



FAMILY BUSINESS

newsletter

Frankel Building Group: Delivering Experiences Through Custom Homes

One Family. One Dream.

By Faith Ideh

After the recession in the 1980s, Jim Frankel took the leap and started Frankel Building Group in 1988. Initially, he ran the small custom-building business by himself. Now, Jim's sons – Kevin and Scott – run the company and have transformed what was once a very small business with many moving parts into a large scale, highly successful firm, fully integrated with cutting-edge technology.

The Frankel business model has evolved into a full-service, custom design-build firm that provides a one-stop shopping experience from architecture, construction and interior design to home care, land acquisition and custom pools. Also, with more young people building homes, Frankel's clientele now consists mainly of younger people who seek out Kevin and Scott based on referrals. While the Frankels use a variety of marketing strategies, a happy customer is often how they get their next customer.

According to Jim, it's very difficult to be successful in the home building business without a unique value proposition. Frankel's unique selling point is "design-build" – the commitment to delivering not just a home but an experience to their customers – and living up to this reputation means everything. "The stakes are pretty high," Kevin said. "You have to give clients the exact experience they want, and you still have to build their house in the shortest possible time, while reducing all the perceived risks."

Although Kevin once worked in commercial real estate, and Scott in production building, neither of them thought they would work with their father. The business was small, and Jim did not have a succession plan. Jim and



Co-president and Principal Kevin Frankel, Chairman and Founder Jim Frankel and Co-president and Principal Scott Frankel lead Frankel Building Group.

his wife, Carol, are devoted to their family and observed that many parents and children cannot successfully and happily work together. "Most self-made entrepreneurs are poor delegators and don't willingly relinquish control of something they have created," Jim said. Jim's priority became to effectively delegate authority and make the transition from parent to co-workers a success.

Jim, Kevin and Scott pay attention to the value of the family relationship while constantly working to make the business successful. This is ingrained in the culture of Frankel Building Group where many employees have spent 10 or more years with the company. "I could have hired somebody and entrusted them with a big piece of what we do, but their goals and dreams might not be the same as mine," Jim said. "My sons and I have one dream. I never wonder how hard they're going to try to get something done. They are as committed as I am." "We don't spend time second guessing each other," Scott added. "We know our intent and we know we're supported. The client comes first, the company second, and everyone is OK with that."

Jim believes that to accomplish great things, family businesses must create an environment of trust where talented people can contribute. Jim is pleased with how things have turned out. "To see your children grow something you've built and be everything that you want them to be for themselves, is immensely rewarding," he said.



Managing Risk in the Family Enterprise: It's More Than Financial

By Michael Fassler and Wendy Sage-Hayward

All businesses face risk — family businesses are no exception. Generally thought to adopt a more conservative approach toward managing their business operations, family businesses are often considered more risk averse than their nonfamily counterparts. According to the Harvard Business Review's article "What You Can Learn from Family Business" they "forgo the excess returns available during good times in order to increase their odds of survival during bad times."

When it comes to managing risk, it is important to ask: How does your family dimension impact your appetite for risk? How do you manage risk tolerance differences among family members? What process do you have in place to communicate decisions that may involve greater risk in order to build alignment and understanding within key stakeholders?

To help answer these questions, we will define the types of risk family enterprises face and explore how they can take an intentional approach to identify and manage risks to their businesses. We will then examine how to measure and monitor risks as they arise. Lastly, we will share how to strengthen the communication of this process within the family enterprise so that decisions around risk are better understood and rationalized or explained.

Types of Risk in a Family Enterprise

Too often, the word "risk" evokes the feeling of danger, uncertainty and the probability of loss

without recognizing the potential upside that is inherently present with good business decisions. For our discussions, we will adopt the Chinese symbol for risk that combines two components: danger and opportunity. This definition perfectly captures both the essence of risk and the problems with focusing purely on the reduction of risk.

There are many domains in which a loss or gain (opportunity) can arise within a family business context:

- **Financial risk:** The potential for gain or loss on a financial level measured in terms of revenue, return on investment, return on equity, shareholder value, profitability, debt level, capital expenditures and free cash flow. Financial risk is the most commonly understood meaning of the term within a business context.
- **Performance risk:** The potential for increased or decreased performance of the business. Decisions include operations, production, materials and human resources. An example of performance risk is purchasing a new machine to potentially reduce production time.
- **Reputational risk:** The potential for gain or loss to the standing or status of the family and business including its name, brand and products or services. Decisions include ethics, safety, security, quality, innovation and sustainability.
- **Relationship risk:**
Nonfamily: The potential for solidifying or weakening the rapport and trust with customers, employees, suppliers and other stakeholders. Decisions include contractual, financial, procedural, communication and safety. Reputational and relationship risk are closely associated with one another. There is greater relationship risk for family businesses, for example, when making decisions about layoffs due to the loyalty and closely held relationships many family businesses establish with their nonfamily employees.
Family: The potential for strengthening or abating trust and cohesion within the family. Family relationship risk is similar to relationship risk except it focuses on family relationships and the family legacy. These decisions are not merely financially oriented because they can affect the livelihoods and quality

of life for parents, uncles, siblings, cousins and other family members.

