BusinessPlus+ Newsletter

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How a Family Feud Created Adidas and Puma – Managing Conflict in Family Business

Adidas vs Puma

A family feud between Adi and Rudi Dassler (the first generation) ultimately started a fierce rivalry between the separate family business brands - Adidas and Puma, which were created by the two brothers in the next generation.

The official family split occurred in the late 1940's and the rivalry between the two first generation brothers escalated. The dispute subsequently heralded decades of fierce competition between the two brands, in a fast- growing sportswear market.

Sadly, the family feud did not die with the brothers from the first generation - Adi and Rudi. It continued with the same intensity in the next generation - by their sons Horst and Armin; it split the community into warring factions for more than 60 years. Townsfolk frequented different bars, barber shops, and bakeries, depending on which firm they worked for.

At the heart of each company's strategy was the desire to outdo its rival.

Emotions, not rationality were the main driver of the conflict.

This does not sit well with most strategists. A strategist is supposed to take a hard look at the facts and after carefully weighing the options, sets up a plan. In reality, emotions have a profound impact on strategy. It shapes our cognition and subsequently our actions.

The best strategists not only know this but integrate emotions into their repertoire**. In the world of business, hope and fear are particularly powerful levers to pull.**

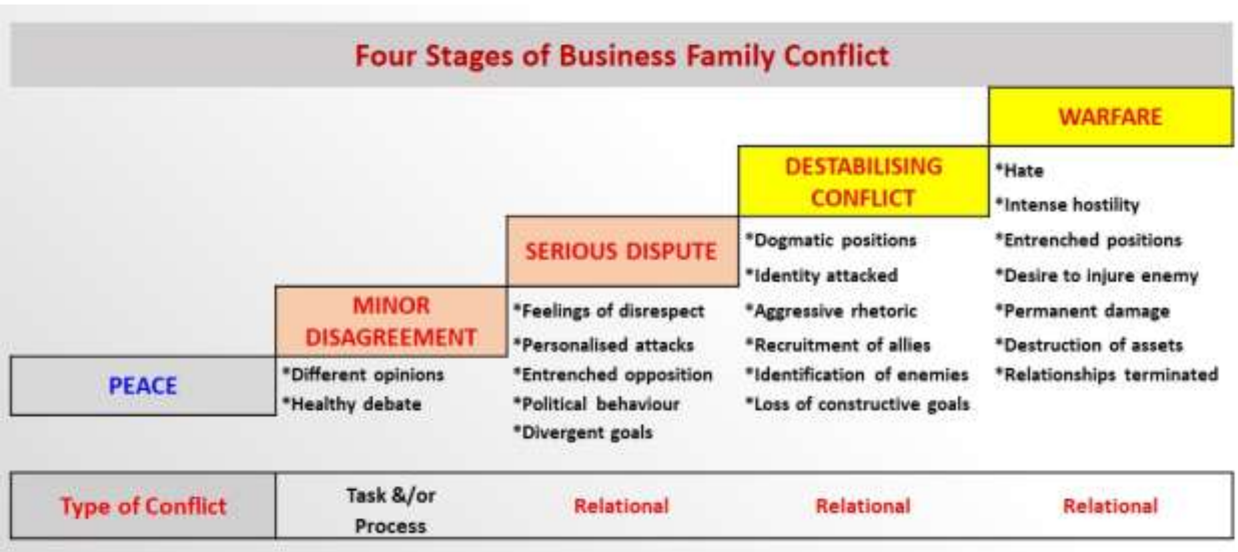
Lessons for Family Business

- Perhaps one of the saddest features of any family conflict (and this is usually present in many family business disputes) is that bad blood breeds bad blood.
  It can be a common frustration in family businesses. Too often, **few people make little effort to overturn the family differences that arose in the past and are prepared to start afresh**;
- Being an adaptive family does not mean you have to sway with every breeze. On the basis of a foundation of strong family and business values, you can be flexible.
  Open and regular communication and applying a problem-solving approach to difficulties as they arise, without expecting too much of yourself and others is a good starting point;
- Treat the past as a place where you had your origins but from where you have now advanced to a new current reality. Find ways of wiping the slate clean – forgiving if not forgetting.
  Have effective reconciliation processes in place to be able to move forward and not remain prisoners of the past events, that only fester over time;
- Expect the future to be different from the past or even the present.
  Be prepared to be aware and mindful of the need to change your style and attitudes to changing realities so you can move on;
- All powerfully held perspectives need some countervailing forces, so individuals can be made more self-aware and adaptive. **Leaders in family business need people around them who will not only support and forgive them, but restrain, challenge and advise them where appropriate**.
- **The bottom line is there is no substitute for a strong, cohesive, self-aware family culture**. One of the most important tasks of leadership is culture building. A successful and sustainable family business needs strongly embraced and aligned values for both the business and the family to build a strong culture. Family members need to participate in the maintenance of the culture. Successful business families involve the family in agreeing on the values, ensuring goals (business & family) are aligned and play active roles in supporting and improving the culture over time and generations.

Conflict Levels Can Vary

In a study of group's interaction, **it was recognised there are three kinds of conflict: Task, process and relationship.** Task conflict – disagreement about the task – is usually productive when it is not influenced by ego and emotion. Process conflict – disagreement about the rules, norms and procedures the group uses to conduct its tasks – is risky. Sometimes it is productive and at other times destructive; it all depends upon the spirit with which it is engaged. Relationship conflicts – disagreements about the value of people and their contributions, is almost always destructive. Research has also shown that it is very hard to disentangle these three types of conflict.

