Spring 2025

OWNER TO OWNER

BROWN BROTHERS HARRIMAN

Serving Up Five Generations of Expertise

with Community Coffee's Donna Saurage

OWNER TO OWNER

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BROWN BROTHERS HARRIMAN

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Dear clients and friends,

We hope you are feeling invigorated for what 2025 has in store. In our Capital Partners business, we remain committed to helping you achieve your definition of success for your families, businesses, and institutions, no matter your goals. That assistance could come in many forms, from investing and growing your capital, to helping you manage life's complexities, to providing advice or capital to support and grow your business. No matter your need, we stand ready to help you. We are excited to continue serving you this year and thank you for your continued partnership.

One segment on which we focus a great deal of our efforts is that of family businesses, which often face a unique set of challenges arising from the intersection of business and family dynamics. In this issue of *Owner to Owner*, the feature interview is with Donna Saurage of Community Coffee – a family business founded in 1919 that that has succeeded under five generations of family leadership. Saurage shared many helpful insights for family businesses preparing for and navigating transition, and gave us a look at her nontraditional journey to family business leadership as a nonblood relative. We hope you enjoy reading the conversation as much as we did having it.

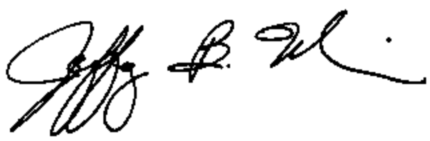
In another article, Mike McGrann of the BBH Center for Family Business sits down with Partner Kathryn George to discuss the importance of legacy. Everyone wants to leave behind a legacy, but creating and sustaining one takes work. Their discussion offers valuable insight on navigating this collaborative process.

A frequent area on which we advise private business owners across industries, as well as a discipline central to our Investment Research Group's (IRG) investment approach, is capital allocation. John Secor, head of Corporate Advisory, discusses the impact that effective capital allocation has on long-term shareholder value creation and the framework for making allocation decisions. We believe so strongly in the value of well-executed capital allocation for business owners and operators that, within IRG, identifying management teams that excel in this area is an integral component of our investment criteria.

And as always, Michael Conti, Grant Smith, and Christine Hourihan provide an overview of the economy, credit markets, and private equity and mergers and acquisitions markets.

We hope you enjoy this issue. If you have any questions about the topics covered in this edition, my colleagues and I would welcome the conversation.

Sincerely,



Michael Conti, CFA / Investment Research Group
Grant Smith / Corporate Advisory & Banking
Christy Hourihan / BBH Capital Partners Private Equity

The Business Environment QI 2025

In each issue of *Owner to Owner*, we review aspects of the business environment on three fronts:

- Overall economy
- Credit markets
- Private equity (PE) and mergers and acquisitions (M&A) markets

The following article examines the state of the economy entering 2025, with anticipated pro-business policies under the Trump administration; uncertainty around tariffs and inflation; and compelling opportunities for new deal activity and exits.

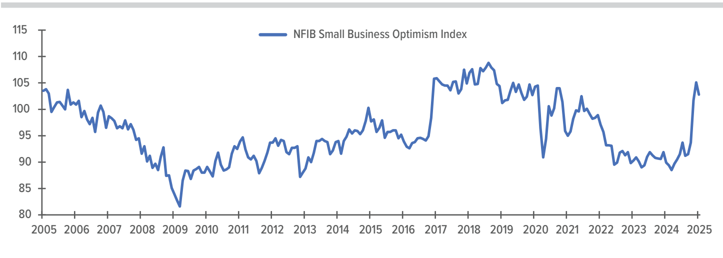
The economy

According to the second estimate by the U.S. Bureau of Economic Analysis, U.S. real gross domestic product (GDP) expanded at a quarter-over-quarter annualized rate of 2.34% in fourth quarter 2024. This marks a deceleration from the 3.1% real GDP growth recorded in third quarter 2024, reflecting a decrease in both investments and exports , both of which were partly offset by an acceleration in consumer spending.

The personal consumption expenditure component of GDP – which drives 70% of GDP over the long run – advanced 4.2%, its highest annualized growth rate since first quarter 2023, with increases in both services and goods. As of February 14, 2025, the Atlanta Fed GDPNow Index forecasts fourth quarter real GDP growth of 2.3%, reflecting strong gains in nonfarm payrolls and wage growth.

Meanwhile, small business optimism, according to the NFIB Small Business Optimism Index, fell by 2.3 points in January to 102.8. This was the third consecutive month above the 51-year average of 98 and the second-highest reading since February 2020. Expectations for economic growth, lower inflation, and positive business conditions have increased in anticipation of pro-business policies under the Trump administration. Small business optimism experienced a similar increase during President Trump's first term, where optimism remained elevated given Trump's pro-business policies, particularly the Tax Cuts and Jobs Act in 2017.

Small business optimism remains above long-term average

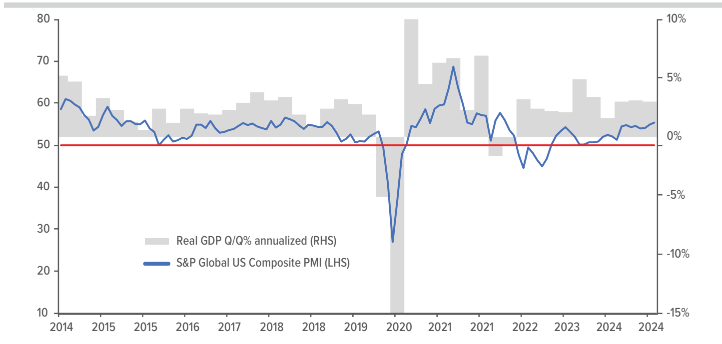


Data as of January 31, 2025.
Source: Bloomberg.
1986=100

In regard to unemployment, the U.S. unemployment rate remained at or above 4% for the ninth consecutive month. January's reading of 4.0% marks its longest streak above 4% since the beginning of 2018 (excluding the COVID-19 pandemic period). While the unemployment rates remain stubbornly above 4%, nonfarm payrolls growth continues to surprise to the upside. The economy added 143,000 nonfarm jobs in January 2025, following 307,000 jobs added in December, which was the highest monthly addition in jobs since January 2023.

