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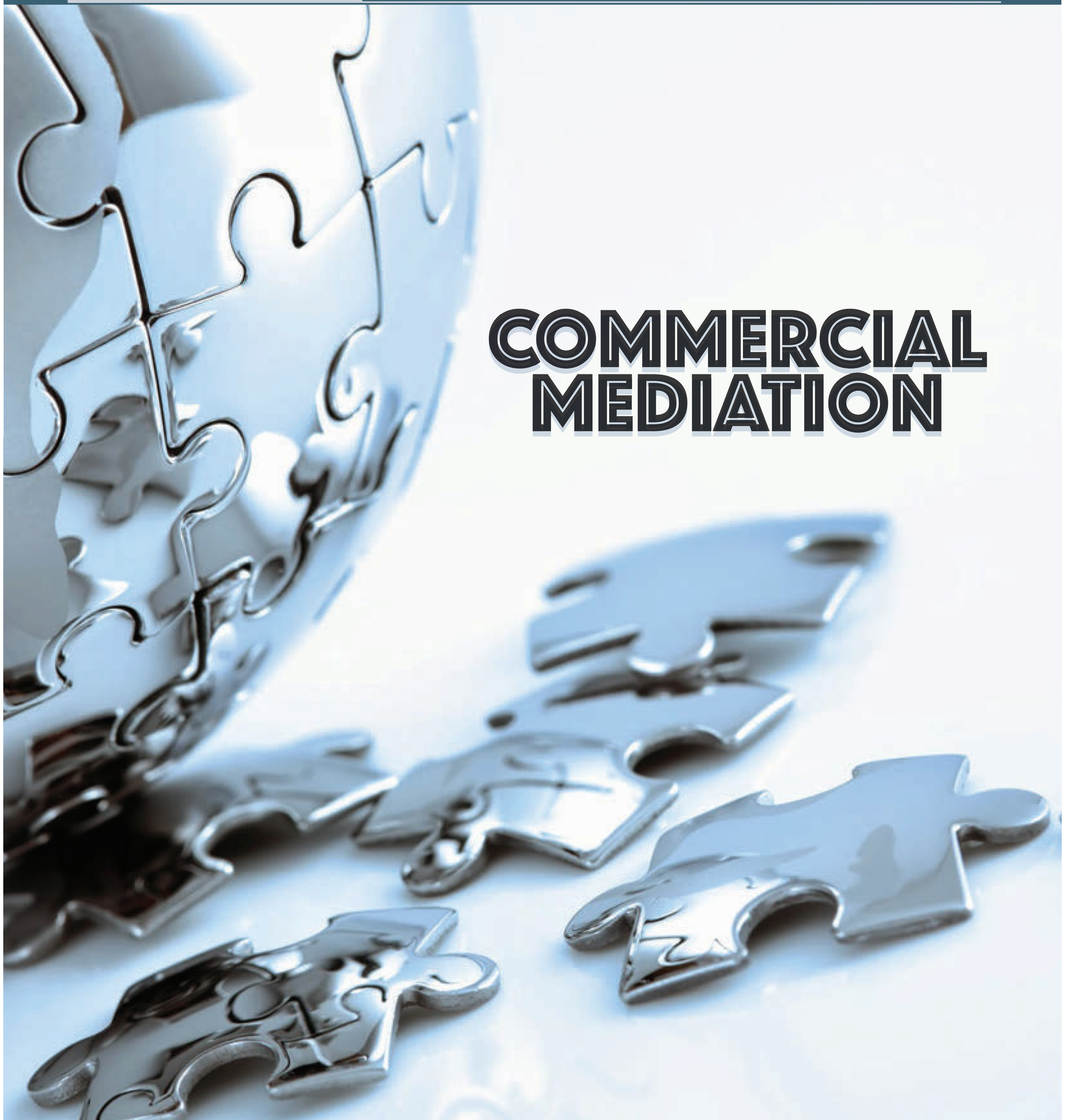

COMMERCIAL MEDIATION

A Mediator's Role In Successful Family-Owned Business Transitions: A Case Study

by
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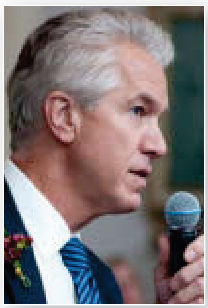
About the Author



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Both families and businesses can find transitions difficult. Combine family and business – as in family-owned businesses – and the difficulties grow exponentially. The network of family relationships (the family system) invariably brings conflict that can jeopardize the survival of family-owned businesses into the next and succeeding generations. Mediators trained and experienced in the complexity of advising family businesses can play a crucial role in helping those businesses avoid the outcome so aptly expressed in the adage "Shirtsleeves to shirtsleeves in three generations."