The objective with any type of conflict is to confront it as early as possible. **Seek to reframe conflict as something that if addressed, can result in a beautiful outcome – much like a pearl shell does when dealing with the grain of sand irritant, which over time can result in a wonderful pearl being produced.**



Source: McKee, Madden, Kellermanns and Eddleston 2014 – *"Conflicts in family firms: The good and the bad."* SAGE Handbook of Family Business - London, U.K.: Sage Publications

Change, Success & Conflict

Governance can be seen as mechanisms for problem-solving, but the problems families face and need to solve evolve over time. Generational transitions often heighten the contrasting but fully natural differences between generations. Daphne McGuffin describes the relationship between durability (as one of the success criteria of entrepreneurial families) and change, with the inclusion of the conflict that always accompanies change, using ***"The Change Equation"*** shown below.

The Change Equation - **Source:** Daphne McGuffin in "*The Governance Marathon: Dynamic Durability in Entrepreneurial Families amid Disruptions" Cheng, C.Y.J., Au, K., Widz, M., & Jen, M. (2021)*

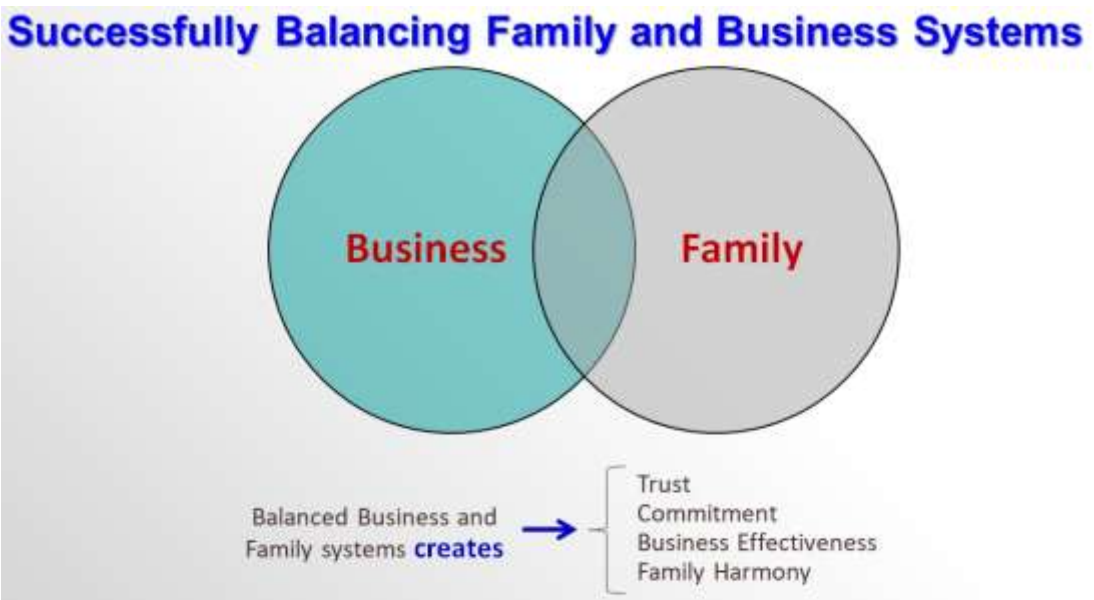
Daphne McGuffin further explains ***The Change Equation*** as follows:

***"Success equals change. Change equals conflict. If you want success, you must embrace change, and you cannot embrace change without some measure of conflict* – [When interpreting the equation from left to right].**

Alternatively,* [interpreting the equation from right to left] *- If you can embrace positive conflict, you can better navigate that change, which will lead to greater success. I am thinking if you take that word 'success' and put in 'durability', durability* [think greater resilience] *means you are going to have to change and that is going to come with some conflict. But if you can manage that conflict, you will create the right change, and you will get your durability."

A Balanced Family Business

By putting in the hard work most family businesses can get to a point where they can achieve balance in both the business and family expectations and objectives, as illustrated in the diagram below.



Source: *T Hubler & G Ayres University of St Thomas 1996* – Family Business Management course

Families who equalise family and business systems create a positive environment where the family thrives and the business performs. This type of thinking is very important as family businesses grow. The balanced approach to addressing the two sub-systems becomes the foundation for healthy family business relationships and for the creation of a family business legacy.

Conclusion

A good plan for conflict resolution includes anticipation of sensitive issues, agreed upon conflict resolution processes and an appreciation of the importance of addressing conflict to building trusting relationships.

It is important to remember that in any conflict all parties are trying to take care of the concerns that matter deeply to them. These concerns are often not readily apparent and, may even be outside of the consciousness of the individual, yet powerfully driving them. Your effort to unearth and discover these concerns and drivers may be just what is needed to break the negative cycle of conflict.

In a practical sense, this might mean asking some questions which, in those moments, we have never asked before. Questions like…

- *What is missing for you in this issue?*
- *What is at stake for you here?*
- *What is important for you that is not being taken care of?*
- *What key concerns are not being addressed?*

