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Hold Them or Fold Them?

When to Sell Your Family Business and When to Keep It

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From time to time, we read in the press about a family selling its business. The Bancroft family's sale of *The Wall Street Journal* to Rupert Murdoch and his family created quite a stir, as battles between titans often do. Other stories raise eyebrows and create chatter about the wisdom in the family's decision to sell. This happened in 2011 when the world's largest eyewear manufacturer and distributor Luxottica, an Italian family business, acquired the Carinelli family business Grupo Tecnol, a vertically-integrated, leading player in Brazil. That was also the year Brazil's Marcopolo, among the world's largest bus manufacturers, bought the Austrian bus maker Volgren, owned and managed by the Grenda family.

After the sale come congratulations from family, colleagues, friends, and some industry onlookers. But people can also feel disappointment about the sale ("How sad the family tradition is lost") and suspicion that the family "lost" its business due to mismanagement or "sold out" because the family became greedy or disloyal to the virtuous aims of the founder. Yes, those things can happen and when they do, we also feel disappointed. But we can also celebrate the sale of a family business. Under certain conditions, selling the family business can be the smartest thing you will ever do to succeed as an enterprising family. And it may be the best thing you can do for the business.

We are guided by this principle: a family should use its assets so that they are productive and return value and satisfaction to society and the family. If a family cannot own and manage its business in a way to make it productive, valuable and satisfying, the family should consider selling this business to others who could do a better job with it and allow the family to focus on other activities. Whenever family owners sell a particular business to buyers who can do more with it, especially when the sale frees up the family to undertake other productive, satisfying activities that better suit its interests and talents, we celebrate.

We believe that many families that grow their business to a sellable size should consider selling it at the right time—for two very good reasons.

First, all businesses have lifecycles. A business that is competitive at one stage of an industry could need a vastly different scale, technology, management skills and style, and capital to compete well in another stage of this "game." If a family wants to remain in a particular business ("game") over several decades, it needs to have the necessary talent, adequate financial resources, and a good measure of flexibility. For a number of reasons at some point most businesses stop adapting to their industries and die. Most family businesses that go out of business do so because they become uncompetitive (due to mismanagement, lack of reinvestment or disruptive technology that destroys or transforms industries) or because the family loses interest in the business. To some extent, this outcome can be avoided with the right actions in the business and family.

The second reason families should consider selling is because families naturally change over decades and generations, in terms of their interests and skills. And some families grow apart from their businesses and become unable or unwilling to support their companies as owners or business leaders. Some people see this as a family "sin" but we don't. (The sin is when family members become lazy, unproductive, and completely reliant on others for their financial support.) You should manage the development of your family and its relationship with your business as best you can and then accept what is real (rather than desired) about your family and the situation you face. The worst situation is to build something valuable and watch its value vaporize because you are unrealistic about your strengths and the threats you face. And remember, if your family is no longer a good fit with your business, it could still be successful in other activities including another business. Studies have shown that families that sell their business often start or buy another business and get back into another game.

Which means that you should periodically assess the fit between your family and business, which you can do by answering these three questions:

1. Is the family the best manager of this business? If not, find others who have the skills and values to manage it well. The family can continue to own the business and will probably serve usefully as board members and in other key roles.
2. Is the family the best owner of this business? Do we have the resources (capital, alliances) to support the development of this business and the skills and attitudes (perseverance, quality focus, risk-taking, sacrificing) needed to be successful in this industry? If the family clearly can't support the business in the next stage of the game, it needs to consider partnering with others that have the needed skills and resources. Or it should exit this industry. The family might be a good owner (able to support basic requirements of the business) but not the best owner for this business (other owners could do more with the business). This is always the hardest situation to evaluate. But don't be blinded by pride or tradition when assessing your family's qualifications as an owner.
3. Is this business producing adequate returns for the family? Owning (and especially running) a business has costs and benefits for a family—financial, psychological, and relational. To remain in a business, the benefits of owning and running that business should outweigh the costs over a reasonable period. Moreover, the returns of having this business should be high enough to stay in this game. If you invested the family's resources and efforts in another game, would the returns be greater?

Given how quickly industries are changing, you should do this calculus every few years with the input of close advisors, key owners, and your board.

Evaluating The Case For Selling Or Keeping

Making the decision to sell or keep a business involves aligning the interests of key players in all three circles of a family business system and typically requires dialogue with the owners (who make the decision), business leaders, board members and family members. They all have their own perspectives and interests and unique methods of reasoning. You need to understand their interests and motivations for selling or keeping the business.