- **Safety risk:** The potential for creating harm or increasing the protection of people as well as material goods or properties. Decisions include compliance, regulatory, training, operational and procedural.

Family Enterprise Decisions and Risk Appetite

A framework for having dialogue about risk is foundational to aligning stakeholders on risk and incorporating risk management into your family enterprise decisions. The framework starts with uncovering and articulating your family business's "risk appetite." Most likely, the risk appetite has evolved over the life of your family enterprise and always been a part of making decisions. Identifying your family enterprise's risk appetite helps formally align stakeholders around risk and more deeply imbeds risk management in the company's decision-making process. The risk appetite can be defined as the amount and type of family risk and business risk the family enterprise is willing to assume in order to achieve its strategic financial and nonfinancial objectives. What makes risk appetite statements unique for family enterprises is the influence of the family's values and vision on how risk is viewed and managed. After considering family input, the management team and board can develop a risk appetite statement that outlines the boundaries.

As an example, one of our client families values close geographic proximity of family members and views growth outside of their geographic core as a risk to family cohesion. They also value individual freedom of choice and support individual growth. In their risk management framework, they established that business growth beyond their core geography is an option for consideration if a family member chooses to live in the more distant geographic area. In order to mitigate the risk to family cohesion, the business provides an annual travel budget for that family branch's trips back home.

Measuring Risk With Quantitative and Qualitative Criteria

To make the risk appetite statement come alive and robustly incorporate it into strategic decision-making, quantitative and qualitative criteria are needed to measure risk. This information guides the board and

management on resource allocation decisions on where to deploy talent and capital. It also enables both teams to make speedier decisions and to focus on managing risk within the established boundaries.

Quantitative criteria are measurements represented by numerical indicators that are objective and verifiable such as financial ratios or customer satisfaction survey

- What will be the impact to the family’s reputation?
- What will be the impact to the company’s brand?
- How does it leverage our core competencies?
- Do we have leadership and management capacity available?

In order to manage risk, it has to be measured. This is

In order to manage risk, it has to be measured.

scores. As you think about developing quantitative criteria, consider using a threshold-target approach to their measurement. This provides a range for the criteria, with the target or better being the preferred achievement and the threshold being the minimum achievement. Once the threshold and target relationships are set, the strategic decision can be modeled.

There are many examples of quantitative criteria:

- Percentage of total equity or dollar amount of equity capital committed to the decision;
- Liquidity to maintain in the business;
- Reinvestment rate into the business;
- Reserve capital and talent remaining for other opportunities in the next three years or the next five years;
- Solvency ratio;
- Impact to earnings volatility; and
- Impact to credit rating.

In contrast, qualitative criteria are subjective and difficult to verify. But what they lack in terms of certainty, they make up for in terms of context for the stakeholders’ perceptions of risk. They play a significant role in identifying constraints as to the viability of a particular strategic decision that may not be readily apparent from only quantitative measures.

There are many examples of qualitative criteria questions:

- How does engaging in this activity support achievement of our family vision?

where both qualitative and quantitative criteria come into play. The risk appetite statement sets the boundary and when combined with qualitative and quantitative criteria, the board and management team have the guidance to make decisions that align with the family enterprise’s risk preferences.

Risk Management and Ongoing Communication Within the Broader Family

Managing risks in the family enterprise can be a tricky affair given the different personalities and many other nuances that may exist within this unique environment. Ongoing communication with all of the key stakeholders is critical to the success of the management’s ability to effectively manage risks.

There are some important tips for fostering alignment among family members around risk:

- Develop a common base level of knowledge in all key stakeholders. Invest in training and development of family, owners and management. A strong foundational knowledge about the business and its industry will provide an educated basis for decision-making.
- Ensure good data and information is available to all key stakeholders. Be transparent and open about information relating to the decision and its potential risks and opportunities. Provide timely management information to help all involved paint a clearer picture of the potential upside and downside of the decision.
- Establish useful decision-making criteria. Understand the most important criteria upon which the decision will be based. In addition, perform an assessment

using each of the types of risks defined in this article, as well as others you may face. This process will help highlight what is important to those who will be affected by the decision.