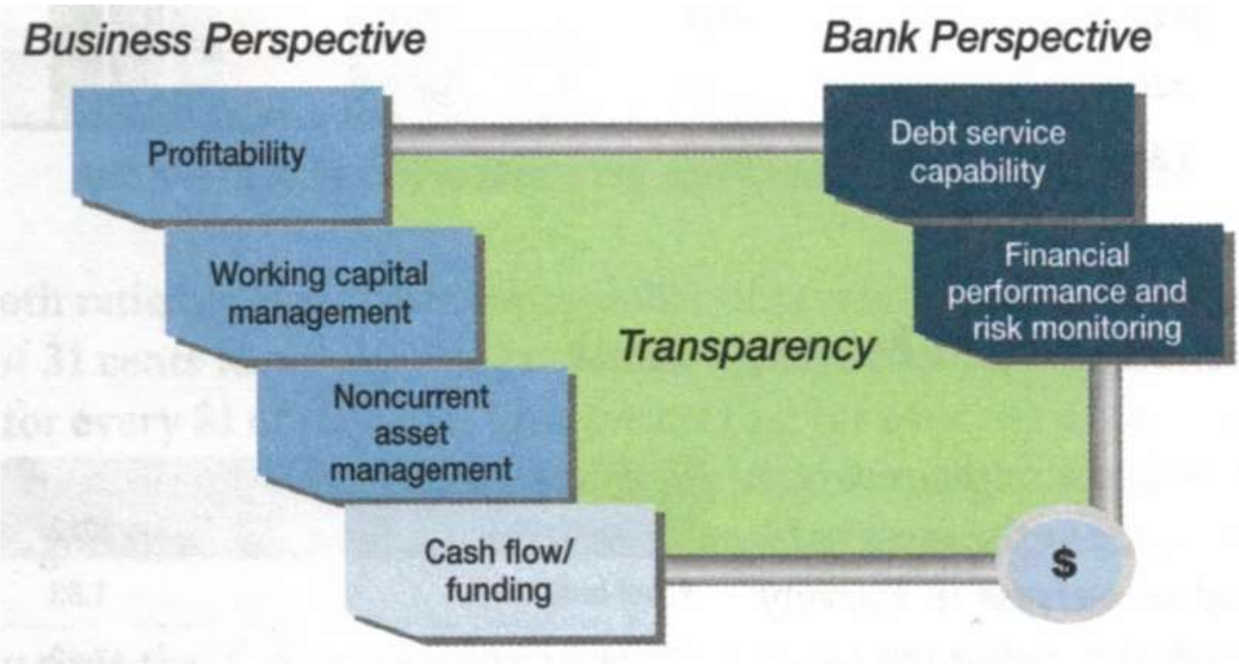
If we can manage our own emotional reactions AND be curious about what matters deeply to the other person, we may well find ourselves on the path to bringing understanding, healing and reconciliation.

There is a common myth about family communication – that if something is not talked about, the family relationship will become stronger because there are no fights. However, in reality, when families have the ability to constructively disagree about important issues and have effective forums/processes for resolving their conflicts, they develop more trusting relationships.

Improving your Business Drivers (Part 1)

To get your business really humming you need to get your four keys drivers operating very effectively. In addition, you need a very functional banking relationship with regular communication and information updates about your business position and banking needs and support for funding business finance requirements.

The interrelationship between the business drivers (“*business perspective*”) and the bank’s core assessment criteria for your business (“*banker’s perspectives*”) are shown in the diagram below.



Business Driver 1 - Profitability

Having a focus on maintaining strong, sustainable and growing profits in the business is usually a fundamental objective of most business owners and operators. However too often they can get caught up in the day-to-day operations and tasks which can disrupt the core focus of good business profitability.

Profitability is underpinned by business performance and is the essential driver of every business. However, it's not just about making money today but also securing the ability to grow the business in the future. Therefore, it must be a key focus of business owners and managers.

Increasing profitability also boosts your ability to enhance performance. A review of profitability should involve a trend analysis – a review of profit levels over time to identify dips and improvements, or if profit levels remained constant.

Sales (revenue) and costs data provide insights into factors impacting profitability at any given time. Drill down on sales and costs data to identify factors contributing towards increasing profits (good Gross Profit margins), or a reduction in profits or losses being incurred. Consider measures that can be taken to improve the performance of those factors.

Ask yourself the following questions: Ultimately, you want to consider how to boost revenue and/or bring down expenses (cost control).

- *How is my business currently performing?*
- *Am I achieving what I want to achieve or am I on track to achieving it?*
- *Are profit levels rising, stagnant or decreasing?*

So, as part of your assessment of business performance, you should consider:

- *Do I have the right products or services to achieve my objectives?*
- *Which markets do I want my business to compete in?*
- *What does my business have to do effectively?*

Improving business performance is also linked to appropriate risk management strategies. You should consider the following factors:

- *What do my current and future competitors do better than my business?*
- *What does my business do better than them?*
- *What external factors are impacting my business and may continue to impact my business in the next few years?*
- *What internal factors are likely to disrupt my business in the short, medium and long term?*
- *How do I implement change with minimal disruption?*

Sales

There are three key components to sales revenue: **price** (giving solid gross profit ("GP") margins)**, volume** (but not just more revenue without maintaining GP margins)**, and quality customers** (perhaps driven by new products & services and improved customer service). An improvement in one or more of these areas will contribute to increased profitability and enhanced business performance.

Costs

Simply put, you need to cover costs (overheads) to make a profit. There are two categories of overheads in a business - fixed or variable. However, overheads are neither completely fixed nor variable, as recently seen during the pandemic period; e.g. rent & related costs could be renegotiated, permanently reduced or deferred and other core administration costs slashed.

- **Fixed Costs:** Profitability is impacted when sales decrease (gross profit is down) but fixed costs remain constant. These are costs that will remain relatively constant regardless of the level of sales. For example, rent, salaries, insurance and depreciation. These costs can increase or decrease in line with changing economic and other trading conditions.
- **Variable Costs:** Monitoring variable costs is critical to profitability. These expenses move relative to sales, for example, raw materials, freight costs, marketing, delivery charges, sales team salaries etc. Where sales remain flat or decrease, it is important to manage these costs in line with sales, to reduce the risk of profit erosion.

Business Driver 2 – Working Capital Management

Understanding working capital ("WC") is fundamental to operating a business effectively and efficiently. The key to successful WC management is reviewing all the essential components in the WC cycle. The diagram above demonstrates how the WC cycle operates.

Effective WC management is crucial to the performance of any business and requires continual review and diligence in managing stock levels, debtor collection and creditor payment whilst preserving profit margins. There are many ways a business can improve the WC cycle. The following commentary provides an overview of the key components of the WC cycle that should be addressed when looking to improve business performance.

Supplier Management

A solid supplier relationship will enhance business operations by minimising sourcing issues and increasing the business's reputation for efficiency and good management. By keeping suppliers up to date on the business operations, they can often provide useful information and advice, including new products or services. Good communication with suppliers will ensure that the business is seen as a reliable customer and may encourage more favourable payment terms from the supplier.

