving, and the idea of patient capital is becoming more expansive and inclusive. Not only does it embody the use of the tangible financial assets of the business, but it now also embraces the less tangible sources of social and human capital that are typically reflected in the family's purpose and values.

The 2021 STEP Project Global Consortium and KPMG Private Enterprise report "Mastering a Comeback", described how family businesses applied a long-term, patient capital approach to protect their businesses during the pandemic.

They recognized that their financial assets alone could not address the full impact of the pandemic on their employees, customers and local communities, and so they deployed their social and human capital assets as well to support all of their important stakeholders.

This was "asset allocation" in its broadest possible sense.

This more inclusive **financial + social + human capital** asset allocation approach has become even more pertinent in today's environment. With high inflation and escalating interest rates, there are heightened concerns about the widening gap between the rich and the poor, the potential for social breakdowns and the importance of building links in communities to fortify the cohesiveness of society.

Many of these issues are also directly linked with the global sustainability agenda, and they have caused many family businesses to take a step back and consider what the definition of success may look like for their families and their businesses in the future.

Is it time for a wealth refresh?

Communities are important stakeholders in the family business eco-system, and the impact of the pandemic on people and the planet have made the need for strong human and social capital even more pertinent. It has encouraged many business families to rethink how they are defining their wealth, and what it means to create wealth — as a business, a family and an individual — by looking at the growth and value of the family's human and social capital as well as its financial assets.

“When we look back at previous generations, it could be argued that the primary focus was generally on creating wealth for wealth’s sake. But current next-generation family members are changing that, and dialing up the human and social elements. It’s still about creating wealth, but now more questions are being asked about, ‘how can we use this wealth to improve society?’ and less about ‘what we can do to just keep building it’.”

Tom McGinness
Global Leader, Family Business,
KPMG Private Enterprise,
KPMG International, and
Partner, KPMG in the UK

This process is referred to as a ‘wealth refresh’ and it underscores the importance of the family itself as one of the greatest and most differentiating assets of family businesses. Family cohesiveness, unity, loyalty and the development and deployment of next-generation talent are intangible, human capital assets — all of which contribute to the socioemotional wealth that results from being a family in business.

KPMG Private Enterprise wanted to hear directly from family business leaders about the meaning of wealth in their families and companies, and how they are growing and preserving it by strategically allocating all of their tangible and intangible business and family assets. Entrepreneurs and family business leaders across the world were invited — as well as academics and family business advisers — to join roundtable discussions and share their experiences.

KPMG Private Enterprise is pleased to have this opportunity to highlight their insights and guidance on asset allocation under a more inclusive, new era definition of business family capital.

Contents

Protecting the family's financial assets

Shortly after the world faced the initial disruptions brought on by COVID-19, many family businesses pulled their families together. Some pooled their financial resources to sustain and strengthen their current business operations and protect the family legacy. Others prioritized their employees and local communities to help reduce some of the strain on their lives and families.

Now, with the most recent economic headwinds — especially inflation and increasing interest rates — financial capital strategies in many family businesses are being driven by the need to de-risk the family's wealth. There is a global view of uncertainty, with no certainty as to where to invest. With double-digit inflation, holding cash is pointless, so where can business families invest their financial assets for an inflation-protected return?

With higher interest rates, should the business refinance its debt using green funds — assuming it can demonstrate an effective ESG strategy?

In the event of an over-dependence on one sector or business, might it make sense to acquire companies outside the legacy business to generate an alternative profit return?

Is there an opportunity to pursue co-investments with other family offices?

Could supporting the startup community (including the next generation of budding entrepreneurs in the family) be a smart diversification strategy, not only in creating new businesses that will help to grow the local economy, but in supporting the ambitions of the business family as well?

In this environment, families in business are thinking increasingly about the actions they may need to take in order to continue to build and pass on their multi-generational wealth. In some cases, after a lifetime or more of having the family wealth bound up in the business, some current leaders are recognizing that upcoming generations may not have an interest in the legacy business. In fact, many are seeking ways to create their own independent wealth, and this is a financial diversification strategy in its own right. This is important for the current generation to recognize, and there should be adequate governance in place to help ensure that it does not accelerate potential financial losses.

In some cases, this is resulting in a shift away from reinvesting most of the company's profits in the business and ensuring instead that there are sufficient dividends to support the independent wealth creation opportunities that may be motivating various family members.

Some are considering the potential for providing seed funding for next-generation new business ventures, for example, or spinning off the legacy business into a new digital business that can be led by younger, tech-savvy family members. This requires a good governance mechanism such as family investment committees to help manage the allocation of the family's capital and manage its risk, while striving to ensure that the younger generation family members are capable of — and interested in — participating in the family's growth strategy. There are many examples of companies that have established funds that family members can access in order to pursue their own interests and entrepreneurial dreams.