We will illustrate the role of neutrals in helping navigate three typical types of transitions that family-owned businesses face: transitions in leadership, governance and ownership, using as a case study a hypothetical family-owned business, Simpson Garden Supply.

SIMPSON GARDEN SUPPLY, INC.

Simpson Garden Supply Inc. ("SGS"), was formed in 1980 by Bob Simpson (now aged 62) and his brother Bill (65) as a garden supply and landscaping business in White Plains, NY. SGS is a New York corporation, with 15 full time and 10 part time employees

When organizing SGS, Bob and Bill allocated themselves 40% each of the 100 shares and 20% was sold for $50,000 to their sister, Hope (64), and her husband, Larry (70). Over the years SGS became primarily a wholesaler to small retail garden centers and a landscape contractor for large commercial and public projects. There are a few large competitors, including Jones Landscape Supply, Inc. ("JLS"), of Albany, but SGS has the advantage of being geographically closer to the customer base in Westchester County, NY and Fairfield County, CT. Six months ago JLS made overtures to Bill to acquire SGS, but he and Bob have declined to consider selling.

Bob focuses on business planning and sales and Bill takes care of plant stock, inventory, equipment, and supervising the outside staff. Bob's wife Barbara (58), handles the financials, runs the office and supervises the retail operation. Two non-family members are also key employees: Jeff Hackett (40), is Vice President-Sales and Sam Winslow (38) is Vice President – Operations. Both have been with SGS for over 10 years and are considered almost indispensable. A few days ago, Bob and Bill became aware that both Jeff and Sam have been approached by a local investor to set up a new business to compete with SGS which would pay them 30% more and give them each 20% of the shares.

Bob and Barbara have two children, Katie (25), a college graduate with a degree in business, currently working for a department store in New York City, and Carl (30), a rock musician. Katie recently married Bruce (29), who dropped out of college to manage his family's organic vegetable farm in Ridgefield, Connecticut (approximately 45 minutes from White Plains), after his father's stroke. The farm supplies high-end restaurants and specialty markets in the New York City area. Carl recently married Chelsea (24), a land use planner who is CEO of Green New England, a well-funded grass roots organization working on projects to make the Northeast more environmentally sustainable.

Bill and his wife, Kathy, have two children, Stephen (28), who teaches at Columbia University, and Dolores (17), who has had difficult teenage years and is currently attending a therapeutic private school in Massachusetts. She has a high IQ and is said by her math teacher to be a computer genius.

In 2014, SGS gross receipts were $6,000,000, net profits were $800,000, distributed pro rata to shareholders –Bob and Bill receiving $320,000 each, Hope and Larry $160,000. SGS pays salaries to Bob and Bill ($200,000 each) and Barbara ($75,000).

After a late night conversation last month, Bob and Bill acknowledged that they needed to think about eventual retirement. Bob insisted that his children Katie and Bruce should take over when he retires. Bill said that his children Stephen and Dolores should definitely have leadership roles in the next generation. Although Bob and Bill expect to continue to work for the next few years, they agreed to start thinking seriously about transitioning the business to the next generation, with the understanding that they both wanted to have retirement annual incomes of at least $200,000 and to ensure that their families were adequately provided for.

Bill and Bob also agree that they should consult a family business mediator.

LEADERSHIP SUCCESSION ISSUES

Like many successful family-owned businesses, Bob and Bill have waited until late in the game to talk about arguably the single most important factor in whether their business survives to the next generation: leadership succession.

Bill and Bob agree that they want the business and the family to survive. They want SGS to continue to be family-owned and family-run. They also recognize that decisions must be made based on what is best for the business with due consideration of family relationships. They accept that, along with the key business leaders Jeff Hackett and Sam Winslow, all family members by blood and by marriage must be involved in devising the succession plan.

This last point is critical. Many business owners (and some mediators) might be tempted to take a limited view of the conflict and treat it as a dispute between Bob and Bill, the founders and decision-makers. But to get succession right, the conflict cannot be viewed as simply one between Bob and Bill as individuals. They are part of a family system and any actions by them (and any other members of the family) impact the entire family network of relationships and the family business. Leadership succession involving family members in the business must consider the family system. To sustain the business into the next generation and beyond there must be alignment of the family's values, goals and expectations with those of the business. To determine those elements and ensure their alignment, the entire family and key members of the business must be involved.

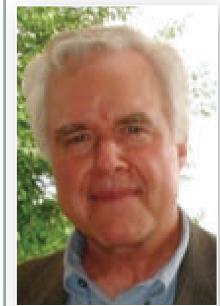
The mediator would use a multi-step process, for example: 1st stage, fact-gathering interviews; 2nd stage, succession plan development meeting with Bob and Bill; 3rd stage, succession plan assessment/refinement meeting with all interested parties; 4th stage, implementation (the mediator's involvement optional).