From 2024 to 2026, the Federal Reserve estimates real GDP growth of 2.8% in 2024, 2.1% in 2025, and 2% in 2026, down from a 2.9% real GDP growth rate in 2023. As such, the Fed does not currently forecast a recession over the next three years. Macro data suggest the economy is expected to remain in expansion territory, which sets a positive backdrop for companies' earnings growth. However, the recent announcements by the Trump administration to impose tariffs on imported steel and aluminum, with reciprocal tariffs on all imports from U.S. trading partners also a possibility, present upside risk to inflation and the probability of lower fed funds rate cuts.

The U.S. economy remains in expansion phase



Data as of December 31, 2024.
Source: Bloomberg

As it relates to monetary policy, in September, 2024 the Federal Open Market Committee (FOMC) joined global central bank peers by beginning its interest rate-cutting cycle. Since then, the FOMC reduced the fed funds rate by 100 basis points (bps)[1] to a target range of 4.25% to 4.5%. As of the end of 2024, global central banks cut rates 195 times vs. 31 rate hikes, a sharp reversal from 84 rate cuts and 161 rate hikes in 2023.

As of February 28, the fed funds futures curve is pricing in that the fed funds rate ends 2025 at 3.6%. This implies a target range of 3.5% to 3.75%, which is slightly below Fed's terminal rate guidance of 3.9% estimated in its December 2024 economic projections release.

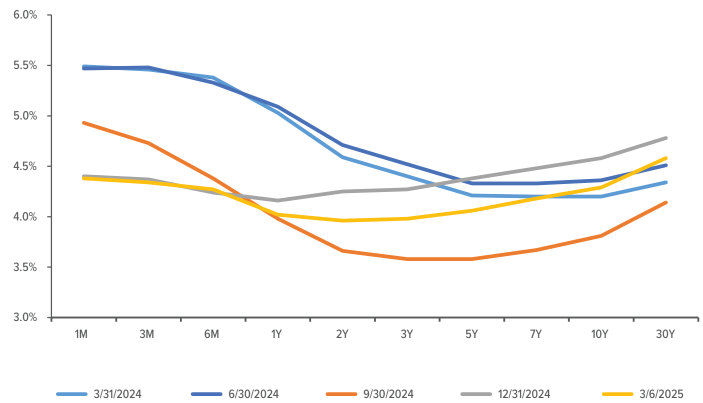
There is much underway as we progress through 2025 – rising tensions in the Middle East, ongoing economic uncertainty in China, and President Trump's policies (tariffs, immigration, and tax cuts), to name a few – and we will be watching inflation and global growth developments closely.

The credit market

It appears the FOMC has adopted a "wait-and-see" disposition, as inflation remains stubbornly above the Federal Reserve's 2% target (although down markedly from post-pandemic levels). Moreover, uncertainty remains as to the potential inflationary effects of the Trump administration's economic policies. The widely referenced CME FedWatch tool, which uses federal funds rate futures contracts to calculate the probability of forthcoming FOMC decisions, suggests the market anticipates the FOMC to continue holding rates steady at its March and May 2025 meetings.

While the FOMC will continue to use data to assess the timing and pace of monetary policy adjustments, which influence short-term rates, the outlooks for future growth and inflation are more impactful on longer-dated Treasury yields. As shown in the nearby chart, the yield curve for U.S. Treasuries, which is a graphical representation of interest rates on bonds with varying maturities, returned to an almost normal upward-sloping curve as 2024 progressed. This followed a two-year period of inversion, whereby current inflation and the Fed's hawkish response drove the two-year Treasury yield above the 10-year yield, while market participants anticipated more moderate longer-term inflation and growth.

Yield curves over time

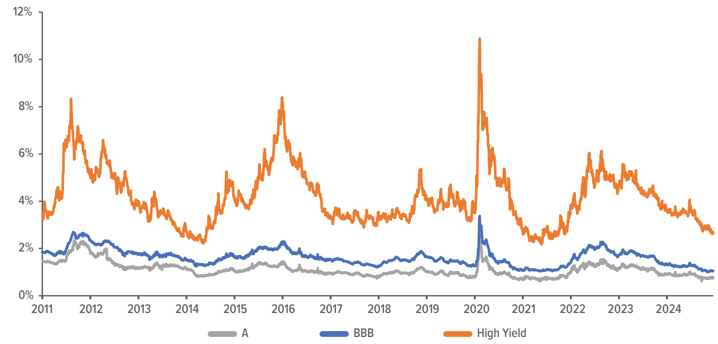


Data as of March 7, 2025.
Source: Bloomberg.

Short-term yields have since fallen, influenced by declining inflation and the Fed's decision to cut rates, while longer-term yields increased with more optimistic future economic growth expectations. As a result, the cost of short-term borrowings – particularly those with credit facilities pegged to floating rate benchmarks – has eased.

Corporate spreads reflect how the market assesses risk and credit quality by measuring the additional return demanded for investing in riskier securities. The nearby chart indicates that the bond market is gaining confidence in corporate creditworthiness and stable or improving economic conditions. Spreads for corporate bonds across various rating classes narrowed through December, reaching a three-year low. As of December 31, 2024, spreads for high-yield, BBB, and A bonds were 2.8%, 1.1%, and 0.8%, respectively.[2]

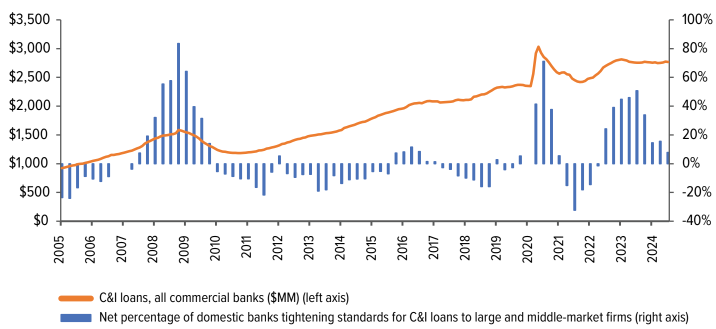
Corporate spreads by quality



Data as of January 31, 2025.
Source: Bloomberg.

The following chart shows the historical trend of commercial and industrial (C&I) loans outstanding, as well as the net percentage of U.S. banks adjusting their credit standards for loans to large and middle-market firms according to the Federal Reserve's Senior Loan Officer Opinion Survey (SLOOS). Note that the SLOOS data corresponds to activity in the prior quarter (that is, a report released in October represents the activity from July to September).

Amount of C&I loans vs. bank standards



Data as of August 5, 2024.
Source: Federal Reserve Bank of St. Louis.