- Identify exceptions to nonalignment. Often there is consensus on many aspects of a decision or event and only a few areas of misalignment. Therefore, it is helpful to identify those areas where alignment exists and focus attention on those areas where greater agreement is required.
- Reframe nonalignment. Sometimes misalignment can become a source of tension and conflict from the feeling of “you don’t agree with me.” Name calling and other negative behavior can arise at these times. Instead, try to frame the misalignment as an opportunity to better understand priorities and interests, as well as to build cohesion between those involved.
- Help the family pull back to macro-level thinking. Sometimes risk-related decisions and conversations can take families, management and owners into the weeds where they lose sight of their vision, goals and the bigger picture. Refocus the discussion by reviewing the higher level strategic direction and priorities.

Fostering alignment around risk starts with having an agreed upon process for making decisions on strategic matters in advance of a decision at hand. It continues with a good set of discussion questions and dialogue related to the family enterprise’s future in order to develop consensus on how to integrate decisions related to what the business needs, the overall family objectives, individual family branch needs and wants, and individual needs and wants.

There are many questions to ask:

- At what rate does the business need to reinvest profits to remain competitive in our markets?
- What is the risk to our family enterprise and our family if we don’t reinvest adequately?
- What is the risk to family cohesion if we don’t grow the business further to create additional leadership and employment opportunities for family members?
- What constraints do we have that impact our commitment of capital to the family enterprise?

- To what extent do we want our investment in our family enterprise to generate personal liquidity as compared to reinvesting in the business?
- Do we prefer one focused business or more of a diversified business?
- To what extent do individual family members identify themselves with the business?

When Sufficient Alignment Cannot Be Achieved

Sometimes a family cannot achieve sufficient alignment on strategic choices and their accompanying risk. In these cases you might want to try several strategies:

- Reduce your family enterprise’s share of the risk by aligning with another group through a joint venture.
- Bring another family enterprise or other equity partner into the mix on the opportunity.
- Segment the opportunity and fund it with capital from those family members who do want to participate.
- Establish a class of capital with a more predictable and less risky return for those owners whose personal risk appetite has deviated from the group.
- At the extreme, consolidate the ownership group.

Insufficient alignment on strategic matters and related risk to capital can be managed structurally. Family relationships can be protected in the face of insufficient alignment by having structural choices, which enables the business to execute its strategy. It is having choices itself that often causes family members to be more patient with their capital.

Where to Begin?

Starting the discussion in the board room or at an owners’ meeting helps ground the family and board in the business’s realities and garners the family’s input and commitment. Involving your management team in these discussions at the appropriate time is critical to effective decision-making execution within your risk management framework. The guidance provided will deepen their engagement and be appreciated.

These initial discussions will likely feel very intangible so it will be important to develop a level of comfort with the ambiguity. The family will need to push through this phase and work towards creating version

Risk Domain	Questions
Financial	<ul style="list-style-type: none"> • What is the maximum amount of leverage we will employ as a family enterprise? • What percentage of our total equity are we willing to commit to any one investment or enterprise? • What is happening in our marketplace that will impact our reinvestment rate in order to remain competitive? • How does a continued investment in our legacy business represent our best investment alternative? • Under what scenarios would our dividend rate need to be reduced?
Performance	<ul style="list-style-type: none"> • What type of leadership and management capability do we need to manage the risk associated with our planned growth? What is our current capacity in this regard? • To what extent is our next generation leadership development program producing leaders who will assure our continuity as a family enterprise? • Are we willing to commit the capital and talent to manage the risk associated with this new investment? • If we accept this risk, what opportunities are we foregoing in the next three years? Five years? • What checkpoints do we need to ensure we have sufficient family commitment in the long term and to manage through a significant economic downturn? • What external market factors may impact our ability to generate return on equity consistent with the past? • How might our performance be affected if we make this strategic decision/investment?
Reputational	<ul style="list-style-type: none"> • Is this business venture consistent with our family enterprise values? • What stakeholders are we dependent on in this venture? How could they impact our reputation? • What cybersecurity risks do we face? What do we need to do to mitigate these risks? • Does our reputation exceed our capabilities to meet the expectations of the marketplace? • How are changes in cultural norms affecting our reputation in the marketplace? • Under what conditions would we exit from our legacy business? How would this impact our family's reputation?

1.0 of its risk management framework and plan. They can then apply version 1.0 of its plan when making strategic decisions as they move forward updating and evolving the framework to match upcoming and new realities as a key part of stewarding the family enterprise.