Stock Management

Appropriate stock or inventory management can be a very effective means of improving overall financial performance. Proper monitoring, organising and coordinating of ordering inventory can substantially improve your cash flow and available WC and result in lower stock holding days.

With the additional WC funds released, you may choose to reinvest more back into your business more regularly, enabling it to grow and to expand its market base.

Inadequate management of stock can drain cash flow and directly impact sales. Inadequate record keeping, lack of understanding of stock movement and lax physical and procedural controls contribute to stock losses and/or overstocking*, which is costly.

**It is estimated that holding stock can cost anything between 10 and 30 per cent of the value of stock. This includes storage, insurance, keeping accurate tracking records, obsolete and aged stock, financing costs and proper controls over theft.*

Work in Progress (WIP)

Good management of WIP is supported by sound management systems for the efficient execution of customer orders. WIP is often only thought to be relevant in manufacturing businesses; however, some retail and service businesses also have a form of WIP – the time between the customer order to final delivery of the goods/services can be defined as the WIP.

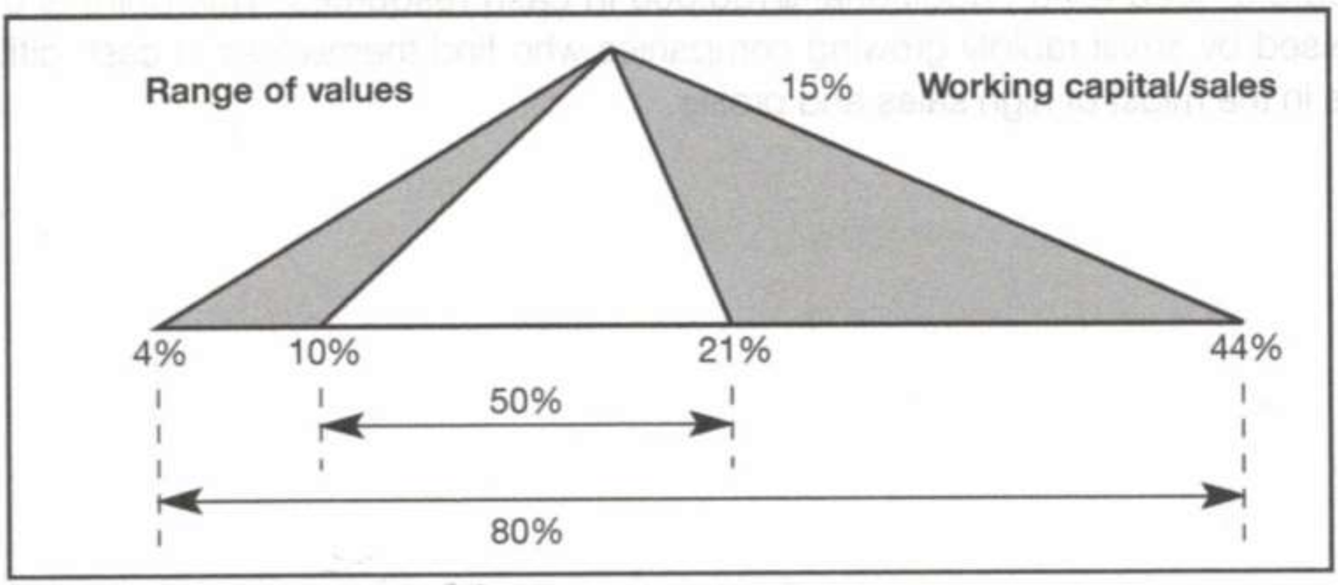
WIP is often a source of inefficiency in business due to the complex nature of completing production. With poor processes in place, WIP can be delayed at various points in production and this can impact all aspects of the working capital cycle. The key to improving performance of WIP is to identify and act on both actual and potential "bottlenecks" and reduce the WIP days.

Debtor Management

A good customer is one that pays within the agreed invoice terms. If you are not collecting cash from your customers, then you are effectively funding their business as well as your own.

Managing the payments due from debtors can involve a lot of (wasted) effort if proper controls and procedures are not put in place at the outset. Thus, it is important to encourage timely payment from the get-go and lower your debtor outstanding days.

Working Capital Required



Source: "*Key Management Ratios*" 4th Edition - Ciaran Walsh 2008

The table above shows that **for half of all businesses, their working capital requirements average about 15%** (ranging between 10% & 21%) **of their annual business sales**; whilst 80% of overall businesses typically have a working capital need ranging from 4% to 44% of annual sales revenue.

The nature of the industry the business operates in, does influence this broader % range, with those businesses with lower profit margins, large stock holdings and long supply lead times - generally having the higher working capital demands.