As illustrated, during economic uncertainty or decline, banks usually tighten their lending standards and increase the cost of borrowing, leading to reduced loan supply and demand in the following months. During fourth quarter 2024, banks reported a net 6.2% of increased standards, while C&I loans increased by $28 billion during the same period.

While most lenders reported about the same C&I loan demand as in the previous quarter, banks reporting weaker C&I loan demand equaled banks reporting greater demand for the first time since October 2022. While bank and borrower caution prevails, driven by an uncertain economic outlook, the results indicate a steady and gradually improving borrower and banker optimism. Warren Buffett would say that uncertainty is the friend of a buyer of long-term values. Similarly, we are actively expanding our corporate loan portfolio while focusing on sound credit opportunities.

> “Spreads for corporate bonds across various rating classes narrowed through December, reaching a three-year low. As of December 31, 2024, spreads for high-yield, BBB, and A bonds were 2.8%, 1.1%, and 0.8%, respectively.”

The private equity and mergers and acquisitions markets

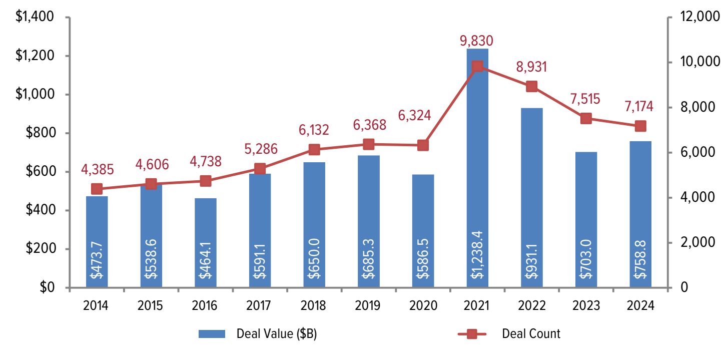
2024 was a strong year for both PE and M&A. An increasingly accommodative financing environment in 2025 should continue to create favorable tailwinds for compelling opportunities for new deal activity and exits. Fund managers are operating with cautious optimism as the U.S. transitions to a new administration.

U.S. PE dealmaking in fourth quarter 2024 saw a 7.7% increase in deal value and 13.3% in deal count vs. the prior quarter. Stabilized inflation and a more positive macroeconomic outlook led year-over-year deal value to increase by 19.3% to $838.5 billion and deal count to rise by 12.8% to 8,473. An additional key growth driver was the resumption of deals exceeding $1 billion in value, which accounted for 36.8% of all PE-backed deals in 2024. Information technology (IT), particularly software, stood out as a favored sector among general partners (GPs) in 2024. IT deal value increased by 30.7% year over year and is only behind business-to-business (B2B) in share of PE deal activity. The healthcare sector experienced a steady rebound in 2024 after several years of regulatory headwinds and high valuations that had dampened dealmaking.[3]

Entering 2025, much of the PE industry is optimistic about what changing macroeconomic conditions will bring. Anticipated interest rate cuts, GDP growth, softened regulations by the Federal Trade Commission, and lower capital gains tax rates are setting the stage for increased deal activity.[4]

> While the uptick in deal and exit activity should have a positive impact on fundraising, it will take some time for the effects to trickle down.”

Annual U.S. PE deal volumes

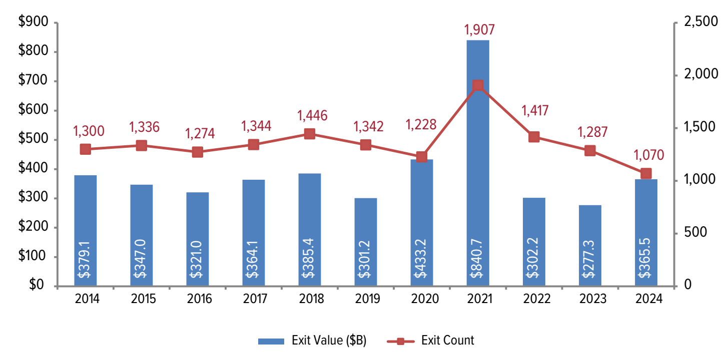


Data as of December 31, 2024.
Source: Pitchbook.

After two years of declines, U.S. PE exit activity began its recovery in 2024: 1,501 exits totaling $413.2 billion in value represent year-over-year increases of 16.6% and 49%, respectively, and have surpassed pre-COVID-19 averages. This rebound in exit value reflects the trend of PE sellers bringing their highest-quality assets to market while holding off portfolio companies that require more value creation.[5]

Exit activity is expected to continue to recover in 2025. The lower exit activity over recent years has created a backlog of companies that GPs are eager to sell. U.S. PE managers are holding an eight-year inventory at the current exit pace. In addition, lower tax rates from the Trump administration may incentivize business owners to sell their companies.[6]

U.S. PE exits by year

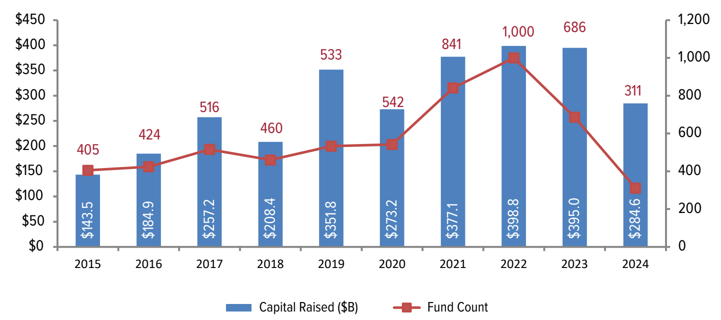


Data as of December 31, 2024.
Source: Pitchbook.

PE fundraising fell off in 2024, with the amount of capital raised dropping by over $100 billion year over year, from $395 billion in 2023 to $286 billion in 2024. Fund count decreased by over half, from 686 to 311. While the uptick in deal and exit activity should have a positive impact on fundraising, it will take some time for the effects to trickle down.

