CAMBRIDGE
FAMILY ENTERPRISE GROUP®

GENERATE ™
THE NEXT

Cash is King, but Value Creation is a Family's Long-term Goal – Even During a Crisis

Marius A. Holzer
Senior Advisor and Associate Partner, CFEG;
Partner, Parkview Group

Mario Marconi
Former Senior Advisor and Associate Partner, CFEG

The real risk in an economic slump is a family losing great value due to lack of liquidity to make it through the difficult times. Only those business owners and investors that have the patience, steady plans, and adequate liquidity–or access to liquidity–to ride out the downturn earn the upside of a recovery.

At this still early stage of the Covid-19 pandemic and economic crisis, visibility about the future is limited, and we are only slowly discovering the enormity of the health, societal, and economic ramifications of this disruption. Regardless of the limited visibility, families still need to make key decisions during the crisis: both *short-term decisions* about the financing of their companies and families, and also some *longer-term decisions* about their future investments.

To make these decisions prudently, family business owners need to understand their short-term financing options and also analyze the sustainability of their total portfolio, businesses, and other investments.

The real risk of monumental economic slumps–like the 2008 global financial crisis and the recession caused by the Covid-19 pandemic–is losing great value due to lack of liquidity to make it through the difficult times. For most enterprising families, the pandemic-induced economic impact is an agonizing reminder of how important *liquidity* and careful *cash flow management* are. Only those business owners and investors that have the patience, steady plans, and adequate liquidity–or access to liquidity–to ride out the downturn earn the upside of a recovery. As we saw in the 2008 Great Recession, the prepared family with liquidity at hand will turn the crisis into an opportunity, picking up strategic assets at pennies on the dollar. If you are forced to liquidate investments or sell businesses to stay solvent because you have run out of cash, you will inevitably destroy considerable wealth. It may be worth the sacrifice to sell useful assets in order to stay financially alive now–but there is much to be learned from the lessons of a crisis so a family is better prepared for the next one..

> **Decisions made during a crisis will materially affect a family's long-term fortune.**

5 Reasons Why Families are Vulnerable to Illiquidity

Families and their enterprises can be vulnerable to the risk of illiquidity for several reasons:

Family Wealth tends to be concentrated in the family business, to which an owning family is loyal and protective. Such loyalty encourages families to think of their company as an institution to be maintained, rather than as an investment to grow value. When businesses don't produce good returns, or even have losses, families often stay loyal to them, not only tying up their capital, but often injecting more capital to keep them afloat. This is generally smart if the company is a good investment and the family has the liquidity to invest. Smart families accumulate large cash reserves for opportunities and downturns.

Given their debt-averse nature and their desire to have complete ownership control of their companies, *families generally carry limited debt and credit lines, and have no access to, or even much knowledge of, capital markets.* This orientation can limit the family company when liquidity is needed at short notice, or when a great deal of liquidity is required to sustain a business, as it is now.

Other investments by the family are typically in what the family knows and likes, and usually in sectoral and geographic vicinity of the main asset. *Enterprising families are generally not strategically diversified, don't have sources other than their business for liquidity, and haven't planned for when liquidity will be in short supply.*

The investment process by families tends to be less structured, with investments made in what they know, heavily influenced by subjective views of family members, friends and other advisors. A systematic look at a family's total portfolio (even in a crisis) will generally produce a number of ways to reduce costs and generate higher returns.

Families in emerging markets are particularly exposed to quickly declining economies. As developed markets are heavily supported by unprecedented fiscal and monetary measures, *the governments of emerging countries have limited abilities to buffer their economies.* While it was enticing to borrow in foreign hard currency at record-low rates during the recent boom years, those loans boomerang back as they balloon due to weakening local currency.

> **Sitting still in a severe economic crisis is the wrong strategy for most families, even if liquidity allows it.**

How to Bolster Family Liquidity in a Crisis

Given the more concentrated exposure of enterprising families, sitting still in a severe economic crisis is the wrong strategy for most families, even if liquidity allows it. In these conditions, some businesses will default and cease to exist, and the value of most investments will change.