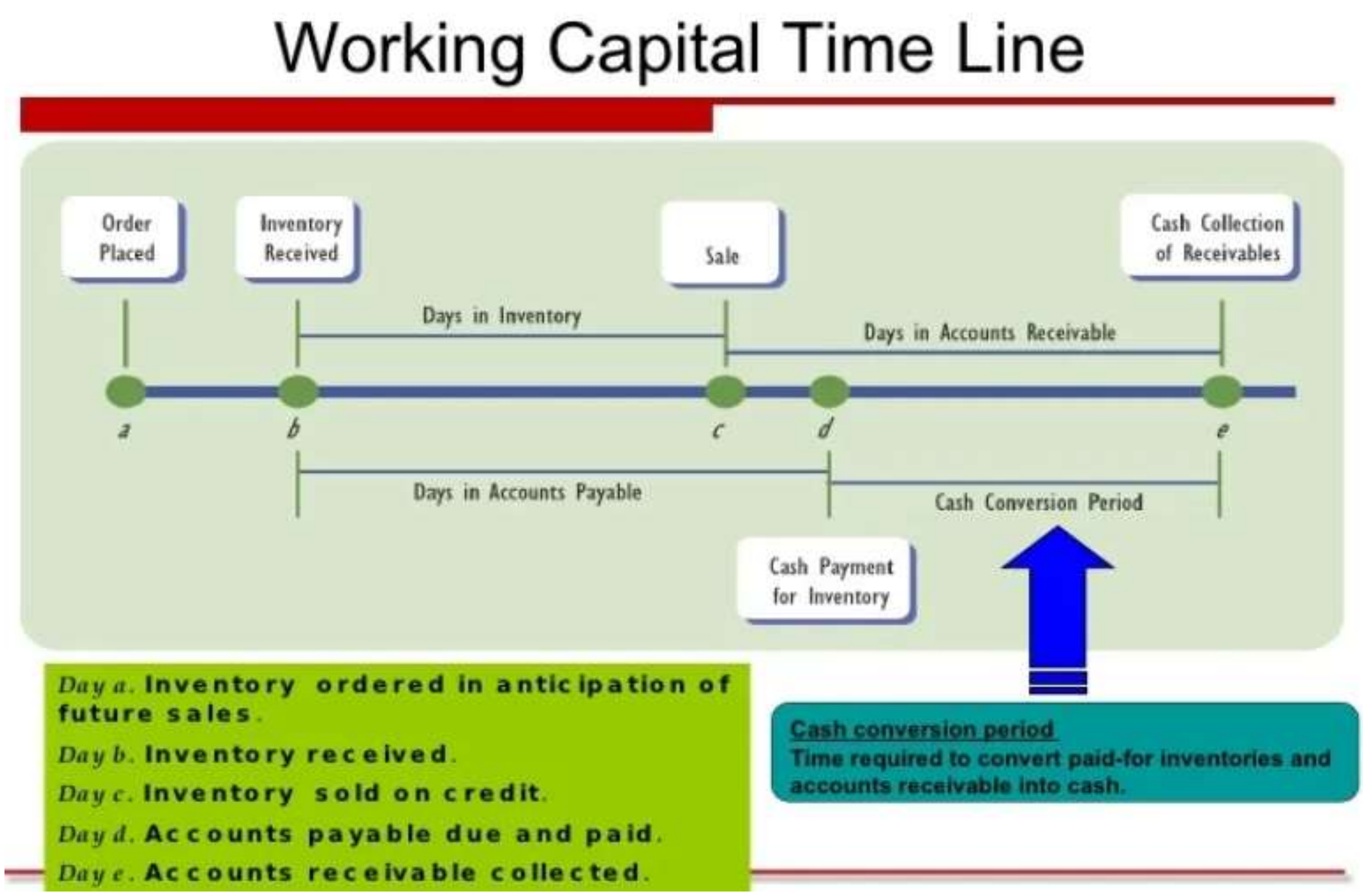
Calculating Working Capital

In its simplest form, working capital is represented in equation form as shown below:

Working Capital $'s required = Debtors/Receivables + Stock/Work in Progress – Creditors/Accounts Payable
Example Business: WC = $750,000 + $1,500,000 -$500,000 **= $1,750,000**

Annual Working Requirement % = Working Capital ÷ Annual Sales Revenue
Example Business: $1,750,000 ÷ $10,000,000 x 100/1
= 17.5%

However, if your sales are growing at say 20% pa then the WC requirement may be higher than 17.5% - perhaps 21% or more, depending upon several inter-related factors - including gross profit margin (stability, erosion or growth), debtor and creditor day's outstanding changes (+/-), supply chain issues impacting stock levels (+/-) and other economic factors e.g. inflation and interest rate impacts, wage hikes etc.