As PE funds are taking longer to raise, the median time to close a fund has gone from 11 months in 2022 to 16.2 months in 2024. Mega-funds ($5 billion and more) continue to bolster fundraising, accounting for 43.7% of all capital raised in 2024. However, a recent survey of large limited partners by Private Equity International (PEI) reflected a sense of optimism for better fundraising in 2025 due to stable interest rates and the ability of PE firms to drive mechanisms for distributions, including continuation funds, GP-led secondaries, and minority recapitalizations.[7]

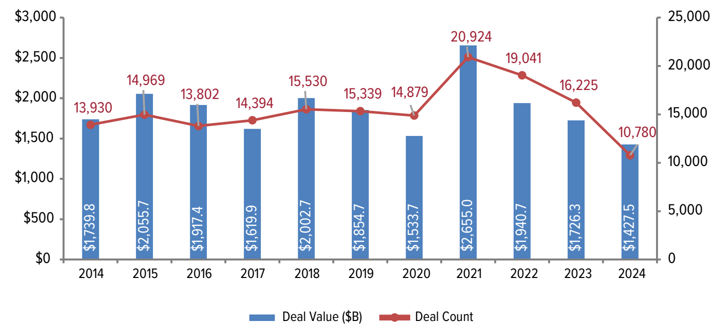
U.S. PE fundraising by year



Data as of December 31, 2024.
Source: Pitchbook.

Through third quarter 2024, North American M&A had already nearly surpassed that of 2023, with deal value of $1.5 trillion across 13,509 deals. When annualized, 2024 deal value is expected to exceed 2023 by approximately 30%.[7] In the U.S., the M&A outlook is positive, driven by lower interest rates, strong equity markets, resilient debt markets, and a narrowing valuation gap – all of which are expected to create a favorable climate for dealmakers in 2025. With the stability of the macroeconomic environment, corporations are likely to view M&A as an integral part of their holistic growth strategies, leading to an increase in M&A activity.[9]

North American M&A activity



Data as of December 31, 2024.
Source: Pitchbook.

Conclusion

There is much underway as we progress through 2025 – rising geopolitical tensions, ongoing economic uncertainty in China, and the new Trump administration's policies, to name just a few – and we will be watching inflation and global growth developments closely.

Meanwhile, in the credit markets, the FOMC is anticipated to continue holding rates steady at its March and May 2025 meetings. Inflation remains above the Fed's 2% target, and uncertainty persists around the potential inflationary effects of President Trump's economic policies. Amid gradually improving borrower and banker optimism, the bond market is gaining confidence in corporate creditworthiness and stable or improving economic conditions.

Finally, fourth quarter 2024 and the beginning of 2025 found much of the PE industry optimistic about the potential for increased deal activity amid changing macroeconomic conditions. A positive M&A outlook in the U.S. is expected to lead to an increase in activity.

If you have any questions about navigating today's business environment, reach out to a BBH relationship manager.

[1]Basis point (bp) is a unit that is equal to 1/100th of 1% and is used to denote the change in price or yield of a financial instrument.

[2]Issuers with credit ratings of AA or better are considered to be of high credit quality, with little risk of issuer failure. Issuers with credit ratings of BBB or better are considered to be of good credit quality, with adequate capacity to meet financial commitments. Issuers with credit ratings below BBB are considered speculative in nature and are vulnerable to the possibility of issuer failure or business interruption. High yield bonds, commonly known as junk bonds, are subject to a high level of credit and market risks.

[3]PitchBook.

[4]BDO 2025 Private Equity Predictions.

[5]PitchBook.

[6]Adams Street Partners Private Markets 2025 Outlook.

[7]PEI International: LP Perspectives 2025.

[8]Pitchbook.

[9]EY Parthenon: M&A Insights.


EST. 1919
FAMILY OWNED
Community
COFFEE

Serving Up Five Generations of Expertise

with Community Coffee's Donna Saurage

Benjamin Persofsky / Head of the BBH Center for Family Business

Founded in 1919, Community Coffee has succeeded under five generations of family ownership. The company employs about 1,000 individuals across 26 states and is enjoyed around the world. But what makes this multigenerational family business different? How does it keep ticking after all this time?

We recently sat down with Donna Saurage, manager of the holding company for Community Coffee, wife of third-generation family member and former chairman the late Norman Saurage, and matriarch of the family business, to answer these questions. During our conversation, we spoke about the importance of family values, her nontraditional journey to family business leadership as a nonblood relative, and her work to nurture the next generation.

Tell us about your family's business.

Community Coffee is a great coffee business. We do what all coffee businesses do. We import the beans, we roast them, and we sell them.

But what makes us different? There's a reason that at 106 years old, we're the largest family-owned retail coffee brand in the United States: the people. It all started with Henry Norman "Cap" Saurage, who founded the company and named it Community after the people who helped him succeed. That value has carried forward – our people make our company what it is.

Everything we do has to be as good as our coffee. If you put that mentality into everything – from relationships to business planning – you're going to be superior.

When you married your late husband, Norman Saurage, what were your initial impressions of the role that the family business would play in your life?

When I married Norman, I had no idea that the business and the family would be so entwined. I knew he had a family business called Community Coffee, but I was so in love, I didn't think much about it.

During those early years, I was busy raising five babies! But of course, that changed as I started learning more about how important the business was to Norman and the family.

How did your involvement grow during those early years?

Norman would come home and talk about what was going on at work, and I realized that he was using me as a sounding board. The more he talked, the more I learned, and the more I became very interested in the business.

Is that when you became formally involved in the business?

I didn't really have a formal role in the business, but as Norman came home with his challenges, I would help him where I could. I started doing the back-end planning for things like sales meetings and company dinners.

I didn't have an idea of the impact I was having until later, when the employees started telling me how important it was that I was there with Norman and how much they appreciated my assistance.

When did you realize just how big of a role the business would play in your family going forward?

I didn't really realize how much of a role Community Coffee would play in *my* life until the 1980s, when whole bean coffee shops started showing up in California. Norman and I went out to see what was going on in this new wave of coffee shops, because we had noticed that young people were drinking coffee differently than previous generations.

That visit made us realize we could take our premium stores, where people traded in coupons for various items, and transition those into coffee shops, where we would sell whole bean coffee and everything that went along with it, from appliances to snacks. We converted our five premium stores into Community Coffee storefronts, and they became a destination gift shop store for young people.

That experience opened my eyes to the fact that the business could grow in different ways, and I could be a part of it.

Take us through the transition from working in the background to taking on an official leadership role.

I became more involved when I was asked to chair our board's Citizenship Committee, which deals with giving back to communities to help them thrive.

That was 25 years ago, and I'm still the chair of that committee. It's been a great joy to help develop that and to know that we are doing the right things in the communities where we serve.

Did you and Norman discuss how to best set up the business for succession?

Norman was really the patriarch of the company after his father died. All the ownership was in our branch of the family; it was owned by Norman, me, and our five children.