There are several actions families can take as they seek access to liquidity during an economic crisis:

Families need to systematically **assess their total portfolio** of businesses and other investments, and **understand their short, medium, and long-term liquidity needs and options.** Which socio-economic changes are temporary, and which are permanent? What expenses can be stopped or delayed? Which assets can be liquidated at fair values without increasing overall portfolio risk? Family values, mission and objectives will guide the decision process.

Once detailed cash flow requirements and strategic priorities are known on an aggregate basis, cash inflows can be matched to these requirements, **existing sources of liquidity can be identified, and financing gaps can be closed.**

Reviewing and negotiating **options for external sources of capital** is essential, as it may prevent the liquidation of otherwise healthy assets at depressed prices. Given the reluctance of traditional sources of debt (banks) and the time and cost required to access capital markets, **alternative financing paths need to be considered,** such as optimizing working capital (accelerating/factoring receivables, delaying liabilities), unlocking long-term capital (e.g. sale-lease-back of fixed assets), or negotiating credit lines with clients and suppliers.

It may be necessary to **close or divest businesses with dim outlooks.**

As a benefit of these moves, liabilities and overall risks for the family may be reduced and capital released for more promising projects. Decisions made during this process likely materially affect a family's fortune.

Prepare for the Next Crisis

Once a family overcomes short-term obstacles from a crisis, it is vital to integrate their learned lessons into their portfolio and governance system to better prepare for the next crisis.

A portfolio of businesses and investments that does not succumb to the five vulnerabilities described above is essential to weathering the next crisis with adequate liquidity. Scenario plan for when liquidity will be depleted. Strategically diversify. Build large cash reserves. Get acquainted with capital markets and alternative sources of capital to have liquidity sources outside of your businesses. Divest assets that no longer build value for the family, no matter its emotional ties.

Adjustments in governance, investment policies, and general risk management are also typically required. A structured investment process that assesses the family's total portfolio and its changing needs is important. As with most tough situations, a trusted advisor can play a helpful role throughout the course of assessing, working out options, re-positioning, negotiating and implementing. Independent advisors have objective judgement and can help overcome limiting viewpoints and attachment to outmoded traditions and unproductive assets that may have built up over time.

Since the future is going to be volatile, it is key to keep one eye on the long-term horizon even in this short-term oriented crisis phase. As we know from elsewhere in life, prevention is better than a cure.

About the Authors

Marius A. Holzer
Senior Advisor and Associate Partner, CFEG;
Partner, Parkview Group;
mholzer@CFEG.com

A multi-faceted career of nearly 30 years in the wealth management industry provided Marius with a wealth of cross-functional experiences and professional knowledge. Since 2011 he dedicated his exclusive focus on providing families and their family offices with support and control they need to manage their wealth and achieve their objectives. Marius is a trained economist and certified expert in information technology with an MBA from INSEAD. He is both, a CFA and CAIA charter holder and earned a certificate in Advanced Risk and Investment Management at Yale School of Management/EDHEC.

Mario Marconi
Former Senior Advisor and Associate Partner, CFEG

It is with great sadness that we say farewell to our dear friend and colleague, Mario Marconi, who passed away after a short illness in August 2022.

Mario was a senior advisor and partner at CFEG, based in Switzerland. He was an expert on family office design and management, trusts and wealth structures, impact investing and family philanthropy, and long-term wealth regeneration. With a background in wealth management, investment banking, and sustainable philanthropy, his focus was advising enterprising families globally on their financial strategies, be it for their private wealth or business needs.

About Cambridge Family Enterprise Group

Cambridge Family Enterprise Group (CFEG) is a global advisory, education, and research organization that serves family enterprises with growth aspirations—enabling them to flourish across generations. As a go-to trusted partner for the world's enterprising families, CFEG offers a wide range of services to navigate changing times, build pathways for continued growth, and achieve lasting success. Its pioneering thought leadership, strategies, and programs are used by families, family businesses, and family offices worldwide. Since its founding in 1989 by Professor John Davis, CFEG has advised and educated thousands of families from more than 70 countries.