Interviews. The mediator should maintain complete confidentiality for all interviews unless agreed otherwise, keep discussions focused on interests and needs, not positional stands, and invoke objective standards and business benchmarks to help create solutions. The mediator may even suggest engaging additional experts. And the mediator should hew to two bedrock tenets of successful mediations: start by finding agreement or alignment on easier issues; and strive for complete ownership by including all interested parties in the process of drafting the succession plan.

Interviewing Bob and Bill separately, the mediator might ask questions like these (and adapt them for the interviews with the other parties):

1. What outcomes would you like to see as a result of this process?
2. What will the business look like in 5 years? In 10 years?
3. How are major decisions currently made in the business? In the family?
4. What do you see as the biggest challenges to the business going forward? To the family?
5. What do you see as the greatest strengths of the business going forward? Of the family?
6. How are conflicts in the business resolved? In the family?
7. What will the family look like in 5 years? In 10 years?
8. What will ownership of the business look like in the next generation?
9. By what date will you and your brother turn over leadership of SGS?
10. What are your core family values? Your core business values?
11. What qualifications do you deem essential for the next leader(s) of SGS?
12. If no family member has the necessary qualifications would you agree to non-family leadership?
13. What role do you see for your children and their children in the business?
14. What are their expectations?
15. Have you shared your feelings on the future of the business with other family members?
16. What impact would losing Jeff Hackett (VP sales) and/or Sam Winslow (VP operations) have on the business?
17. Are you willing to commit the necessary company resources to see the leadership transition and the company succeed?

About the Author



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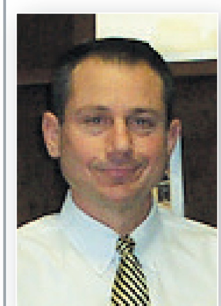

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Plan Development. After the fact-finding interviews, the mediator will meet with Bob and Bill to help them develop a SGS leadership Succession Plan covering:

1. Participation in the business by next generation family members, taking into account education, qualifications and commitment, with required apprenticeship and work experience at SGS and/or third party employment.
2. Mentoring, training and necessary resources provided by the founders, and involving Jeff Hackett and Sam Winslow who will be compensated for their roles.
3. Decisions on business leadership based on merit and performance evaluated by non-family members.
4. If Bob and Bill do not agree on one or more family member(s) to be their successors, they will look to non-family leadership starting with Jeff Hackett and Sam Winslow.

The last important step in successful succession plan development is the meeting with all interested parties to assess and, if need be, refine the initial plan drafted with Bob and Bill.

Mediation skills can be indispensable when two brothers are conflicted about whose descendants should lead their business to continued success.

GOVERNANCE ISSUES

"Good fences make good neighbors"
—Robert Frost, "Mending Wall", (1914)

Although Frost may have used the adage ironically, in the world of family business, boundaries set out clearly in governance structures can spell the difference for the next generation between internecine warfare and a smoothly running business. SGS, like every business, currently has a governance structure which regulates by whom and how decisions are made and rewards are distributed. In the absence of any modifying provision in the charter, bylaws or shareholder agreement, Bob and Bill, with 80% of the shares of the company between them, are , as a matter of corporate law, in a position to make effectively all decisions. Among other things, they would have broad discretion to set salaries and perks and either to distribute proportionally all or a portion of the profits as dividends (40% to each of them and 20% to Helen and Larry) or to hold profits in the company.

The Simpson family structure, on the other hand, is an amalgam of Bob and Bill's and their wives' family culture, tradition and inherent values. The family and business systems interact with each other, but their goals, while they may overlap, are different. The family goals typically focus on allowing Bob, Bill, their sister Hope to live reasonably well themselves as they mature and to nurture each of their children to attain success and happiness in life, while the goals of SGS, as a business, are to be profitable while providing satisfying work to competent and fairly paid employees with long term benefit to the owners. Helping to resolve the contradictions that arise as family and business goals conflict is the challenge of the family business mediator.

After a discussion and tentative decision as to leadership of SGS in the future, as described in the previous section, the next tasks for the family business mediator (which may best be addressed simultaneously with the leadership issue), are to uncover the issues/problems/needs and interests of each family member, and to help Bob and Bill and their families decide whether SGS can be a source of wealth, work satisfaction and security for the next generation, and, if so, what structures might be useful in the future to avoid and/or regulate conflict among the future owners.