While many business families are paying close attention to steps such as these to preserve and grow their financial capital, there is an increasing focus on two additional capital assets that are critically important — namely, their human and social capital.

A new era of capital allocation — leveraging human capital

Under the broader definition of 'capital', human capital encompasses the knowledge, skills, experience and social qualities of family members and employees and their ability to generate value.

The family itself is one of the largest and most influential human capital assets because it represents the socioemotional wealth that is associated with being part of a family…in business. It also contributes directly to the preservation of the family's entrepreneurial spirit and the founder's legacy. Making a conscious effort to transfer the invaluable knowledge, skills, experience and values of the current generation to every succeeding generation is an excellent allocation of the family's human capital, as is deploying the diverse talents and skills of the company's employees and next-generation family members in new ways.

Greek families traditionally invest in the education of their children, and family businesses invest extensively in the preparation and development of the next-generation of leaders. They encourage young family members to secure a premium education (frequently in acclaimed international universities). On top of this, family members are often socialized at a very early age to understand the nature of the business, its customers and competitors and to receive hands-on training from experienced family leaders."

Vangelis Apostolakis
Deputy Senior Partner,
KPMG Private Enterprise,
KPMG in Greece

Often these efforts to explore the interests and talents of next-generation family members include multi-generational workshops and formal family meetings to help younger family members understand how they can contribute to their company as good shareholders, governors and operators. Others have been known to implement "family rules of engagement", such as restricting family members from working in the family business for at least four years following their graduation from university and opportunities to gain experience in another company, industry or market. The purpose of such a rule is to provide younger family members with enough time to learn from others and to get to know themselves, their own sense of purpose and how they may be able to contribute to the future of the business.

"Even if it isn't formalized, there is likely natural family governance that is woven into the decisions that next-generation family members make. Developing formal processes for how multi-generations work together is particularly important as families grow and become more complex. Formalizing these processes further solidifies transparency and accountability for families and key stakeholders."

Jonathan Mayer
Tax Partner,
KPMG Private Enterprise,
KPMG in the US

The diversification of human capital assets

As Millennial and GenZ family members enter the workforce, it's possible that the family business may not always be the right fit. However, it is still possible to pass along the entrepreneurial spirit of the family to each successive generation, without necessarily transferring the control and management of the business along with it.

It isn't necessary to "handcuff" family members to the business. It's important to tap into everyone's insights, but forcing family members into the business is a recipe for disappointment. It definitely isn't a good way to make sure the business and the family are able to keep growing."

Luiz Gustavo Kass Mwosa
CEO,
Grupo Paranoá,
Brazil

Family members whose skill sets may not be aligned with the family business can contribute in other ways as well, by drawing attention to relevant social impact issues that are important to them and, potentially, to the family business.

There is more than enough potential for continuing to grow the family's human capital as well by encouraging next-generation innovations and enabling family members to become entrepreneurs in their own right. This can be a highly effective way of leveraging the family's financial capital while also growing its human capital by funding next-generation innovations and new ventures.

“Culture is what determines the success of our family business. It is the basis of our operations from generation to generation and well into the future. How we create that culture is better than creating wealth through any family investment strategy. That changes over time. But if you focus on building the right culture around you, that for me is more sustainable.

My children have built very successful careers outside our family business. When they were young, they worked in our company from the ground up, and that helped them to build a strong work ethic. Now, they have the luxury of building new capabilities outside our family business, but they still have a voice in how we are allocating all the different types of our family's capital.”

Owen Curtin
Partner, Odasa Investments, Ireland

Expanding the capabilities of the family's human capital in this and other ways can become a critical success factor for multi-generational business families. If they aren't working inside the business, upcoming generations can continue to add value as potential sounding boards, as Board members in companies in which the family business invests or as bellwethers on emerging social and environmental opportunities that the family and the business can address.

Diversifying the family's skills and experience

In many multi-generational family businesses, decision-making is still in the hands of the current generation, though that situation is beginning to shift. The upcoming generation is typically well educated, has had early exposure to the world, is comfortable with technology and is ready to gain decision-making rights.

To diversify and leverage the totality of the family's human capital, it's important for current-generation leaders to recognize the leadership abilities and competencies of their upcoming family members and to begin carefully delegating decisions — especially as they relate to environmental, social and governance (ESG) opportunities and new technologies. Millennial and GenZ generations, in particular, are keen to embrace both of these opportunities. They understand the potential, they're energized by it and they have a great deal to contribute.

On the flip side, the suggestion to next-generation family members is that they should take the time to learn from the current generation and gain an understanding of their long-term goals and concerns. By finding ways to engage with them in a meaningful and respectful way, the younger generations can not only benefit from their wisdom and experience, but they can also show their leadership capabilities by initiating the first steps in building a transitional generational bridge for continuing to grow the family's human capital.