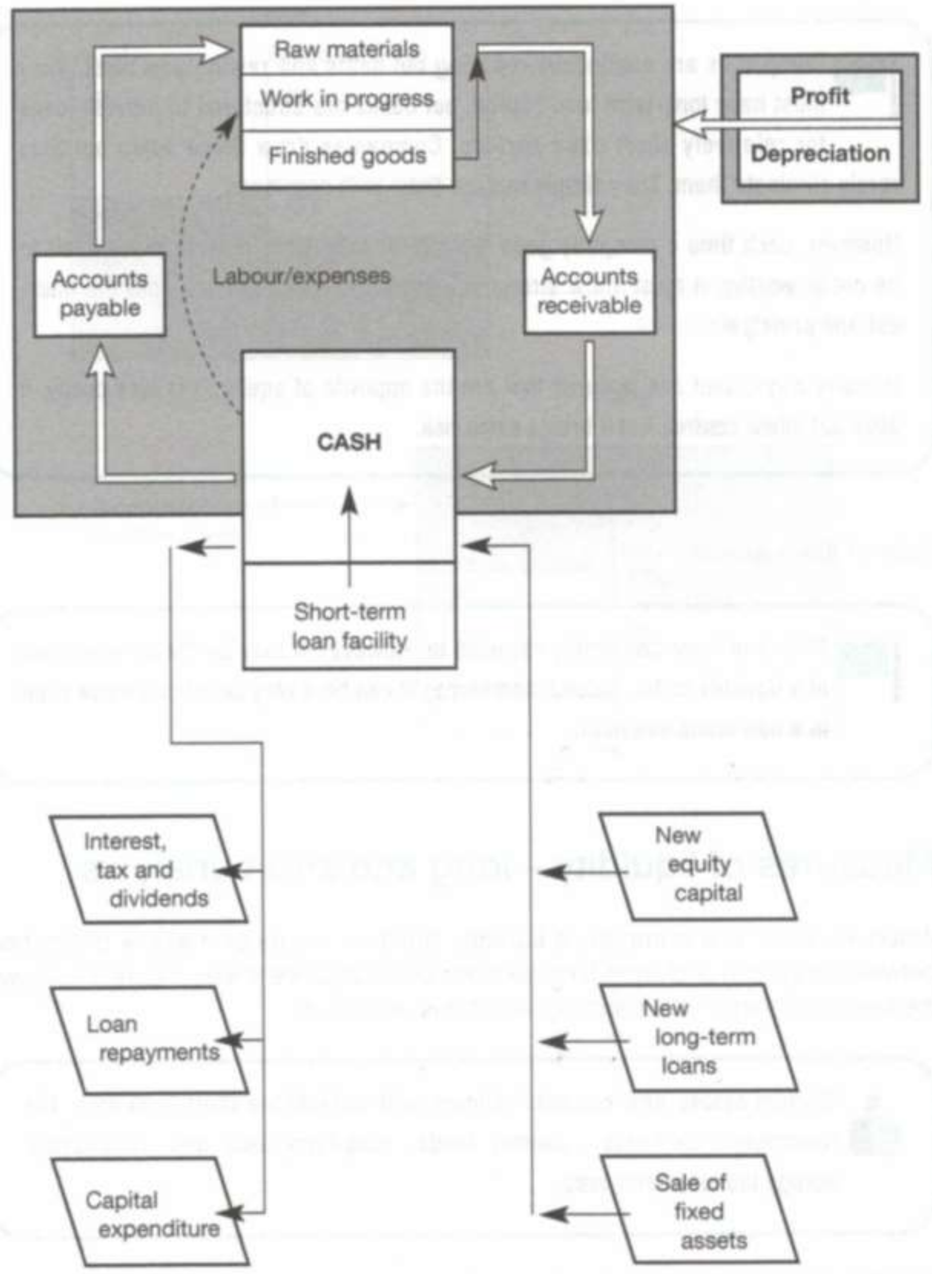


Working Capital Efficiency

The objective for the business owner is to continually improve the working capital efficiency (towards an optimal position), by making small and positive changes - to reduce working capital days over time.

An example of tracking this improvement process is illustrated in the table below.

Working Capital (WC) Component - Days	**2021 Financial Year**	**2022 Financial Year**	**2023 (New Targets) Financial Year**
Receivables/Debtors	55	47	40
Stock/Work in Progress	120	110	95
Payables/Creditors	45	40	35
Total WC Days for Year	130	117	100
WC Efficiency Improvement from 2021		**+10%**	**+23%**



Source: "*Key Management Ratios*" 4th Edition - Ciaran Walsh 2008

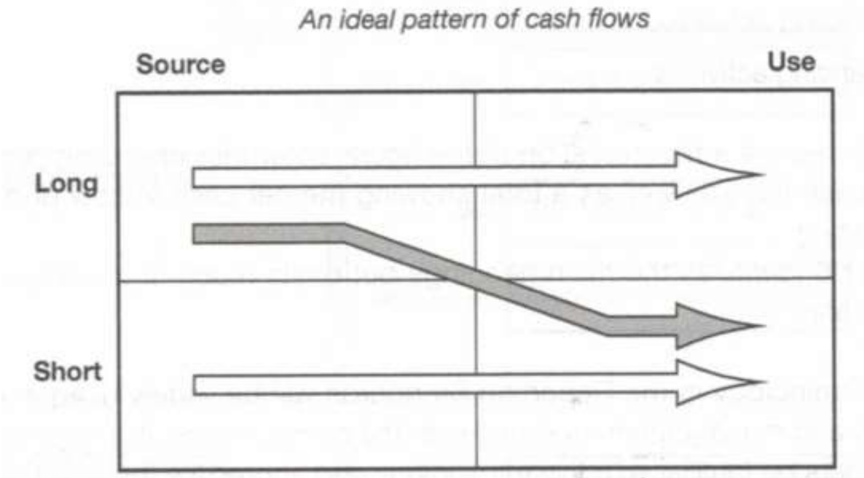
The inter-relationship of working capital with the other sources of capital and the use of funds in a business is outlined in the diagram above.

The business cash position is improved by the net after tax profit from operations, plus the non-cash item for depreciation of plant & equipment and potentially by new sources of cash from owner increases in equity funds, sale of assets and perhaps new loan facilities for funding growth and new capital items. Of course, annual cash outgoings are also typically required to pay tax on net business profits, service loan repayments and pay dividends or distributions to the business owners.

We have seen many examples of business owners having to (or choosing to) either partially or fully fund the working capital needs of the business. This has meant they cannot access all of their dividend/distribution entitlements in a reasonable timeframe and this can in turn create cashflow stress at the personal level too. There is another better approach that should be taken by business owners/operators, as we discuss below.

By having strong working capital efficiency and sustainable business profitability, a business can usually arrange appropriate short-term working capital funding facilities with their bank. This then means the lock-up of owner's dividend/distribution entitlements in the business can then be released to them on a timely basis, so their personal cashflow needs are met. Speak to your bank to seek to arrange suitable WC funding facilities at reasonable interest rates and solve your working capital funding headache.

The other important thing when organising finance funds for your business is to appropriately match short term funding requirements with short term facilities and generally – long term funding needs with suitable longer-term facilities. The reasoning for doing this is clearly explained in the diagram below.



Note:
Over a long period we would expect to see a cash pattern as illustrated above, with these elements:
(1) long investments being funded from long sources
(2) short investments being funded from short sources
(3) some long-term funds being invested in short-term assets.

The reason for item (3) is that working capital needs to expand in line with company growth. The funds to meet this requirement must be drawn from a long source.

Source: "*Key Management Ratios*" 4th Edition - Ciaran Walsh 2008

We will continue to discuss the other drivers of business – and also discuss the banker's perspectives for a business customer - in part 2 of this topic next month.

Business Essential Briefs: The Hardest Leadership Task

What is the hardest thing for a leader to do? Are you thinking firing people, remaining calm, managing conflict, making the tough decisions?

It is something much more fundamental - it is communication.

We truly believe communication is the single hardest challenge a leader faces. If you communicate well, you will ensure the right people are hired and lead, so no need to fire poor recruits. Remaining calm will be much easier as you won't need to be exasperated at the actions of others. Conflict will be the domain of the lunchtime sporting context because staff will be standing side by side and near perfectly aligned with your organisational purpose. As for the tough decisions, they won't seem as tough, as you will have extreme clarity over your business options.

