

4 ways family firms are letting outside investors in

More family businesses are opening up to external investors these days. IESE's Jeroen Neckebrouck maps out four main scenarios, based on two key questions, and points to their governance implications.



November 25, 2019

It's no secret that business-owning families like to keep things, well, in the family. Even so, more and more family firms today are looking beyond kith and kin, to welcome outside

investors in.

IESE's [Jeroen Neckebrouck](#) and co-authors Miguel Meuleman and Sophie Manigart consider two important family objectives: providing liquidity to either family or firm, and ceding or retaining long-term family control. From here, they map out four scenarios for family businesses opening up to outside investors — and point out governance implications for each.

Two key questions

- Will external investors provide liquidity to the family or to the firm?
- Will family control be ceded or retained over the long term?

1. Gradual exit (liquidity for the family, ceding control)

Families in this scenario are looking to eventually bow out of their family business, but not too abruptly, in order to maximize value. In this position, owners often choose to diversify some of their wealth in the short term, before their final exit. To this end, they seek equity investments that only involve a partial change in ownership and don't provide extra capital to the firm.

Take the 2003 buyout of the fifth generation-owned agricultural equipment manufacturer La Buvette of France. The family still felt their firm had potential, but they lacked successors and intended to withdraw. They joined forces with Alliance Entreprendre, a finance firm which helped streamline management processes right away. The family relinquished the CEO position and took a minority stake while they prepared for a joint exit.

2. Extend the firm (liquidity for the firm, ceding control)

In this scenario, family members are planning for a medium-term exit. They want to sell, but wish to further develop the business to its full potential before doing so. To do this, family members retain their shares and seek outside investors to provide an injection of capital to the firm.

In 2014, Molecular Products Group, a U.K.-based manufacturer of chemistry-based products, were in just this position. They wanted a medium-term exit, but had just started to internationalize. Business Growth Fund (BGF) stepped in, providing capital and strengthening key roles. Three years later, when profits had doubled, both family and investor sold the firm on and exited successfully.

3. Replacement capital (liquidity for the family, enduring control)

Families in this scenario want to cash out some of their shareholdings but also want to pass the business on to the next generation, who may or may not be interested. These long-term aims probably stretch beyond the outside investor's time horizon.

For example, Market Basket, a New England supermarket chain, was almost brought to its knees by a conflict between two cousins. This was resolved when one branch of the family purchased the 50.5% stake they did not already own from the other branch, with funding from the Blackstone Group and a significant amount of debt. The authors argue that in such deals, where the firm's capital generally is not increased, management focus is likely to be more trained on efficiency gains than growth.

4. Strategic investments and turn-around (liquidity for the firm, enduring control)

In the fourth scenario, the family are looking to hold on for the long term. Here, the authors distinguish between two possibilities: "strategic investment," where family firms are looking to grow, and "turn-around," where the firm aims to strengthen their financial structure. In both cases, outside investors bring in extra capital to the firm, not the family.

In 2015, craft brewery Dogfish Head needed money to continue growing. A deal-breaker, however, was that any new investor would need to safeguard the company's culture of smart over fast growth. They also didn't want the company to go public. LNK Partners eventually entered with a 15% stake and one seat on the brewery's four-member board.

Meanwhile, Gimv's 2009 investment in Belgian baked-goods company Vandemoortele was a clear case of strengthening the balance sheet. The investment allowed the fourth-generation family firm to turn a corner. After several successful years, Gimv's share was sold back to the family.

For family firms, forewarned is forearmed

Bringing in an outside investor doesn't have to take the "family" out of family firm. But any change in ownership structure needs to consider the types of investors who are going to provide a good fit and the governance implications going forward. The authors of this practical article provide a conceptual configuration leading to four distinct scenarios, with examples to help illuminate the path ahead.

www.iese.edu/insight