Sales of family businesses are motivated by many factors, including these:

Financial considerations

- Desire to monetize the value of a business
- Desire to take advantage of a favorable opportunity (sales price is high; attractive offer has been tendered)
- Other good business opportunities that require capital and attention, making the sale of the current business attractive

Performance

- Strong business performance that supports a high sales price but may not be sustainable
- Weak company performance or equity shrinkage that might accelerate in the future, due to industry or economic factors
- Poor dividends threatening family liquidity

Ownership issues

- Alienation of shareholders from the business caused by a number of factors
- Family strife caused by the business, or family conflict within it
- Self-interest (possibly including greed) of some owners, putting their own interests above the interest of the family
- Shareholders do not feel respected by management

Leadership issues

- No family leadership of the business
- The business leader (whether family or nonfamily) is disliked

Family issues

- Liquidity needs in the family
- Lack of interest in the business by the next generation
- Feeling that selling will enhance the family's image
- The company is not following family values or harming the family's image

On the other hand, families tend to keep their businesses under these conditions:

Financial considerations

- Large size of the business relative to competitors
- Inadequate sales price

Performance

- Strong business performance, business growth, and equity growth
- Adequate dividends
- Belief that the owners and management can do more to improve and sustain the business and that it can be successful going forward

Ownership issues

- The company maintains adequate communication with the shareholders
- Shareholders feel respected by the company

Leadership issues

- Long history of family leadership of the business
- Family involvement in senior management

Family issues

- Liquidity is adequate for family needs
- Family pride in the business
- Family name is connected to the company (e.g. on the door, products)
- The company supports family values and the family's image
- Strong interest in the business by the next generation
- Long history of family ownership and sense that selling it would violate a family value

- Strategic importance of the company to the family's status and family activities (e.g. philanthropy)
- Belief that the family's wealth is better sustained owning a business than owning financial or other assets
- Feeling that selling the business will harm the family's image

These factors need to be understood in relationship to a valid market price for the business. A high or low sales price can dramatically affect some families' decisions. And the likely sales price for the business should be determined using experienced external advisors.

Because families tend to be strongly attached to and sentimental about their businesses, a decision to sell the business generally requires a much stronger motivation to sell the business than to keep the business. Some motivations are based on factors that are hard to change. Others can be managed or influenced. Consider whether, and to what extent, your motivations for selling or keeping might change if any of the key factors changes. And always consider other factors, not listed here, that influence you and your family. Then make the case for selling or keeping as clearly as you can. If you decide to keep your business, you can benefit from the process you just underwent by making it a regular part of evaluating your family enterprise.

Preparing For A Sale

Timing the sale of your business is a very important consideration. If you want to receive a good price for your business, the time to sell it (or anything) is when a buyer is ready to buy it, not when you are ready to sell it. This is a terribly difficult lesson for owners of companies to comprehend. They generally time the sale based on their needs, often waiting until the end of their careers, and only after determining there are no possible family successors, before selling. At that point, there may or may not be a buyer and the business may not be able to be packaged to look like an attractive company to buy.

Typically, if an industry is consolidating, you don't want to be the first or the last company to sell and you should be closer to the front end of an industry roll-up than the tail end. This requires an understanding of what is happening in your industry and skillful negotiating.

Selling a business requires special skills, and it's likely that a family operating a business is not experienced with this process. How many times have you sold your company or another company? But others are very experienced at this process because they do it all the time. Do you want to be sitting across the table from a vastly more experienced team representing the buyer? We doubt it. And just because a potential buyer tells you how much he admires what you have built and that he wants you to stay connected to the company (please don't believe that) it doesn't mean that he has your best interests at heart. If you are thinking of selling, you need an ally who can guide you through this process.

As the singer Kenny Rogers reminds us about poker and life and we have adapted to selling a family business—you have to know when to hold them (keep your business), and know when to fold them (sell your business). Like good poker players, only leaders with manageable egos who understand their situations, motivations, and strengths and weaknesses have this ability. You should be one of them.

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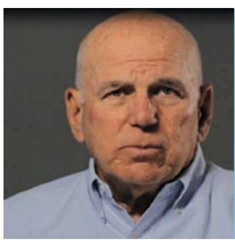
John A. Davis is a globally recognized pioneer and authority on family enterprise, family wealth, and the family office. He is a researcher, educator, author, architect of the field's most impactful conceptual frameworks, and advisor to leading families around the world. He leads the family enterprise programs at MIT Sloan. To follow his writing and speaking, visit johndavis.com and twitter @ProfJohnDavis.



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Dr. Jonathan Pellegrin was the 2nd generation CEO of his family business before selling the business that his father started. He is an advisor to families on selling their companies and is co-author, with Professor John Davis, on the forthcoming book about strategies for selling the family company.

About Cambridge Family Enterprise Group

Cambridge Family Enterprise Group (CFEG) is a global advisory, education, and research organization that serves family enterprises with growth aspirations—enabling them to flourish across generations. As a go-to trusted partner for the world's enterprising families, CFEG offers a wide range of services to navigate changing times, build pathways for continued growth, and achieve lasting success. Its pioneering thought leadership, strategies, and programs are used by families, family businesses, and family offices worldwide. Since its founding in 1989 by Professor John Davis, CFEG has advised and educated thousands of families from more than 70 countries.