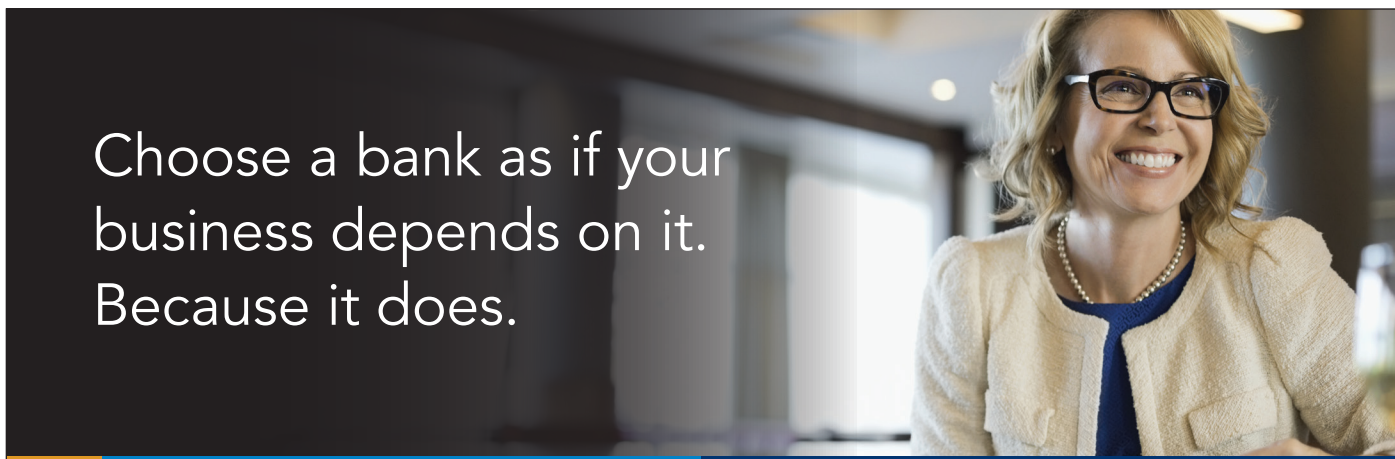
Risk Management Conversation Starter

This tool is a guide to start the risk management conversations with your family ownership group and executive team. In either a group planning session or through a survey, gather responses to these questions. Analyze the answers looking for the areas of alignment on responses and the areas where there are divergent

viewpoints. Use the results to prompt further discussion to move toward a consensus viewpoint on your family enterprise risk appetite and to begin the development of your risk management framework. Not all questions will be relevant to your family enterprise. You may also need to develop additional questions for the risk management circumstances unique to your family and business.

The Family Business Consulting Group Inc. principal consultant Michael Fassler provides family business planning services with a focus on helping his clients grow their relationships, capabilities and capital. Senior consultant Wendy Sage-Hayward is co-author of the book "Human Resources in Family Business: Maximizing the Power of Your People."

Risk Domain	Questions
Relationship	<p>Nonfamily</p> <ul style="list-style-type: none"> • To what extent is our business dependent on external stakeholder(s) in order to be able to create value and compete in the marketplace? • To what extent does our customer concentration expose our company to risk of a sudden downturn in revenue? • To what extent does our supplier concentration expose our company to risk of interruption of our ability to meet our commitments to customers? • Do we have sufficient outside influence within our governance system to ensure accountability for expected behaviors and results? <p>Family</p> <ul style="list-style-type: none"> • How are we building relationships and emotional ownership in our family to ensure continuity? • What family participation policies and protocols do we need to effectively manage the family’s interaction with the business or vice versa? • How are we investing in development of the next generation ownership group? • How do we strengthen our capacity as a family to effectively communicate, resolve conflicts and make decisions together?
Safety	<ul style="list-style-type: none"> • What safety risks do we have in our workplace? • How are we addressing these risks? • What safety training do we need in our workplace? • What resources do we require to monitor our safety program and improve it over time? • What recovery measures do we need to adequately handle a major disaster (i.e., to sustain safe operations, meet customer commitments and recover operating costs)?



Choose a bank as if your business depends on it. Because it does.

calbanktrust.com/**inyourcorner**
1-800-CALIFORNIA



©2020 Zions Bancorporation, N.A. | A division of Zions Bancorporation, N.A. Member FDIC



FAMILY BUSINESS

— newsletter —

4320 La Jolla Village Dr, Suite 250
San Diego, CA 92122

calbanktrust.com

IN THIS ISSUE:

- Frankel Building Group: Delivering Experiences Through Custom Homes
- Managing Risk in the Family Enterprise: It's More Than Financial

Articles provided by The Family Business Consulting Group, Inc. and reprinted with permission from "The Family Business Advisor" newsletter. Copyright 2019. Chicago, IL. All rights reserved.

www.thefbcg.com or 773-604-5005

The Family Business Newsletter may contain trademarks or trade names owned by parties who are not affiliated with California Bank & Trust. Use of such marks does not imply any sponsorship by or affiliation with third parties, and California Bank & Trust does not claim any ownership of or make representations about products and services offered under or associated with such marks. California Bank & Trust is a division of Zions Bancorporation, N.A.

Articles are offered for informational purposes only and should not be construed as tax, legal, financial or business advice. Please contact a professional about your specific needs.