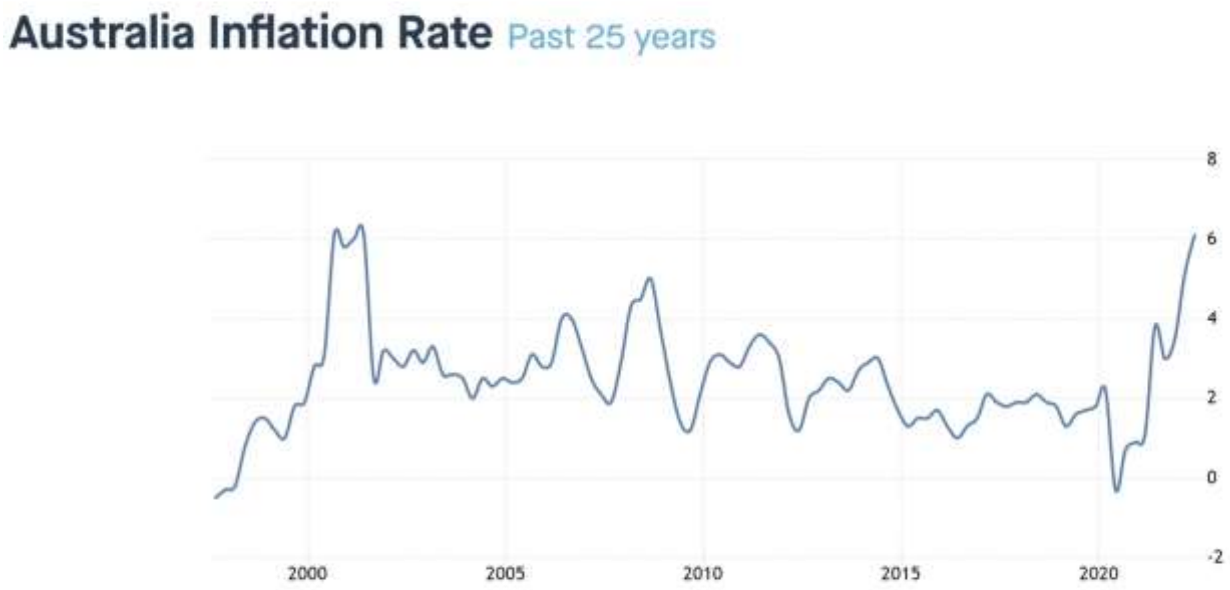
So, if you want this nirvana, here are a few tips: -

For a Risk Leader - the communication challenge is to translate risk concepts into strategic or operational business concepts management and staff will understand. For that we recommend spending time understanding the business.

For a Strategic Leader - the challenge is to translate strategy into operational concepts the average worker can understand. For that we recommend placing yourself in their shoes.

For an Agile Leader - the challenge is to simplify strategy and risk down to the most important core imperatives that management and staff can focus on. For that we recommend you measure what matters.

While we all have our roles in organisations, sometimes we need to show leadership across the board. Perhaps the hardest thing for a leader to do is to shift from role to role and be a great communicator in each of them.



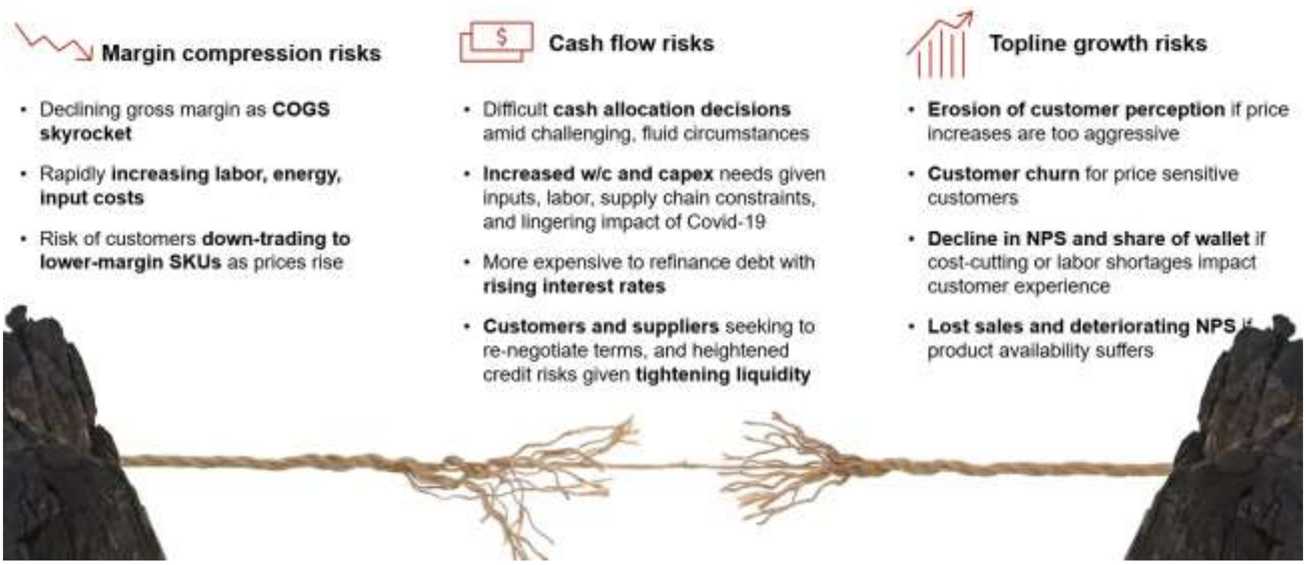
When inflation occurs, companies typically pay more for input material. One way for companies to offset losses and maintain gross margins is by raising prices for consumers, but if price increases are not executed thoughtfully, companies can damage customer relationships, depress sales, and hurt margins.

