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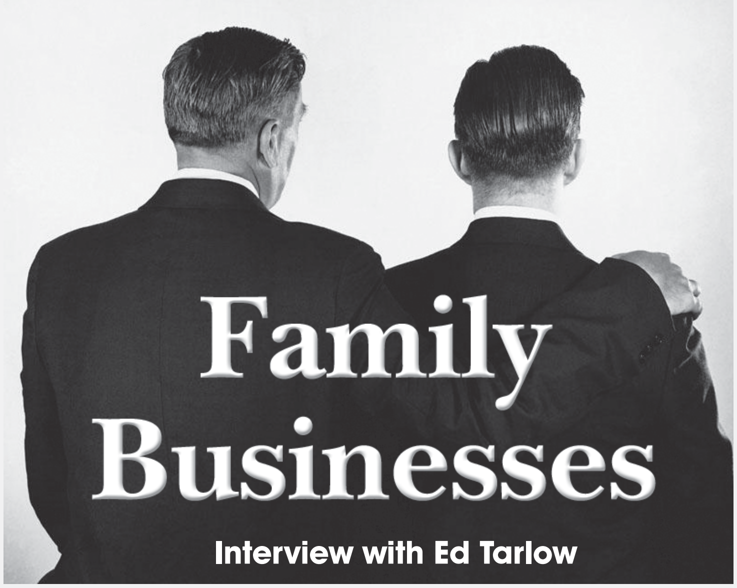

Family Businesses

Interview with Ed Tarlow

INTRODUCTION

Ed Tarlow, a founding shareholder in the Boston based law firm Tarlow, Breed, Hart & Rodgers, P.C., describes himself as a family business lawyer. In this capacity he has helped hundreds of clients who have started, managed or inherited a family business. His work spans the range of entrepreneurs' needs, from corporate formations to debt and equity financings, from tax and estate planning to attracting and motivating employees, from buying and selling businesses to dispute resolutions. We sat with Ed recently and inquired into his experience dealing with family business owners and how investment bankers can help them. His observations are described below.

As family businesses age, they often prepare less and less for their future. This phenomenon can be particularly prevalent in businesses which are owned by the third and fourth generations of the founders of those businesses. It is surprising how frequently owners who are actively involved in the business fail to address the foreseeable and thorny questions the future holds in store – is the business well positioned to face the inevitable industry change, is there a plan for management succession, and is the company's corporate governance model still appropriate for a widening shareholder pool? The more complacent a family business and its owners become, the greater the risk that the business and the owners will be unprepared for those future challenges which, if not responded to adroitly, can damage the business and disrupt family relationships.

It is not unusual for a family business that is no longer graced by its founder's energy and vision to consider a sale or a merger as its response to industry change and business obstacles. However, these transactions are frequently unappealing for many family businesses. Why? Because a family's emotional attachment to the business, or the importance of the business's legacy within the family structure, can stir feelings of guilt and obligation within families.

For some families, the idea of selling Grandpa's business can be as unsettling as putting your child up for adoption — the ultimate capitulation. Many abhor the thought that the company name (and sometimes even the family name), the corporate culture, the employees, the customers, the vendors — cultivated over generations and an almost living and breathing part of a family — will simply be handed over lock, stock and barrel, to another entity. Imagine if Ford Motor Company, where 40% of the company's voting stock is owned by Ford family members, decided to sell to Toyota. Do you think Ford family members might worry that Henry Ford would roll over in his grave? That Bill Ford, its current CEO, might be unwelcome at family holidays?

These reactions, however sincere, can and do get in the way of an objective evaluation of a sale or merger opportunity because selling or merging the business may be very a logical response to a rapidly consolidating industry, a sprawling ownership structure, or even to divisive differences arising between family branches.


Ed Tarlow

The Sale or Merger Process with Family Businesses

The sale of a family business is a traumatic and emotional event. The sale of a family business usually occurs only after other scenarios have been examined and found wanting or are just unavailable. These can include:

- Bringing in younger family members to take over the business so that senior family members can retire — sometimes junior family members are uninterested or incapable of taking control and managing the business.
- Replacing founders and family managers with a professional management team – private companies can not always attract knowledgeable, experienced, qualified professionals.

- Investing in new plant and equipment for future operations – the current needs of family owners who depend on company distributions can occasionally preclude a company from making the investment it needs into its future.

A family owned business can receive invaluable assistance from an investment banker with experience dealing with family run businesses. Bankers who are familiar with the dynamics of familial decision making, who are able to present alternatives in a clear, compelling and informative way, and who are sensitive to not only the needs of the business but also the history of the family, can often achieve wonderful results — transactions where the family is left feeling financially secure, proud to have owned the business and confident that the business has been transitioned into good hands.

These outcomes are greatly facilitated by a solid working relationship between the family lawyer and the banker. Investment bankers rarely succeed in securing an audience with family owners through cold-calling. Yet when well introduced by a trusted family advisor, a banker can enjoy a real jump start towards developing a rapport and relationship with the family and can find that practicing in this area is both personally fulfilling and financially rewarding.

Providing Solutions for Companies at the Crossroads

Like any other business, a family business will eventually be faced with a variety of challenges. How they are handled will likely have a significant impact on the company, its relationship with its stockholders and even the interpersonal relationships among family members. These challenges can be all the more daunting in family businesses because a significant portion of a family's wealth is at stake and, for whatever reason, ineffective or incomplete communication among owners and poor governance practices are often lurking in the background. These circumstances combined with a competitive landscape can place this family wealth at risk.

Family owners need trusted advisors to help them guide their businesses and their families. While not all family businesses are immediately ready for sale, with a bit of help from lawyers and bankers a lot can be done to prepare the company for a transaction. This preparation should begin well before the family business and its owners reach the decision whether to sell the business. Useful steps might include:

- Establishing a governance system, such as an outside Board of Advisors, in which family owners (both active and inactive) can participate;
- Determining who or what is missing from the current management team (for example, reliance on a controller when what the business really needs is a CFO) and developing a plan for addressing any management deficiencies;
- Creating an employee evaluation system to determine whether employees are adequately performing and rewarded for the tasks required of them;
- Selecting independent directors to serve on the Board of Directors; and
- Formalizing a system for disseminating information to all shareholders.

Having taken some of these steps as suggested by the family business advisor, can the active family owners of the family business, acting as family stewards, feel increased comfort in addressing sale or merger issues? According to Ed, the answer is "Yes!" By improving communication and corporate governance, not only will the business become more attractive to buyers but the family will be more knowledgeable about the business, its needs and prospects and be better able to make the decision regarding sale or merger with the confidence that family harmony can be maintained.

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