The following steps might be appropriate at this point for the mediator:

1. Meet with Bob and Bill, together and separately, as well as with each of their wives, separately and together with their husbands, to help them each articulate a long term vision and describe their family's long term needs. As some issues by their nature should generally be discussed only privately, caucus rules as to confidentiality would continue to apply to these meetings. The following is a suggested list of introductory topics:
   a. Describe how you see retirement, including how much income and participation in the company you each expect.
   b. Do you have sufficient other assets so that if something should happen to SGS that you would have enough income to live comfortably?
   c. Do you have interests in life other than SGS so that you can psychologically allow the next generation to take the helm?
   d. How do you intend your assets to be distributed among your children at the time of your death and/or your spouse's death?
   e. What do you see as the greatest challenges facing the family in the next 5 years? 10 years?
2. Meet with each of the children and the new potential management team to have them describe their own long term needs and interests. Do they

want to be owners of minority shares in SGS, and if so, under what conditions?

3. Meet separately with the company lawyer and accountant to make it clear that as a family business mediator, you are not there to usurp their roles, but to work together with them to help the family and the business.

4. After the mediator gives Bob and Bill a summary of the general tenor of the discussions (with confidentiality respected as to each participant unless he or she waives it), they, along with the mediator, should meet with all children separately. At that point Bob and Bill may decide jointly to make tentative decisions as to how they would like to see an ownership transition for themselves, and proceed to develop the specific plan with their lawyers. The plan may include mechanisms to protect minority interests, such as buy-sell provisions, super-majority (*e.g.*, 75%), approval for certain transactions, nominations to board of directors, mandatory sale requirements on certain conditions (known as "tag-along" and "bring-along" provisions), dividend expectations, and price formulas for voluntary and involuntary sales.

5. Once the legal structures are decided, the mediator should facilitate a family meeting to discuss the legal and other aspects of the plan. In many cases it is also useful to create additional, less formal structures, such as regular family meetings among the family members to keep the family informed, give feedback about the business and share family concerns (e.g. environmental concerns, dividend policy and charitable giving).

OWNERSHIP ISSUES

SGS is a small company. It has provided a good livelihood for Bob and Bill. However, its continued prosperity is dependent upon two key, non-family employees, Hackett and Winslow. It is unlikely that the current business operation has the resources to meet the multiple objectives of:

1. Keeping Hackett and Winslow motivated and adequately compensated;
2. Providing substantial annual retirement income to Bob and Bill; and
3. Providing for each of Bob's and Bill's four children and their respective families, through employment and/or ownership (*i.e.*, distributions).

Given those facts, Bob and Bill would be well advised to consider a transfer of ownership to a third party in a transaction that is structured to achieve the objective of maintaining SGS as a family-owned business and satisfy the potentially conflicting objectives of individual family members, thus avoiding disputes that could cause irreparable harm to the family and to SGS.

JLS, SGS's competitor in Albany, NY, would appear to be a candidate for a merger with SGS. The two companies are in the same industry, operate in contiguous geographic markets, and have some complementary products. Moreover, JLS is already interested in Hackett and Winslow because JLS's current management is nearing retirement age. Through a merger with SGS, JLS can "acquire" the Hackett/Winslow management team, and SGS can obtain the resources to adequately compensate Hackett and Winslow while still providing substantial retirement income to Bob and Bill and employment or ownership benefits to the children of Bob and Bill. In short, a merger presents the opportunity to become bigger and better, and to become more stable, resilient and profitable.

The owners of small companies rarely consider a merger as a family business strategy or solution, even though it can offer many advantages. Why? Because the threshold issues that arise in connection with the consideration of a merger are overwhelming to most small business owners. Who will control the merged company, and how will decisions be made? Who will manage it on a day-to-day basis? How will equity in the merged company be allocated? Will the cultures of the two companies be compatible?

A family business mediator can create a process for addressing these threshold issues, and then successive issues such as valuation, organizational structure, shareholder rights and deal terms, on a step-by-step basis, in a fashion that is manageable. A mediator has the ability to do what a representative or advocate for one company or the other cannot do: facilitating—and improving—the negotiation by continuing to keep the discussion focused on the important issues; preventing focus on an individual who is perceived as being unreasonable; providing options and alternatives; ensuring that decision making is informed; ensuring that the term "deal breaker" is not in anyone's vocabulary; eliminating ego as a factor in the discussion; providing insulation for the owners; and providing the ability for each company to "caucus" with the neutral to review options and test ideas outside the presence of the other company.

Transactional experience, mergers and acquisitions skills, and industry knowledge are important in order for a mediator to be successful serving as a family business mediator in the context of a merger transaction. However, armed with this experience, knowledge and skill set, combined with strong mediation skills, a mediator can play an invaluable role in the context of a transaction. The mediator can thus help ensure that a family such as the Simpson family will maintain its business, avoid disputes, and satisfy the objectives of individual family members. ■