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# Selling the Family Firm Without Tribal Feudalism

BY CHARLES STEIN

Marc Schecter's business had come a long way since his father began importing watches and clocks 25 years earlier in Warren, Mich. Advance Watch Group had reached $100 million in annual sales and more than 300 employees, and had provided a nice living for the Schecter family. But there were issues to deal with. Nearly all of the family's net worth was tied up in the business, which meant Schecter and his brother were responsible for the financial well-being of their parents and sisters. "I wasn't comfortable with that," he says. Beyond that, the business needed to expand, which meant it needed more money. Schecter concluded there was only one way to reconcile the conflicting pressures: sell the family company.

Selling a family business can be wrenching, as difficult emotionally as divorce. It can pit family member against family member and generation against generation. It doesn't matter whether you're unloading a large importing concern like Advanced Watch or a mom-and-pop; the same dynamics apply. "Imagine a dysfunctional family around a Thanksgiving table, and throw $50 million into the center of it," says Peter Hermann of Heritage Partners, a Boston-based private equity firm that specializes in buying family companies.

What can trigger the sale of a family-owned company besides needing cash to expand? A range of personal and business issues. On the family side, it might be divorce or death of a founder. In another common scenario, the founder may reach his 60s and conclude that there is no one in the family capable of taking over. On the financial side, that same entrepreneur may decide that selling is the only way he can give his children an equal inheritance, especially if not all of them work for the company. He may also feel uncomfortable having nearly all of the family's wealth tied up in a single illiquid investment.


**McGrogan:** *To keep his staff intact, he turned down the highest bidder.*

Put these pressures together, and you see why only one in four family-owned firms makes it to a second generation and only one in ten makes it to a third, according to a study by the Wharton School at the University of Pennsylvania.

For those who decide a sale is the right way to go, here's what you'll have to deal with in today's marketplace. First the good news: The demand for family companies is strong. Thanks to the wave of consolidation sweeping through so many industries, there are plenty of buyers willing to scoop up solid family firms, even in the most prosaic old-economy fields. According to Thomson Financial Securities Data, nearly 1,600 private companies were acquired for $50 million or less last year (a good proxy for family businesses), roughly three times the number of deals done in 1990. The bad news: Since the economy began to slow down in the third quarter of 2000, banks have become gun-shy about lending money for deals of all kinds, large or small. Interest rates have not climbed. Instead, the financiers are cutting back on the amount of money they will lend on any given merger.

The bottom line is that purchase prices of family concerns have come down, perhaps as much as 20% since last fall, according to investment bankers. When and if prices will rebound is anyone's guess. Thomson Financial expects the number of deals to decline this year as some sellers hold off, hoping for better days ahead. "You may get people waiting three or six months to see what happens to the economy," says Paul Sperry, an investment banker at Sperry, Mitchell & Co. in New York City, and co-author of *The Complete Guide to Selling Your Business* (Institute of Directors, $24.95).

Considering the challenges, we asked investment bankers and buyout firms that specialize in this area to help us come up with a five-step exit strategy for founders of family firms. Here's their advice.

**Clean up the company for a sale.** Paul Schaye, an investment banker at Chestnut Hill Partners in New York City and an FSB columnist, says that a family company needs to make itself look and operate more like a public company before presenting itself to potential buyers. "That means getting Uncle Charlie off the payroll and getting rid of excessive expenses like country club dues," says Schaye. Putting together three to five years of audited financial statements is another key element in the cleanup process.

**Be realistic about price.** Most family business owners have an inflated view of their business' worth, according to Sperry. They assume their firms can command prices comparable to those of public companies. Not so. Sperry estimates that because the market is less liquid and efficient, private businesses sell for anywhere from 20% to 50% less than similar public companies. These days, he says, a typical family company might sell for between four and five times earnings before interest and taxes. (Last fall those same companies sold for five to seven times earnings.)

**Decide whether you want to stick around.** If the entire family is looking to make a clean break from the business, it probably makes sense to sell to a strategic buyer, someone in the same industry who has a management team ready to run the company. But if you or a family member wants to keep a key to the executive suite, selling to a financial buyer might be a better approach. Financial buyers, usually private equity firms, normally purchase a controlling interest in a business and leave the family in place as minority owners. On the plus side, such a deal lets a family take some of its money off the table and still keep a hand in the business. On the minus side, the new majority owner ultimately calls the shots.

**Hire a pro to handle the transaction.** "People who run family firms are good at running their businesses," says Lloyd Greif, a Los Angeles investment banker. "They don't know anything about buying and selling companies." Greif's advice may be self-serving—he makes his living doing just that—but it is still good advice. That's because such pros are likely to identify a large universe of potential buyers and negotiate the best price. They are also more likely to make sure the deal actually closes. The last thing a company wants is to distribute confidential information to its rivals and then have a sale fall apart.

Taylor Thompson can attest to that. He nearly sold his company on his own, but in the end he chose to use Sperry's investment banking firm. He ultimately sold for $25 million, about 50% more than the initial offer he had negotiated himself. He also got to pick from 12 offers for his unsexy business: FTS Systems, a $14 million maker of heating and cooling systems in Stone Ridge, N.Y.

**Thompson:** *His banker gathered a litter of buyers for him to choose from.*

So how do you find a good investment banker to spearhead the entire process? Lawyers, accountants, and trade associations are places to go for referrals. Expect to pay commissions of 1% to 5%, depending on the size of the deal. For example, on a $1 million deal the fee would be 5%, and on a $20 million sale the fee would be about 1.5%.

**Pick the buyer you like the best.** The sellers of a public company have a fiduciary responsibility to sell to the highest bidder. Family companies have no such constraint. When Pat McGrogan sold his 36-person Jacksonville company two years ago (he declined to give sales figures), he turned down an offer from the highest bidder. "I thought they were going to turn around and sell the company in three years," he says. "It wouldn't have been fair to the staff." McGrogan, whose firm distributes replacement parts for golf carts, instead picked a buyer, Koda Enterprises, a Boston investment firm, for about $15 million. He felt Koda would give him autonomy and let him keep the staff intact.

Marc Schecter had a choice of buyers when he decided to sell Advance Watch Group. In the end he sold to Heritage Partners for about $100 million. The money allowed Schecter and his brother to cash out the rest of the family. The two brothers retain a minority equity stake in the business and run its day-to-day affairs. "We now have upside potential and a partner with deep pockets," says Schecter. And one more thing: a happy family. For now, at least.