He wanted to develop our children into leaders, rather than me. But when he became ill with ALS, he knew that his time was finite and that there would be a middle time where I would need to take over the leadership and ownership of the company. It would ultimately be my job to help develop our children into those leadership roles.

We planned for all of this, so when Norman passed away, there was not a hiccup in the company.

Many business owners struggle to pass on a company to the next generation because it is part of their identity. But Norman did it early, which is pretty amazing. He knew that he was going to need to pass the torch, but he wanted to make sure his children developed and matured in the business before handing over the reins.

How did you feel when he asked you to take on the responsibility of developing the next generation into well-heeled owners?

I welcomed it. I have always wanted to see my children be way more than I could ever be, and it's been such a joy to see that happen over the past 10 years.

I can see myself phasing out without a worry in the world. I get so excited when we are sitting in a meeting, and I hear them ask management the questions that Norman or I would have asked.

Was there anything that happened earlier during your relationship with the family that set you up to be so involved in these later years?

One key thing happened. All of the shareholders are Saurage blood relatives, except for me – I am not a blood relative. The reason I have even been able to be in this position and do all that is because Norman's grandfather gave me some Community Coffee stock a few years after I married Norman. If he had not done that, I would never have been able to inherit more stock because I'm not in the bloodline.

His grandfather believed in me and knew I was here for the long haul. He saw a marriage that was going to last and prosper.

Were there any hurdles when assuming leadership?

I felt very confident when I first assumed the role of manager of Community Coffee's holding company. I had been active in the nonprofit world and had served on about 50 boards. And I knew the company well.

The challenge I saw was how to get future generations involved – how to get my grandchildren involved and how to grow the involvement of my two sons. One was chairman of Community Coffee, and one was on the board but had not really been involved in the company.

Over the past 10 years, my two sons have become very involved and stepped up to the task. My biggest worry was whether they'd really love the company and become the interested shareholders that we wanted them to be. And they did.

Did you have to do anything to cultivate that interest?

My two sons and I get along very well. There's no conflict. We come from different directions, but we have always come to consensus on everything.

When my husband was ill, it was amazing to watch my sons communicate with him. There came this real listening and understanding. We have continued that in our family.

Hank, Matt, and I realized that we needed to really work on developing the future shareholders and that we needed to be on the same page when it came to working with management. We started meeting once a week for an hour and a half, and we continue to do this. We talk through all of the issues, and it helps us avoid conflict.

When you took on the role of leadership, was there anything you did to ensure you left the legacy you desired for future generations of the family?

When I took on this role and we started looking at how to develop the family to be interested shareholders, one of the first things that Matt, Hank, and I did was list out our values. When all was said and done, they turned out to be the same as those that we had already documented for Community Coffee. Once we had that solidified, we had a base to start working on teaching the grandchildren.

Norman used to say, "You can't run the family through the business, and you can't run the business through the family." The Saurage family name and Community Coffee are very connected in people's minds, but we were not going to run the business for the family, where every child just gets a job here. And we weren't going to let the family feel that the business was the only thing that they had, because we wanted them to develop as individuals.

> "Giving back is at the core of our family – we give through the company, and we all give personally."

We made it clear that we would love for qualified family members to come to work for Community Coffee, but it would never be demanded. They would never be criticized if they did not. They can still add value as shareholders, but they don't have to work for the business to succeed.

Some families wonder if it is still a family business if family isn't leading the business in the top executive roles. How does your family think about it?

Our family believes that the business can be well run by the smartest person we can find to run it. If that happens to be a family member, fine. It has happened several times during our history. However, we've more often had an outsider running the company. We have family members on the board, but we have outside directors who outnumber them.

We're proof that a family business can grow with outsiders in management.

With respect to philanthropy, giving back is important at Community Coffee. Talk about your activity and mission with your giving.

When Cap started the business, he always believed the community was so good to him. He wanted to give back, so we have always offered coupons and other giving opportunities to those who drink Community Coffee.

Giving back is at the core of our family – we give through the company, and we all give personally.

"We made it clear that we would love for qualified family members to come to work for Community Coffee, but it would never be demanded. ... They can still add value as shareholders, but they don't have to work for the business to succeed."

You are active in a women's investment club and have seen great success. Tell us about that. What do you think makes that group function so well?

I became a member of this women's investment club long after it had been started, and we just have so much fun investing together. I was just looking at the notes from my latest meeting, and we were up 57% the past year – vs. 42% for the market.

Many of us have been involved in the nonprofit community, and we've served on boards and investment committees, which is where a lot of us learned about investing. The more you're exposed to investing, the more you understand it, and the more you understand taking risks and being careful about what you do.

Interview conducted by Ben Persofsky, and article written by Kaitlin Barbour.

Through the Eyes of the Fourth Generation: A Discussion with Matt and Hank Saurage

Tell us a bit about your roles at Community Coffee.

Matt Saurage: I am chairman of the board of Community Coffee, which I've been for 13 years. Before that, I served as CEO. I started with Community Coffee officially in 1995 in marketing, and I worked many odd jobs here during high school as well.

Hank Saurage: I'm a director on Community Coffee's board of directors. I've served in that capacity for more than 20 years.

During high school, I worked in many different areas of the company, including one of our distribution centers and a packaging line. There were no job titles – I just did what I was told to do, including cleaning doors and decaling delivery trucks!

Did you always plan to go into the family business?

MS: I did not plan to when I entered college. I had my own career goals in mind. I always felt there was a place for me here and assumed that at some point I would be drawn back, but I did not know when that would be.

Eventually, I was dissatisfied with the engineering career I had and the track I was on. I felt a strong desire to come back and work with my father in the business. I wanted to leverage some of my stronger sales and marketing skills that I wasn't using.

Our parents always let us know that the company's door was open if we wanted to come back and were qualified to do so, but there was no expectation that we needed to work for the family business or that we would disappoint anyone if we didn't.

We were taught about the business from childhood, so we had an appreciation for what the business was, whether we were internally employed or just on the outside serving in an advisor role.

HS: I also did not plan to work here. I was the black sheep who resisted and charted my own path for a long time!

I was passionate about sailing, so when it came time to choose a career path, I decided to pursue sales, so that I could afford to live and also do my hobbies.

When they asked me if I would consider joining the Community Coffee board, I was excited because I felt it was where I could truly contribute something to the business. This also allowed me to continue to pursue my career in real estate, which I had started to focus on.

Why do you think your father chose your mother to take over the business when his time came to step down?

