Navigating a Succession Plan That is Impacted by the 5 Ds

It is imperative that business owners consistently think about being ready for any moment. Unfortunately, this includes having plans in place for unforeseen moments. In this case study, a family is faced with the devastating and inevitable uncertainties of running a family business and experiencing the death of a critical employee. As this family begins the planning process, the advisor can determine the root of issues and the true vision of where the family sees this business going in the future. As a guide, we felt that this case study shed insightful light on dealing with a family business amid uncertainty and grief. Additionally, we found the case study empowering in helping us all understand the power of planning around a common purpose.

COMPANY

XY Construction, Inc.

FOUNDED

1950s

OWNERSHIP:

Z Corporation owned by the founding couple's four children

ANNUAL REVENUE:

$30,000,000
Annual EBITDA: $5,000,000

Business Background

XY Construction Inc. is a construction company located in Boston, MA. The business was started in the 1950s and has served clients across the US since. The company is structured as a Z Corporation and generates approximately $30,000,000 in annual revenue and $5,000,000 in EBITDA each year. The owners of the business are the four children of the matriarch and patriarch that started the business.

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The Situation

The company is currently owned by four siblings as a second-generation business. All of the shareholders want the business to remain in the family for the next generation, just like their parents did for them. Unfortunately, the CEO was diagnosed with terminal cancer six months prior and recently passed away. As the family group has begun their grieving process, they now turn their attention toward the business to figure out next steps.

At the first board meeting after the CEO's passing, each family group had their own thoughts on how the business should operate going forward and, more importantly, who should now take the title of CEO and decision-maker for the family. Perhaps more importantly, each family knew who they did not want to serve in that role going forward.

The Goal

Ultimately, the primary goals for the family group are to preserve the value of the business, ensure ownership remains within the family to promote their family legacy, achieve financial security, reward their long-term employees, and ensure harmony amongst the family members. However, it became clear through subsequent conversations that the definition of "fair" for each family group had a different meaning.

The Strategy

During the initial discovery process, it became apparent that there were two camps within the family group.

1

The oldest son and oldest daughter, Vice President and CFO, respectively, were aligned in the sense they wanted to either run the business or be bought out of their ownership.

2

The youngest daughter, her husband, and the widow of the CEO were aligned. They believed they had a longer runway and could take on more risk. Additionally, they had children they wanted to see be given an opportunity to own and run the business in the future.

After thorough financial analysis and stress-testing the future cash flows of the business, it became clear that an internal buyout would be the most likely strategy to implement. While the family group initially considered selling the entire business, as there was much back and forth on what to do, it was determined that it would be detrimental to the family group due to the large amount of taxes that would be paid on the transaction as their Z Corporation status has increased taxation.

The Results

After much discussion and analysis, the buying group ended up buying out two of the other family members. Interestingly, the two shareholders in the buying group were inactive in the business (youngest daughter and widow). This created an interesting dynamic as the youngest daughter's husband was the only active member of the buying group. However, due to the estate planning that was done by the first generation, the husband did not actually own any of the shares! This family dynamic was a key aspect they had to navigate prior to making the offer to purchase the shares.

The purchase took place by using a combination of bank financing and seller carry-back financing to redeem and purchase all the older son and older daughter's ownership. The purchase allowed the exiting shareholders to achieve financial security and exchange their illiquid business ownership for liquid assets. Furthermore, it allowed the buying group to ensure the business would remain in the family for the future generations.

The buyout involved borrowing $7,000,000 from their bank and then carrying back an additional $4,000,000 personally. Once the purchase was completed, the new shareholders navigated the drafting and completion of their shareholder agreement to define how they were going to work together in the future.

What's Next?

Now that the ownership succession plan for the business has been defined, a significant amount of work remained to achieve the goals of the family. The company needed to address internal succession and evaluate its management succession plan. It also needed to engage in a strategic planning process to define the future goals for the business and ensure alignment amongst the key leaders and the vision for the company's future.

Over the next couple of years, the company engaged on a wide range of projects including:

- Proceeded with an employee survey to identify what the employees viewed as weaknesses within the organization and developed a plan to address them.
- Evaluated compensation across all departments and levels to better align compensation with the market standards.
- Created a formal Board of Directors comprised of the new owners and independent directors.
- Drafted a family employment policy that governed when and how a family member would be hired by the company.
- Developed a long-term incentive plan for key leaders aligned to the business's value growth.
- While this transition plan was an emotional and lengthy process, the buying group was excited about the potential for future growth in the business and worked hard to make their long-term dreams a reality.