Multiple perspectives and objective viewpoints are essential for discussing mid-to long-term strategic directions in business families. Family constitutions and other family governance mechanisms such as Family Councils and Next-Generation Committees have shown to be effective in fostering engagement across the generations.

Brand and reputation — powerful social capital assets

Large, publicly prominent family businesses have always taken great care to maintain a positive profile with their key stakeholders, including relevant tax authorities in many cases.

In general, families prefer not to be known by local residents and the community as 'that company's priority is its own financial success'. Family-owned companies understand they have a social responsibility and a public presence, so managing their reputational risk is a priority."

Makoto Otani
KPMG Private Enterprise Leader,
KPMG in Japan

For example, as good corporate citizens, business families would never take advantage of emerging tax opportunities if their actions could be construed as inappropriate or questionable in the eyes of their customers, employees or community members. They aren't willing to risk the impact that such actions may have on their reputation and the potential damage to the trust in their brand if people began to view their family and company in a different — and potentially negative — light.

ESG — The great integrator

It is widely expected that every aspect of ESG will be regulated within the next 5 years, and customers will vote with their feet if businesses are not compliant. Business families were making significant philanthropic contributions to environmental and social issues and supporting their communities well before the ESG agenda became a global priority.

Making money and having a positive impact on the world are not mutually exclusive. In fact, many long-term financial, social and human capital investment strategies are strongly related to environmental, social and governance issues — all of which are also important factors in the reputation of businesses and their families.

As good corporate citizens, they now have an opportunity to achieve an above-average rate of return on all their long-term investments by integrating their philanthropic and business activities in an overall review of how they are allocating their financial, social and human capital.

"We see ESG, as a practical concept, as reputational. ESG as presently presented by some companies is mere "greenwashing." ESG to be functionally valuable needs rigorous and fact-based metrics and standards. We don't just think about doing the right thing, but what is also the admirable and thoughtful thing to do. We also want to measure and hold ourselves accountable for doing better by talking openly about it and its true targets with our employees, and in having everyone in management, the board and ownership focused on doing what's right for our stakeholders from owners to our communities.

At the end of the day, we can afford to lose money in our company, but we can never afford to lose a shred of our reputation."

Ed Weisiger, Jr.
President and CEO,
Carolina Tractor & Equipment Co.,
United States

Now, with the increasing impetus for companies to advance their progress on ESG issues, family businesses that are 'doing the right thing' are increasingly pursuing B Corp certification. It's one more way to fortify their reputations and to differentiate themselves as the preferred employer of high-performing talent and the company of choice for customers. It can also expand their access to financial capital — especially green capital. While preferential interest rates are becoming increasingly difficult to secure, green capital tends to favor businesses that have a very clear ESG strategy, which can make a very big difference in the credit levels that are offered to companies by the green banks.

Most family businesses in Spain are less willing to invest in businesses that are not fully committed to ESG principles. Some family businesses are taking a big step forward by applying for B Corp status, which is not only a potential differentiator in terms of the retention and recruitment of skilled human capital, but it improves their access to financial capital as well."

Ignacio Martinez
Partner, Deal Advisory — Corporate Finance,
KPMG Private Enterprise,
KPMG in Spain

Adopting a world view of strategic assets

After a lifetime or more of having the family wealth bound up in the business, many current company leaders are recognizing that not all of their next-generation family members will work in the business. And there are increasing concerns regarding the succession of the business among business families.

> **The number of children in many business families is decreasing. As each generation gets older, they are less and less interested in succeeding in the family business. As a result, these families are looking at opportunities for selling the family business to other families or to larger organizations. This is becoming an increasingly important concern for many business families who are faced with resolving the management and distribution of their shared wealth when the business is no longer in their hands."**
>
> **Akihiro Okumura**
> Emeritus Professor — Keio University
> Chair of Family Business, Japan

This suggests that future generations will likely define their wealth in entirely new ways both inside and outside the business family as they continue to deploy the family's financial, human and social capital in progressing the world's sustainability agenda.

This doesn't mean that family members who are not in the business will disengage from the business. The family is the glue that binds, and family members will continue to care about the legacy they've inherited and how all of its assets are being allocated.

In this sustainability-focused environment, it is expected that the next generation will be the pivot point in redefining the meaning of wealth and how to create and grow it in family businesses. They have a different value set and recognize the power of human and social capital as well as the family's financial assets, including, but not limited to:

Looking ahead at the many dynamic changes that are taking place across the world, it is the view of KPMG Private Enterprise professionals that family businesses have an opportunity to change the lens on the definition of wealth and to achieve the highest possible returns on their financial, human and social capital investments.

Here are a few thought-starters and questions to consider as you begin to look at capital through a wider lens.