MS: To me, it seemed like the most natural option. She had always been with him on his journey of leading the company. They navigated the difficult decisions and learnings together. I would have been surprised if he had not chosen her.

HS: I agree. They were married very young and had a long, happy marriage. They were so close and shared every moment, every part of the family business. She was the most knowledgeable outside of him.

This also wasn't her first rodeo when it came to leadership. She has been a leader in this community for decades.

What is it like working alongside your mom?

MS: My mother is my most challenging director on the board – in a good way. She asks very direct, insightful, thoughtful questions that challenge me and others. She just has an ability to speak with great clarity and to the point. She speaks about things that other people may be thinking but don't know how to articulate. It helps to elevate the conversation.

HS: She brings a lot of depth with the knowledge of the past – how products went to market, the experiences that my father had, and so forth.

When working with her, there is an expectation to elevate to her level of charisma, charm, and poise – which she carries with her day in and day out.

What are the biggest leadership lessons you have learned from your mom?

HS: The first thing that comes to mind is to start and end meetings on time.

In addition, don't be afraid to ask the hard questions. If they come to your head, just get them out.

And lastly, be confident in your team. She doesn't claim to know it all, and she doesn't want to do it all, but she is not hesitant in asking those in a room to figure it out and get it done.

MS: There's always time to do things right the first time. But don't wait – take action and step in. As a leader, it is your responsibility to be constantly exploring – to be thorough and thoughtful about what you're going to do and to not leave anything unturned to get it done right the first time.

One other lesson that relates specifically to the family business is the importance of keeping everyone informed. My mom keeps all of the family members across generations up to date about what is going on at Community Coffee so that they remain engaged owners. She knows the importance of keeping us connected to the company and its purpose. She's kept it front and center as part of our family's life.

How to Engage Your Family in Legacy Co-Creation

Kathryn George / BBH Partner
Mike McGrann / Managing Director, BBH Center for Family Business

Everyone wants to leave a legacy. But how do you make sure the legacy you leave behind is the one you wish for? According to Mike McGrann from BBH's Center for Family Business, you need to start working on it today. He recently sat down with BBH Partner Kathryn George to discuss how to approach co-creating your legacy, including engaging family members in discussions around the topic.

Let's start by defining legacy. What does it mean?

Legacy is often described as what we leave behind – tangible items in the form of wealth or property, as well as intangible items like values or faith. The magical thing about a legacy is that we can intentionally co-create it with our loved ones while we are alive.

Here's an example to put this into perspective. I was working with a couple and their attorney. The couple had built a wonderful business, but there was family disharmony. Their attorney said, "Can you set aside money for the lawsuit that we know will happen when I read your will?" The couple was dismayed and wanted to know how to avoid this. With no changes, the couple was going to pass away, and their legacy would play out as one of relationship pain and value destruction.

Very few people wish for that as part of their legacy. If you want your legacy to be the one you wish for, then you need to start working on it today. Step one would be to begin discussing your legacy goals with those whose lives you hope to impact with your legacy. Usually, this includes the people closest to us – those we love the most.

When you are working with someone on their legacy, and you ask their loved ones what they view as that person's legacy, how often is there misalignment? Where does that misalignment come from?

The place that we see this misalignment most profoundly is around money and wealth, when generations are not aligned, or the next generation is not well-informed about their parents' plans. The next generation knows the wealth will affect them and their families, but they don't know what the plan is. The irony is that parents fear the impact that wealth will have on their kids, so they avoid discussing it – a situation which often leads to the exact fear they have about the wealth.

It seems families need to improve communication to co-create a legacy. How do you start the conversation?

It begins with reflection: Who are the people, the communities, and the causes you wish to impact? Why do these matter to you, and how might you help them?

Step two is to share these wishes with those closest to you – especially the parts of your legacy goals that will impact your family. For example, if you value education and wish to leave resources to pay for your grandchildren's education, share that legacy goal with your adult children (the parents of your grandchildren). This kind of discussion acknowledges that your decision impacts *both* generations – your adult child, their spouse, and your grandchildren. They will have questions – especially if you have more than one child and multiple grandchildren.

A reality check: Part of your legacy decision-making is tied to your wealth and how it will be allocated. This presents challenges because many find it difficult to talk about wealth. Fears of giving up control and fears of how wealth will affect future generations are common. As you engage in these conversations, keep in mind that the act of giving your adult children a voice in conversations about your legacy goals (and the wealth tied to it) does not imply that they have a vote on the issues.

With this framework in mind (voice does not equal vote) we are free to share our goals and seek feedback without fear of loss of control. Most importantly, these discussions build relationships and contribute to a legacy of trust.

> "The magical thing about a legacy is that we can intentionally co-create it with our loved ones while we are alive."

What types of scenarios have you seen where this goes well? And when does it not go well?

These discussions go well when we remember that a legacy is built slowly, over time, and in dialogue. Embrace the journey. Begin with short conversations and remember that no matter what kind of reaction or questions you may get, they are simply opinion and questions. It is still your decision.

The key is to be open to feedback. If you are not ready for questions or feedback about your legacy goals, then don't ask for it. The worst thing we can do is to ask for feedback about our goals and then get angry when we don't like the feedback we get.

If you have multiple children, is it better to have these conversations individually or as a group?

In general, if we can learn to do this with our whole family in the room, that is a wonderful thing. If this feels overwhelming, then begin the conversation individually. Either way, your legacy will affect your entire family in one way or another. If part of your legacy includes a difficult decision, my advice is to begin discussing the issues today. Patience and empathy for those impacted are a big part of the process.

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Earlier you referenced the fear that many people have about the impact that wealth will have on their children or grandchildren. How do you address this concern?

First, recognize that this is a very normal concern, and we all know people whose children have enormous wealth and who struggle to find purpose in their lives. But it is never really the money that "ruins" kids. I often ask people, "If money ruins kids, then how much money does it take to ruin a kid?" Obviously, there is no answer to that question because it's not about the money, it's about how they are raised.

Most important is the age-appropriate dialogue. Consider starting with a simple conversation about money, wealth, and estate planning:

- **Money:** Whose money is it, and how did we earn it?
- **Wealth:** What does it mean, and what does it not mean? What are the responsibilities that come with wealth?
- **Estate plans:** What are the plans, how will they affect all of us, and whose call is it?

Having those conversations starting at an early age and creating boundaries around wealth is hard, but I once heard a parent say, "You can create boundaries that make your kid cry when they're 10, or fail to define any boundaries for them, and you'll be crying when they're 20."

