LONE MOUNTAIN ASSOCIATES

# But I Don't Want to Run Dad's Business

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## BUT I DON'T WANT TO RUN DAD'S BUSINESS

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The family (or closely held) business has grown and prospered nicely over the years under the direction of the patriarch. But now, a "crisis" is brewing—the individual who built the business is dying or wants to retire to enjoy the fruits of his/her labors. The natural expectation is to look to the CEO's sons and daughters for a replacement. Yet none of them wants to follow in his/her footsteps or, perhaps, none is recognized as a qualified replacement. The dilemma of generational change has the power to destroy significant economic value as it rends apart families and long term friendships.

The problem becomes more complex if operating management sees an opportunity to demand equity participation for their work. Various structural alternatives, such as going public, issuance of benchmarked phantom shares, or creating ESOPs, are proposed and discussed, each with its own champions.

It becomes more complex again if the company is several generations old and there are many heirs.

And, of course, complexity grows exponentially when very large sums of money are at stake.

These are issues of ownership transfer and monetization of value. As such they are the focus of attention for all relevant stakeholders. Yet they do not address the question: who's minding the store? Who ensures that value is not lost through distraction or the lack of an operational leader? Without a leader, value can dissipate rapidly, as customers flee, competitors see weakness and indecision, valued employees leave, and product development languishes.

Forcing a new generation into leadership roles they do not want, though providing an immediate answer to the question "who is in charge?" is not a value enhancing solution.

Existing managers may be candidates, of course, but someone needs to evaluate their capabilities to perform without the patriarch.

Alternatively, one heir or other party at interest may propose someone he/she believes to be a great fit for the company. However, in the jockeying among parties at interest, regardless of the talent of the individual, this may be perceived as a political move.

Further, at such inflection points in the company's life cycle value investors or competitors may come calling, seeking to acquire the whole enterprise. While immediate monetization of their holdings may appeal to certain heirs and other shareholders, the question must be asked: is the would-be acquirer offering the maximum price?

An effective solution to deal with these multiple uncertainties is to engage a transition advisor, either as a consultant to the board or as an Interim CEO. Engaged for a limited duration—usually measured in days or months—the transition advisor should be well-versed in strategic assessment and general management, and can provide insight or actually lead the transition of the company through the generational change and position it for future growth. Such a person, with no agenda other than to maximize the value of the business enterprise, can successfully identify strategic choices, lead a dismayed staff through a resetting of roles and responsibilities, and provide sufficient calm to enable the orderly recruitment of a successor CEO to lead the company, from a solid base, to long term growth.

A transition advisor makes especially good sense during a generational change in a closely held business because the issues of operational leadership and valuation have such immediacy, must be addressed simultaneously, and, while inextricably linked, potentially have vastly different time frames.

Generational change precipitates immediate assessment of ownership issues for heirs and other shareholders. Each must evaluate what is in his or her best interest, affected by individual tax exposures. Multiple ownership choices, including cash outs, restructured ownership positions, and sale of the entire enterprise may have to be considered, each from the perspective of financial impact on the various shareholders now. Of course, each analysis may include consideration of deferrals of monetization, but the decision must relate to the timing of the precipitating event—the change in leadership. A transition advisor, whose purpose is to maximize the value of the company, can provide the necessary neutrality to ensure unbiased analysis of the various alternatives, work with valuation professionals, and make recommendations to the whole of the board. In the event that the board determines to sell the company, a transition consultant can provide the necessary transactional management, work with investment bankers, and complete the transaction, all without the burden of high cost expectations that "permanent" executive leadership would demand.

Operational leadership of the enterprise, on the other hand, assumes a longer term horizon. Even daily operations assume the company will do business in the long term, the dimensions of which are determined by corporate objectives and strategies. Regardless of how explicitly they had been communicated in the past, whether formally written, adopted and periodically evaluated, or residing solely in the brain of the patriarch, strategy and objectives drive the company operations. The generational transition is a useful time to redefine the business objectives of the enterprise and reconsider the strategies to achieve the objectives. A transition advisor can lead the process of analysis and decision-making focused on building the business, cognizant of the valuation issues being addressed by the shareholders.

While the going-in hypothesis is that the required operational strategy during the transition is "steady as she goes," it must be tested to ensure that steady does not mean steadily weakening. A clean slate business environment and as-is condition assessment, describing and dimensioning the business opportunities and challenges the company faces as well as its capabilities to meet those opportunities and challenges, provides a basis for thoughtful decision making and minimizes the risk of continuing obsolete strategies or making decisions based upon temporary blips, the fashion of the day, or personal preferences.

The as-is assessment should contain analyses of:

- Cash flow assumptions for both the near term and for longer term sustainability.
- Potential major, immediate cash flow improvement actions and their impacts.
- Competitive landscape and the position of the company within it.
- Major dynamics within that landscape—new ideas, trends, and competitors.
- Estimated life cycle of the company's products and services.
- Human resources capabilities and unfilled needs.

Concurrent with the strategic analysis, an effective transition advisor will undertake a review of company policies and practices to ensure operational integrity. This review will include assessments of:

- Accounting system.
- Chart of accounts.
- Data management, network, and communication systems.
- Employment policies and procedures.
- Benefits plans.

and may identify changes to these procedures. In addition, the transition advisor/interim CEO may identify and implement sensible cost savings initiatives.

Managing important business relationships is especially critical during a leadership change. An advisor/interim CEO can help:

- Ensure that important customers continue to feel important.
- Sustain supplier and distributor relationships to prevent interruption of the business flow.
- Calm creditors' concerns about uncertainty.
- Communicate with all other stakeholders.

A transition advisor thus provides to all constituents the essential sense of stability within the company that enables it to move through the transition with minimal disruption.


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