SOMERSET CAPITAL

Ownership Objectives & Shareholder Alignment for Private Companies

Ownership Objectives & Shareholder Alignment

When Alice asked the Cheshire cat "which way I ought go from here?" the cat wisely replied, "That depends a good deal on where you want to get to". "I don't much care where" said Alice. "Then it doesn't matter which way you go" said the Cat. (Alice in Wonderland by Lewis Carroll)

When it comes to managing a business most private business owners and senior managers are very good at determining where they want to go and how to run their business. The use of KPI's, balanced scorecard measures, SMART goals, strategic targets etc are widespread. By having clear objectives a business is more able to align its strategy, organisation, people and systems and direct effort towards the achievement of these goals.

At the same time and by contrast, many business owners are unclear about their objectives regarding their ownership / shareholding. Perhaps they know their ownership objectives but communicate them poorly. Boards and managers of private companies are often unaware of the owner's objectives or that different shareholders have different preferences. Sometimes they are aware of the differences but there is no process to resolve them.

There are many possible reasons for this. When companies are founded, the objectives of the owners are typically clear and consistent. For companies with multiple owners it is usually the case that the owners begin with similar objectives and are primarily focused on building the business. But over time as circumstances change so too can the owners objectives. The changes are often not related to the business and are more personal in nature: stage of life, wealth, inheritance, preference for risk, death and divorce. Often owners are so busy managing operational matters that they have no time to look at the big picture.

When ownership objectives are unclear, the business and its senior managers are left to their own devices on critical matters. This can result in a disconnect between the way the business is run and what is in the best interests of the owners. Usually it is presumed by the Board or senior managers that existing ownership of the business will continue in perpetuity. Sometimes this is the case, but more often it is not. It is therefore an important step for Boards and owners to clarify the owner's objectives and communicate them, as appropriate, with the other owners and senior management.

Some examples below demonstrate the dilemma Boards and senior managers may face when there are different objectives between owners or when certain assumptions are made about the owner's objectives that are not accurate. They also demonstrate the importance of having clear and realistic ownership objectives and ensuring the business is managed in a manner that is aligned with those objectives.

- Owner 1 views the business as a career option for his children and grandchildren while Owner 2 wishes to sell the business within 3 years to fund her retirement.
- Owner 1 wishes to invest capital in the business to grow it and sell within 5 years but Owner 2 wishes to hold the business for 15 years extracting large dividends.
- Owner 1 works long hours in the business, is dependent on a salary, and wishes to own the business for the long term while Owner 2 lives at the beach house, plays lots of golf and is becoming increasingly disconnected from the business.
- Owner 1's ownership of the business is her most significant asset and she prefers to target cautious growth. Owner 2's ownership is a small part of his net worth and he prefers to take higher risks in pursuing growth.

- Owner 1 is elderly and depends on the consistency of the annual dividend while Owner 2 has other sources of income and prefers to invest free cash flow to grow the business.
- A sole owner has worked hard for 25 years to grow a business and educate the children. Having recently bought a beach house the owner wishes to “slow down and smell the roses” and significantly reduce time spent in the business.
- Four partners in a professional services firm wish to grow the business. Another two are more interested in practising their profession and looking after their existing clients.
- Four siblings inherit shares in a business. One goes through a divorce and wishes to sell his interest to help buy a new home. The other three prefer to continue owning the business but don’t have sufficient cash to buy out the other.
- Four siblings and their mother inherit shares in the business following the death of their father / husband who founded the business. Two siblings work in the business and wish to retain it, the others would prefer to sell to pay off their mortgage and cover the school fees.

These are real situations that reveal why ownership objectives are pivotal to how a business should be managed.

Somerset Capital’s core purpose is to help business owners and sophisticated investors achieve their business ownership objectives. Combining many years of experience, Somerset Capital has developed a proprietary process to assist in identifying the needs of its clients and help form the basis for more effective and innovative solutions. The process applies to businesses with either single or multiple owners. It focuses on understanding ownership objectives across six areas and where appropriate to determine the level of alignment between shareholders. The six areas of Somerset Capital’s shareholder alignment index are:

- Ownership Timeframe
- Financial Return
- Growth and Strategy
- Funding Growth
- Succession and Governance
- People

If you are interested in a general discussion to learn more about Somerset Capital’s process and explore how it might be of value to you, please contact us on (03) 9654 5080 or andrew@somersetcapital.com.au .

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