How can parents of adult children navigate that transition from the parent-child dynamic to a more peer-to-peer relationship when their children are adults?

We often talk about the concept of transitioning from the parent-child hierarchy to a peer-based relationship with our children. The hierarchy still exists as they get older, but we can choose to interact as peers.

The challenge of parenting is understanding when kids need parenting and when they don't. An 8-year-old definitely needs parenting, 18-year-olds sometimes need it, and a 28-year-old should not be parented. Hierarchies are a reality in our families and an important part of our organizations, but hierarchical behavior creates distance and mistrust in our relationships.

At the same time, we need to consider that if we're going to give money to our children, will it come with strings attached? When we give them wealth, are we going to continue to parent them, or are we prepared to say, "Here's the money. It's your call"?

We've been talking a lot about the parent-child relationship, but how does this all work when the grandparents are the ones leaving the money to the children?

It's important to engage all generations when it comes to this – you should include everyone who will be affected. It's your wealth that you are handing down to the grandchildren, but the parents will still be affected by your decision, so give them a voice as well.

One idea for this scenario is to communicate in writing or a video what you want to do for your grandchildren, because you may not be here when they inherit the wealth. Make sure that they understand what you want your legacy to be for them. It's not dictating from the grave – it is about values.

What do you do when you have children with vastly different capabilities and earning potential? Do you ignore that in this whole process and have everyone be equal?

This is one of those factors that makes building your legacy so hard! First, fair does not mean equal. Parents want to be fair to their kids, and they often think that means everything needs to be equal. But let's set the deal straight: fair does not mean equal. An old friend of mine often says, "Different things, for different kids, at different times."

The important thing is to get in a room with your family and discuss your thinking. It can be very difficult to cut an estate into perfectly equal parts, so talk about your estate plans with your kids and ask for their thoughts. If there is disagreement, that is OK, as conflict is not always a bad thing.

Conflict *is* a bad thing if it is left unaddressed, or if it comes out in the form of anger that creates distance in the relationship. It is the nature of families to disagree and to have some conflict. The goal is not to create agreement – rather, it is to create alignment.

So, how do I actually get started co-creating my legacy?

Define your legacy and what you wish for it, and then it's time to co-create. Sit down with the people who your legacy will affect, and talk about what your legacy wishes are in relation to your wealth and your values.

What is your final piece of advice for families who care deeply about legacy? What should they do?

It's one answer in three parts:

- **Be vulnerable.** Be open to exploring and sharing your wishes and your fears with your family. Ask your family members to share their wishes and fears.
- **Talk about the concept of fair vs. equal.** Explore each family member's perceptions of what is fair, and remember who in the room has the vote (while still giving others a voice).
- **Finally, recognize that in every substantive interaction we have with the people we love, we're either creating closeness or distance in our relationship.** As you think about what you're going to do with your wealth and the impact it's going to have, think about what part of this is going to create closeness for your family, and what's going to create distance. Look at everything through that filter, which is a wonderful way to think. It is a great tool for engagement. There is something everyone can find common ground with.

We have helped countless business owners and their families answer the question, "How do I design and communicate my legacy?" To learn more about shaping your legacy, reach out to your relationship manager or centerforfamilybusiness@bbh.com. We would be happy to help.

Capital Allocation for Private Business Owners

John Secor / Head of Corporate Advisory

"Understanding intrinsic value is as important for managers as it is for investors. When managers are making capital allocation decisions … it's vital that they act in ways that increase per-share intrinsic value and avoid moves that decrease it. … Over time, the skill with which a company's managers allocate capital has an enormous impact on the enterprise's value."

– Warren Buffett, Berkshire Hathaway Letter to Shareholders, 1994

Berkshire Hathaway Chairman Warren Buffett is widely regarded as one of the most successful investors in history; his management track record is arguably just as singular. A hallmark of Buffett's management philosophy is his unusual attention to capital allocation. He advocates that capital allocation is equally, if not more, important than operating prowess in driving long-term shareholder value.

Studies show that companies that continually evaluate the performance of business units, acquire and divest assets, and adjust resource allocations based on relative market opportunities outperform those that do not. The development of a capital allocation framework is a strong catalyst for value creation. While capital allocation is generally perceived to be more relevant for public companies, it is just as important for private companies.

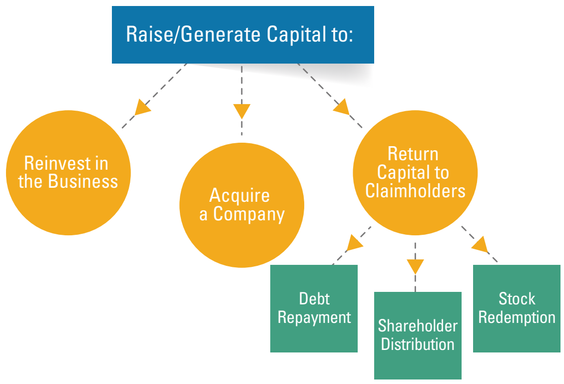
"Although it is important to operate in a tax-efficient manner, tax planning should inform, not determine, long-term business strategy."

Capital allocation framework

Capital allocation decisions are vital in determining a company's future and, as such, are among management's most important responsibilities. Managers have three basic choices for deploying capital:

- Reinvesting in the existing business (underwriting capital expenditures, funding research and development, or adding to the sales team)
- Acquiring another company
- Returning cash to claimholders (issuing dividends, redeeming shares, and repaying debt)

Capital Allocation Framework



Choosing between these options requires discipline and careful consideration. An unsound capital investment decision can hinder value creation in a business by depriving more deserving initiatives of scarce resources.

Capital allocation's importance becomes more apparent over a business's life cycle. In the early stages, decisions about allocating capital are relatively simple – most of the cash flows are poured back into the growing company, and there is typically limited cash to deploy. Eventually, a business matures, meaningful organic growth opportunities tend to diminish, and cash is accumulated.

Whether capital is generated through operations or raised through the issuance of debt or equity, the deployment of capital drives the long-term value creation opportunity for the business.

Why capital allocation matters for a private company

While capital allocation is a central issue for all firms, it deserves particular attention for private businesses for which capital is scarce and less readily accessible compared with publicly listed companies. Capital allocation decisions are often viewed too simplistically by business owners who frequently take a reactive approach, such as defaulting to decisions made at year-end to reduce taxes. The year-end purchase of a new piece of equipment may reduce near-term taxes, but may also underfund other opportunities to accelerate longer-term growth and larger future distributions to shareholders. Although it is important to operate in a tax-efficient manner, tax planning should inform, not determine, long-term business strategy.

