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WHEN PLANNING TO SELL YOUR BUSINESS, BE SURE TO ADDRESS YOUR FAMILY ISSUES

By Warren H. Feder

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DRIVING SUCCESS THROUGH
CHANGE AND GROWTH

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By Warren H. Feder



Warren H. Feder
Partner
Carl Marks Advisors

CONTACT

212-909-8449
wfeder@carlmarks.com
vCard

Selling a family business is an intense process that draws on the skills and experiences of everyone involved -- the CEO, owners, management team and outside advisers. Combining family issues with business considerations further complicates the sale process. Understanding what the family business provides to each key family member and addressing these needs ahead of time is essential to getting the required buy-in from the family and, ultimately, the successful execution of a sale.

Several areas require careful consideration early on in the sale process: the reason why a sale is being considered, timing of the sale, educating family members on the sale process and preventing or resolving conflict.

Motivation and timing

The key driver of the sale of a family business inevitably involves the family circumstances. The business leader may be nearing retirement age or thinking of moving on to something else. There may be no capable family successor who is willing to run the company, or perhaps several competing successors are in conflict with each other. The business may require new investment, a management overhaul or a repositioning, and the owners may not be interested in more heavy lifting.

Understanding what the family is looking to achieve through the sale is crucial. If it is to be a complete sale and exit from the business, maximum cash at closing and a short transition will be the likely key drivers. Other families may want to take some chips off the table while continuing with a partner that would fund and guide growth. Sometimes a generational issue can be resolved by having the senior leader exit in full while the next generation moves forward with a new partner.

The timing of the sale is critical. I have always been impressed by successful entrepreneurs who had the judgment to exit at the right time rather than waiting for the next big (or little) thing. On the flip side, we have known many owners that didn't pull the trigger when they had the opportunity and ended up with very little to show for years of effort.

Right timing involves a number of factors. Is the economy growing? Is financing readily available? What is the health of the industry sector in which the business operates? Is it growing, contracting, consolidating or undergoing other significant structural change? What are the implications for the company in question? Has the company been approached by a financially capable and motivated buyer? As a general rule, having a strong and motivated buyer at your door is far more important than improving performance a bit and going to market without an aggressive suitor.

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www.carlmarksadvisors.com

New York City
900 Third Avenue
33rd Floor
New York NY 10022
(212) 909-8400

New Jersey
336 Main Street
P.O. Box 1005
Bedminster, NJ 07921
(908) 234-2373

North Carolina
212 South Tryon Street
Suite 1685
Charlotte, NC 28281
(701) 714-1240

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Rallying the family

Driving agreement around the sale of a business requires that all family members have a clear understanding and realistic expectations as to what a sale of their company entails. Family business owners generally underestimate the intensity and length of the sale process, which often takes six months or more to complete. And, while good investment bankers will do their best to minimize distraction to management during the sale process, selling a business is a labor-intensive process and requires additional work and commitment on the part of management. At the same time, the business must continue to run successfully; there is nothing more important in value creation during a sale process than management hitting or exceeding its numbers each month.

Disclosure and sharing confidential information with prospective buyers is often a source of concern for family businesses. Many families are very secretive and sensitive about dispersing information within their own company, let alone to third parties. Most are highly concerned that if word gets out that their business is up for sale, this will have a devastating effect on customers, employees and the business as a whole. And, while they understand conceptually that the use of non-disclosure agreements and secure data sites offers some protection in regard to what information is disseminated and to whom, such measures never fully alleviate their concern.

The quality and degree of financial information that must be provided to prospective buyers also requires some education. For example, many family businesses do not track profitability by unit or segment, nor do they prepare detailed projections and forecasts for the upcoming years. Others may not have an outside accounting firm prepare audited or even reviewed statements. Corporate governance might be minimal; board meeting minutes may not have been kept, and other records and contracts may be hard to find. Getting these in order in advance of a sale process is time well spent.

The other area that is typically of concern to family business owners contemplating a sale is the requirement that they provide the buyer with representations, warranties and indemnifications. Many family owners don't like to "guarantee" anything and so shy away when asked to give these assurances. Part of the education process involves explaining to the owners that they are standing behind the historical information and actions of the company rather than giving any guarantees about future performance.

Potential sources of conflict

Family businesses are peculiar animals and serve a variety of needs and roles for different family members. Selling all or part of a business that has been in the family for generations raises a vast array of intense emotions that color virtually all decision making. It

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Warren H. Feder, a former owner and operator of a family business, is a partner and the co-founder of the investment banking group at Carl Marks Advisors.

CONTACT

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wfeder@carlmarks.com
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is helpful to understand what the business provides to each of its owners in order to identify potential conflicts and structure solutions in the context of a sale. Areas to consider are:

- Job with salary and bonus.
- Dividends or distributions.
- Lifestyle benefits (e.g., health care, cars, travel).
- Self-worth.
- Status in the community.
- Something to do every day.

Giving thought to what different family members are getting out of the business today and what their participation might be in the business after a sale is important. A change in circumstances could spark a range of potential conflicts. Often, if addressed properly, solutions accommodating the various family members' goals and expectations can be found. For example, conflicts involving status and position may be addressed by having the new owner offer continued office space, a role on the board, service on a relevant committee or an honorary title.

In one instance, the founder of a high-growth family business wanted to cash out and move on to other endeavors. His two younger partners running the business wanted some liquidity but also a strong partner to help them grow the business. Once we understood what each family member wanted, it was possible to structure a deal that accomplished exactly that: The founder was

paid in full (in cash) at closing. His partners received cash but continued to own part of the company going forward, with finely structured put/call options giving them a potential substantial second payday down the road.

Another client, with two children in the business, was in his 70s and looking to move on. His daughter was married to the CEO and wanted to grow the business. His son preferred to run a smaller discrete operation. A transaction was structured in which the daughter and her CEO husband raised capital to buy the bulk of the business from the father, giving the father cash at closing. At the same time, one property was carved out to be owned and run by the son. This structure facilitated an orderly transition that left everyone happy. In our experience, many family business owners are unaware of solutions that could mitigate their seemingly huge conflicts and result in very desirable outcomes.

Owners of family businesses will do well to draw on all available resources in preparing for a sale and exploring their options. Trusted advisers, including investment bankers, lawyers, former family business CEOs, accountants and specialized consultants can be helpful. While family business owners are quite comfortable leading, tapping sources from outside may not come easily to them. However, gaining this knowledge and perspective in advance will provide a more solid foundation for the consensus building needed to get family members on board and execute a successful sale.

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