According to McKinsey & Company, done the right way, recovering the cost of inflation on a case-by-case basis can strengthen customer relationships and overall margins.

There are five steps companies can take to **ADAPT** (Adjust, Develop, Accelerate, Plan, and Track) to inflation:

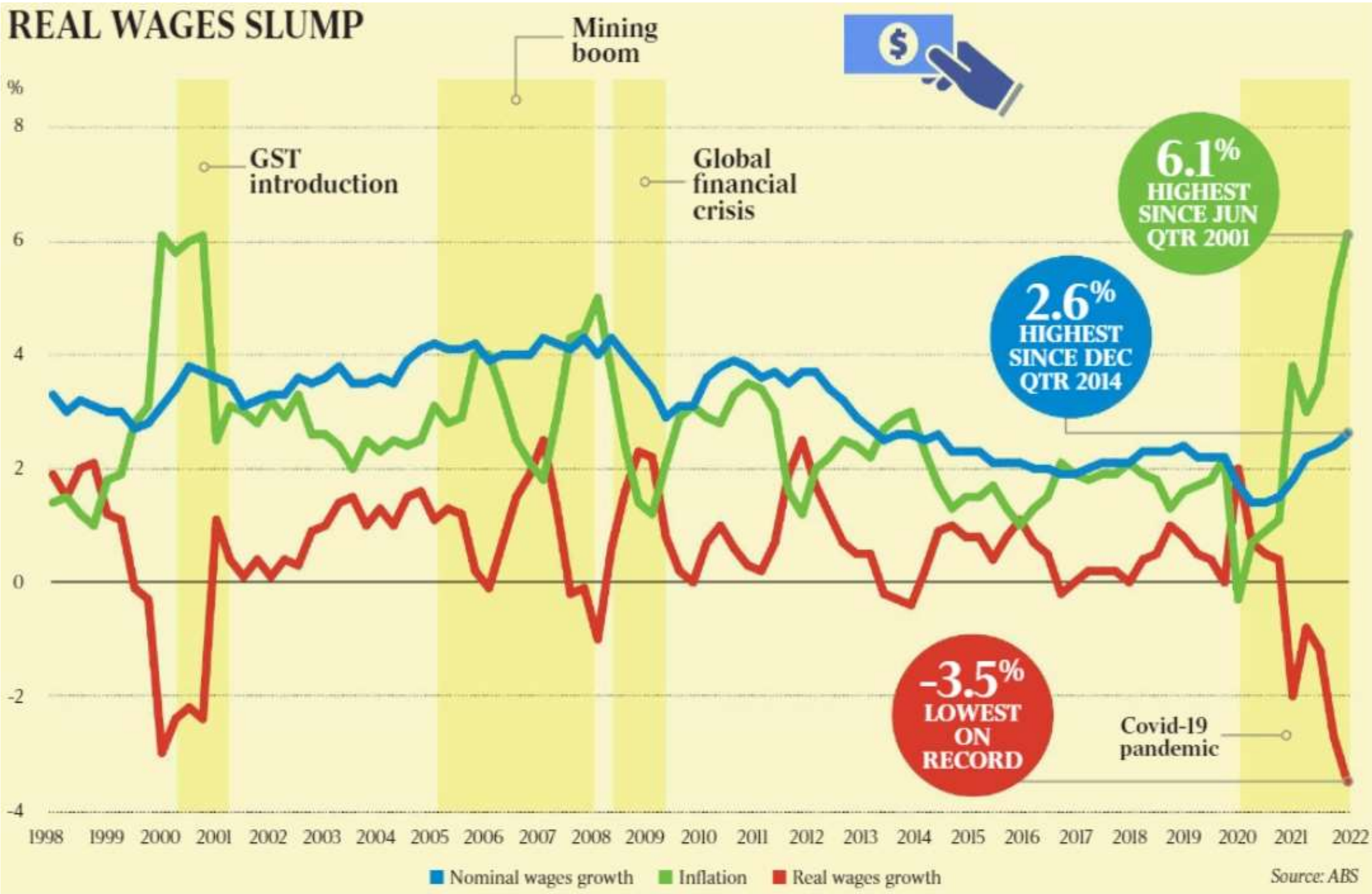
1. **Adjust discounting and promotions** and revisit other aspects of sales unrelated to the base price, such as lengthened production schedules or surcharges and delivery fees for rush or low volume orders;
2. **Develop the art and science of price change**. Don't make across-the-board price changes; rather, tailor pricing actions to account for inflation exposure, customer willingness to pay, and product attributes;
3. **Accelerate decision making tenfold**. Establish an internal "inflation action group" that includes dedicated cross-functional, inflation-focused decision makers who can act nimbly and quickly on customer feedback;
4. **Plan options beyond pricing to reduce costs**. Use "value engineering" to reimagine your portfolio and provide cost-reducing alternatives to price increases.
5. **Track execution relentlessly.** Create a central supporting team to address revenue leakage and to manage performance rigorously.

A summary of the key inflationary impacts that businesses need to vigilant around for - gross sales margins, business cashflow and total sales revenue - are shown in the diagram below (COGS = Cost of Goods Sold):



The potential impact of wage pressures will also need to be actively monitored and controlled where possible. The cost of living pressures at the personal employee level will no doubt mean potentially significant wage increases may be sort by individuals and groups with union support in the bargaining process.

The diagram below shows a good comparison of the historical wages growth in (both nominal and real terms) and inflation levels from 1998 to the current position today – perhaps indicating that wage pressures may be more constrained than general expectations being speculated in the media. Supporting this are some economists forecasting the inflation spikes are likely to be short lived and cost of living pressures may get some relief too with the cash interest rate perhaps peaking in 2023 and then reducing.



Additional Resources

If you would like a copy of McKinsey & Company's article "***What is Inflation and Related Inflation Guidance***" from August 2022, please click on the link **HERE**.

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