In addition to having limited access to capital, an owner of a private company is also uniquely challenged to balance the needs of the business with personal estate planning, particularly as private company stock often represents the largest asset on an owner's personal balance sheet. Unforeseen personal events can present additional demands for capital that affect the business and make the capital allocation calculus more difficult.

This can be further complicated particularly in multigenerational businesses with passive shareholders and/or institutional investors that have conflicting holding periods and priorities for liquidity vs. reinvesting in the business. Developing a disciplined approach to decision-making will help owners navigate the capital allocation process and drive long-term value in their business.

A private company approach to capital allocation

The manner in which companies allocate capital is remarkably varied. Some companies make capital decisions based on relative size, performance, or growth potential of the business units. Others simply apportion the same resources provided in the prior year. Regardless of the approach, capital allocation decisions should be guided by an active and objective approach to identify, analyze, execute, and evaluate the firm's options for managing its capital.

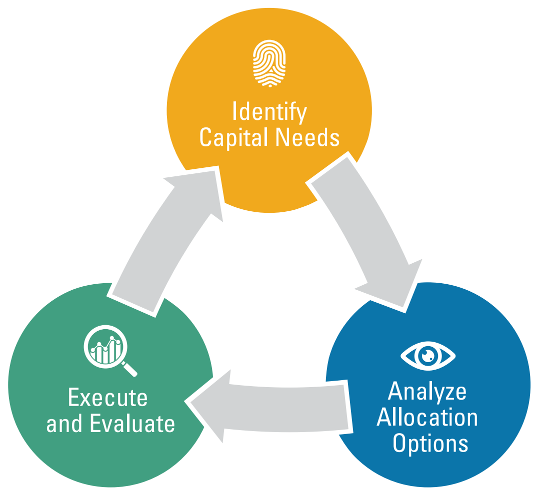
Well-run public companies develop core principles to steer their capital allocation decisions. For instance, Microsoft establishes specific capital allocation goals that encompass growth funding, mergers and acquisitions, dividends, and buybacks. Microsoft also tracks various metrics, such as revenue growth, operating profit margins, and return on invested capital (ROIC) to assess the success of its capital allocation strategy and inform future decisions. For Microsoft and other leading companies, a clearly defined framework and set of objectives is the roadmap for effective capital management.

For private companies, the principles developed to guide capital allocation decisions should support the business's needs and strategies and take into consideration shareholder liquidity timeframes and objectives. The ultimate outcome of capital allocation choices is rarely immediate or obvious, thus requiring decision-makers to adopt a long-term view when developing goals and assessing success. In that sense, most private companies are well suited to the capital allocation process given their orientation toward building a sustainable business that can be passed on and harvested across subsequent generations.

Similar to the multiyear business planning process, it is important to create a multiyear capital allocation plan that is guided by long-term owner goals and business objectives while also maintaining sufficient flexibility to adjust to changing market conditions and act decisively when opportunities arise.

A robust process will enable decision-makers to identify competing capital needs, analyze the various opportunities, execute the strategy, and evaluate the effectiveness of the decisions made.

Capital Allocation Process



Identify capital needs

The first step in the capital allocation process for business owners is to identify the capital demands within the business. Beyond fundamental tax and debt service requirements, the uses of capital are often more situational and dependent on a variety of factors, including risk appetite and business life cycle.

Owners with higher risk appetites and a history of successful business integration are likely to be more comfortable accelerating growth through an acquisition strategy. Owners with lower risk tolerances may favor more gradual organic growth strategies while diversifying their holdings through dividend distributions.

After establishing the capital needs to support the business strategy, business owners must consider debt obligations and near- and long-term shareholder liquidity needs. Finally, they should determine whether capital is necessary to achieve certain long-term personal goals or objectives, specifically business succession. For example, the sudden death of an owner can create a major taxable event that puts unnecessary stress on the business's capital if a thoughtful, tax-efficient estate plan is not established ahead of time.

Acquisitions, ownership transfers, and stock redemptions are other key capital-intensive events that are best handled within the firm's long-term capital allocation plan. Balancing these competing demands requires careful consideration and discipline. Equally as important is retaining the flexibility to move business resources to adjust to shifting market conditions and act decisively when opportunities emerge.

Analyze allocation options

Business owners should evaluate the alternatives before deciding on how best to allocate capital. Many private companies rely on qualitative approaches such as "gut feel" to make capital allocation choices; however, when contemplating a project (e.g., building a new factory) or business initiative (e.g., growing the sales team), strategic imperatives should be quantitatively assessed using an appropriate technique such as ROIC, internal rate of return (IRR), or net present value. Smaller firms are more apt to lean on simpler metrics such as payback periods to evaluate projects, as future project cash flows are less predictable, and owners are less likely to utilize external sources of capital to fund initiatives. Regardless, these quantitative tools bring discipline to decision-making and can help the business owner make deliberate, well-informed decisions.

Execute the allocation plan and evaluate the results

Capital allocation decisions should be revisited, reviewed, and refined as circumstances and opportunities change. Looking back at historical perceptions and actual outcomes is an honest way to weigh the success of prior decision-making. Many companies form internal committees to collaboratively decide on the best uses of capital within the business. Others rely on board members and advisors to debate capital allocation decisions on a formal biannual schedule and link the two areas of competing demands – family and business.

It is important to appreciate that the allocation process is evergreen. The process itself is a positive feedback loop, as the lessons learned deploying capital in prior years will inform and improve future decisions.

Conclusion

Bringing an investor's mindset to the business of management is as critical as operational excellence. While the details are specific to each company's unique business strategy, capital structure, financial condition, and owner needs, and there is no one-size-fits-all solution, the development of a capital allocation strategy is important for every private company. A well-defined approach to capital allocation will lead to better decisions and drive long-term value creation.

The Corporate Advisory Group (CAG) is dedicated to building and expanding relationships with clients and prospects of BBH Capital Partners through an objective long-term corporate finance dialogue. CAG operates outside of the traditional transaction-focused, success fee-based investment banking model. As a result, we are able to approach your unique needs without bias for any particular outcome and provide advice to best help you achieve your business and personal goals and objectives. For more information, please contact your BBH relationship manager or John Secor, head of Corporate Advisory.

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