

CASE STUDY

Using Transition Design to Enhance Multigenerational Family Goals

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A third-generation family-owned heavy equipment dealer/distributor retains RFN Advisory Group to design a transition plan for the four sibling shareholders, who range in age from 62 to 78. For 10 years, the four brothers attempted repeatedly to work out an acceptable plan, without success. The need for a plan has become more urgent as two of the brothers are in their 70's, causing them to reconsider their personal financial exposures and a desire to pursue other interests beyond the business, free of lingering risks.

Fact Pattern

- \$100M annual revenue, \$12M net income
- Projected to grow to \$120M over the next two years
- \$47 million in mostly short-term debt
- 250 employees
- Stable customer base and excellent reputation
- No business planning.
- C-suite includes a CEO/Shareholder, CFO (close to retirement), and VP of Sales. The CFO has no successor.
- The youngest brother is the CEO. There is succession disruption risk if he is incapacitated
- The buy-sell agreement is partially funded by life insurance (term only, and several policies expire in the next few years)
- None of the four brothers owns a majority share of the company
- The brothers have different wealth profiles – the oldest could retire easily, the youngest has a very low net worth (apart from his share of the illiquid value of the business), but decent annual income.
- Two children work in the business, but they don't get along and employees have taken sides



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Advising a Family-Owned Business – The RFN Approach

Typically, families-in-business have a strong desire for continuity and legacy and may prioritize multigenerational stewardship over proceeds from a sale of the company. Uncovering transition priorities for all shareholders, understanding individual and family motivators and making the scope of the engagement broad enough to include successor generations and their needs, are key aspects of the RFN approach. We start with deep discovery, using both individual and group interviews as a basis for identifying common ground and differences. Although we never ignore differences, reminding family members of what bonds them can dial down stressors, reduce rivalries and resentments, encourage more objective approaches to potentially difficult transition discussions, set the stage for more rapid conflict resolution and help family members achieve clarity. Helping owners identify, clarify and prioritize their goals is fundamental to successful transition design. A good design is the output of a good process.

We encourage owners to step back from any biases regarding transitions and examine all the options, weighing them against their short- and long-term business and personal goals. The technical design work must align business strengths and weaknesses, present and future, with each of eight transition options for private businesses. We score and prioritize each option based on fit, likelihood, feasibility and degree of difficulty. Higher scoring options are considered first.

The last step is to create pathways to transition, identifying barriers, risk factors and required resources. Ideally, transition designs are married with personal financial planning to determine whether the timing and transition values are acceptable for each shareholder.

We view transition design through the lens of at least two-family generations: predecessor and successor simultaneously. A design that works for the former but not the latter is destined to fail. Whether the business is sold to a third party, or kept in the family, we believe successful designs embrace the family's need to steward wealth and enhance legacies.



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Transition Requirements

In this case, we quickly discovered the shareholders were stuck, in part, because previously they had been advised incorrectly that all four would need to exit the business simultaneously. Striking down this myth was crucial because it made space for the brothers to reconcile their personal needs and timing with the needs of the business and each other.

Five design priorities emerged:

- 1 Getting to the fourth generation was important
- 2 They needed to address succession risks
- 3 Rewarding employees for their contributions was fundamental to the plan
- 4 Agreeing to a firm timetable for the buyout plan was crucial
- 5 The two oldest brothers must accept a reduction in net proceeds in return for less financial risk

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The Solution

The shareholders agreed to a staged transition beginning in two years. RFN designed a hybrid transition plan consisting of an employee stock ownership plan (ESOP) that would ultimately own 60%, combined with preferred equity for family members, and a separate slice of performance-based equity for executives and managers. The oldest brothers agreed to sell their shares to the ESOP. The purchase would be funded by the company through a five to seven-year term loan, based on a debt restructuring acceptable to current lenders. The preferred family equity ensured complete control of the business and provided additional cash flow to family members. Because of a well-designed Management Incentive Plan, the company became an employer-of-choice for top performers in the industry.

Two other priorities emerged from the process: the need for strategy to drive enterprise value for family and employees and immediate management succession planning.

**Today, the family's biggest asset is well-protected,
and the company is outperforming its peers.**