Is your business fit for the future?

Is the legacy business still relevant to the next-generation and the future-generations? If not, where does the family want to go next?

Asset reallocation is rarely a one-generation decision.

How does your family currently value its assets?

How are the various generations of your family involved in important discussions and decisions about the family's wealth?

Can (and should) next-generation family members outside the family business have a voice on business strategies and capital allocation decisions?

In the last 3 years, have you re-examined your business and investment portfolio?

What decisions have you taken to focus on the assets with the highest growth and impact potential?

What was the rationale for your choices, and are they still relevant?

How has the current generation's attitude towards potential diversification evolved over the past few years, if at all?

With the input of the next generation, does the family have an appetite for redirecting the family's assets to meet the aspirations of the next/younger generations?

How might you implement, manage and oversee your family's investment strategy if wealth is being created outside the family business?

How do you measure the return on investments in relation to your definition of success?

Are both financial and non-financial success factors, including ESG, measured? And if so, how?

How might you implement appropriate governance mechanisms to manage and oversee your family's investment strategy if wealth is being created outside the family business?

We welcome your feedback and perspectives on how you define wealth in your business and your family, and how you are balancing the allocation of your financial, human and social capital today. Contact us any time at familybusiness@kpmg.com

"Redefining Wealth" is the third of this article series on "Pushing Boundaries: Why family businesses are the drivers of change".

If you missed the first two articles you can find them here: "Sustaining a culture of continuous transformation in family business" and "Good for business, good for the world".

Interested in learning more about how KPMG Private Enterprise can help your family business? Contact your KPMG Private Enterprise adviser or find a KPMG Private Enterprise Family Business adviser.

Acknowledgements

KPMG Private Enterprise sincerely thanks the family business leaders and academics who generously gave their time to share their views and outlook for the opportunities to redefine wealth in family businesses.

Family business leaders

Owen Curtin
Partner, Odasa Investments
Ireland

Luiz Gustavo Kass Mwosa
CEO, Grupo Paranoá
Brazil

Akihiro Okumura
Emeritus Professor, Keio University
Chair of Family Business
Japan

Ed Weisiger, Jr.
President & CEO, Carolina Tractor & Equipment Co.
United States

KPMG Private Enterprise member firms

Thank you to the KPMG Private Enterprise member firms that contributed to the development of this article and shared their insights in roundtable discussions.

Canada

Mike Baxter
Senior Manager,
KPMG Private Enterprise,
KPMG in Canada

Greece

Vangelis Apostolakis
Deputy Senior Partner,
KPMG Private Enterprise,
KPMG in Greece

Japan

Makoto Otani
KPMG Private Enterprise Leader,
KPMG in Japan

South Africa

Alan Barr
National KPMG Private Enterprise Leader,
Partner,
KPMG in South Africa

Spain

Ignacio Martinez
Partner,
Deal Advisory — Corporate Finance,
KPMG Private Enterprise,
KPMG in Spain

United Kingdom

Tom McGinness
Global Leader,
Family Business,
KPMG Private Enterprise,
Partner,
KPMG in the UK

Giles Taylor
Partner,
KPMG Private Enterprise,
KPMG in the UK

United States

Jonathan Mayer
Tax Partner,
KPMG Private Enterprise,
KPMG in the US

About the KPMG Private Enterprise Center of Excellence for Family Business

As with your family, your business doesn't stand still — it evolves. Family businesses are unique and KPMG Private Enterprise family business advisers understand the dynamics of a successful family business and work with you to provide tailored advice and experienced guidance to help you succeed.

To support the unique needs of family businesses, KPMG Private Enterprise professionals coordinate with KPMG firms from around the world that are dedicated to offering relevant information and advice to family-owned companies. KPMG Private Enterprise professionals understand that the nature of a family business is inherently different from a non-family business and requires an approach that considers the family component.

Visit: kpmg.com/familybusiness

About KPMG Private Enterprise

Passion, it's what drives entrepreneurs, it's also what inspires KPMG Private Enterprise advisers to help you maximize success. You know KPMG, but you might not know KPMG Private Enterprise. KPMG Private Enterprise advisers in KPMG firms around the world are dedicated to working with you and your business, no matter where you are in your growth journey — whether you're looking to reach new heights, embrace technology, plan for an exit, or manage the transition of wealth or your business to the next generation. Working with KPMG Private Enterprise, you'll gain access to a trusted adviser — a single point of contact who shares your entrepreneurial mindset. Access to KPMG's global resources and alliance network, can help you drive your business forward and meet your goals. Your success is KPMG Private Enterprise's legacy.

Visit: kpmg.com/privateenterprise

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/privateenterprise

kpmg.com

Designed by Evalueserve.
Publication name: Redefining wealth in business families
Publication number: 138515-G
Publication date: December 2022