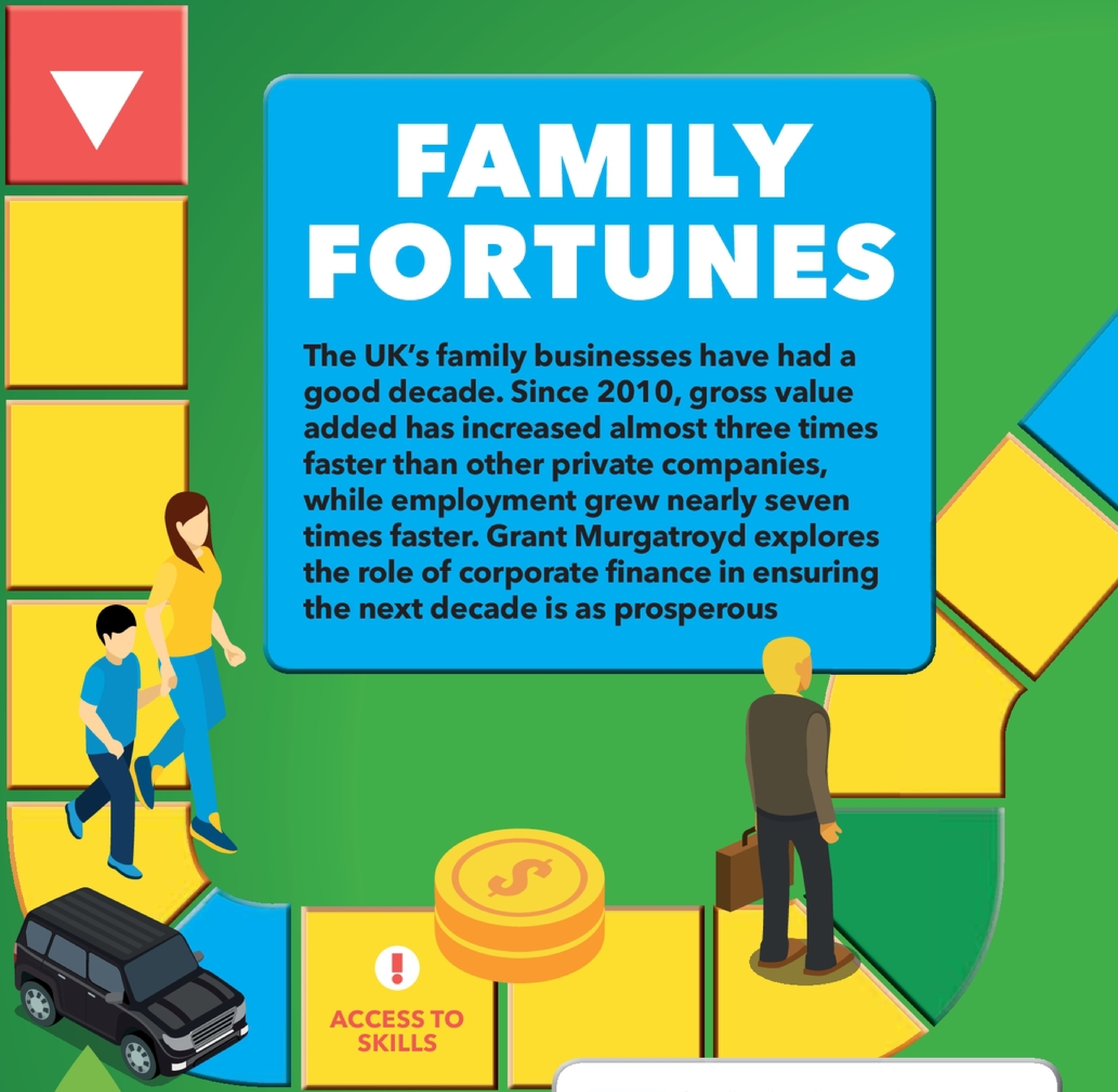
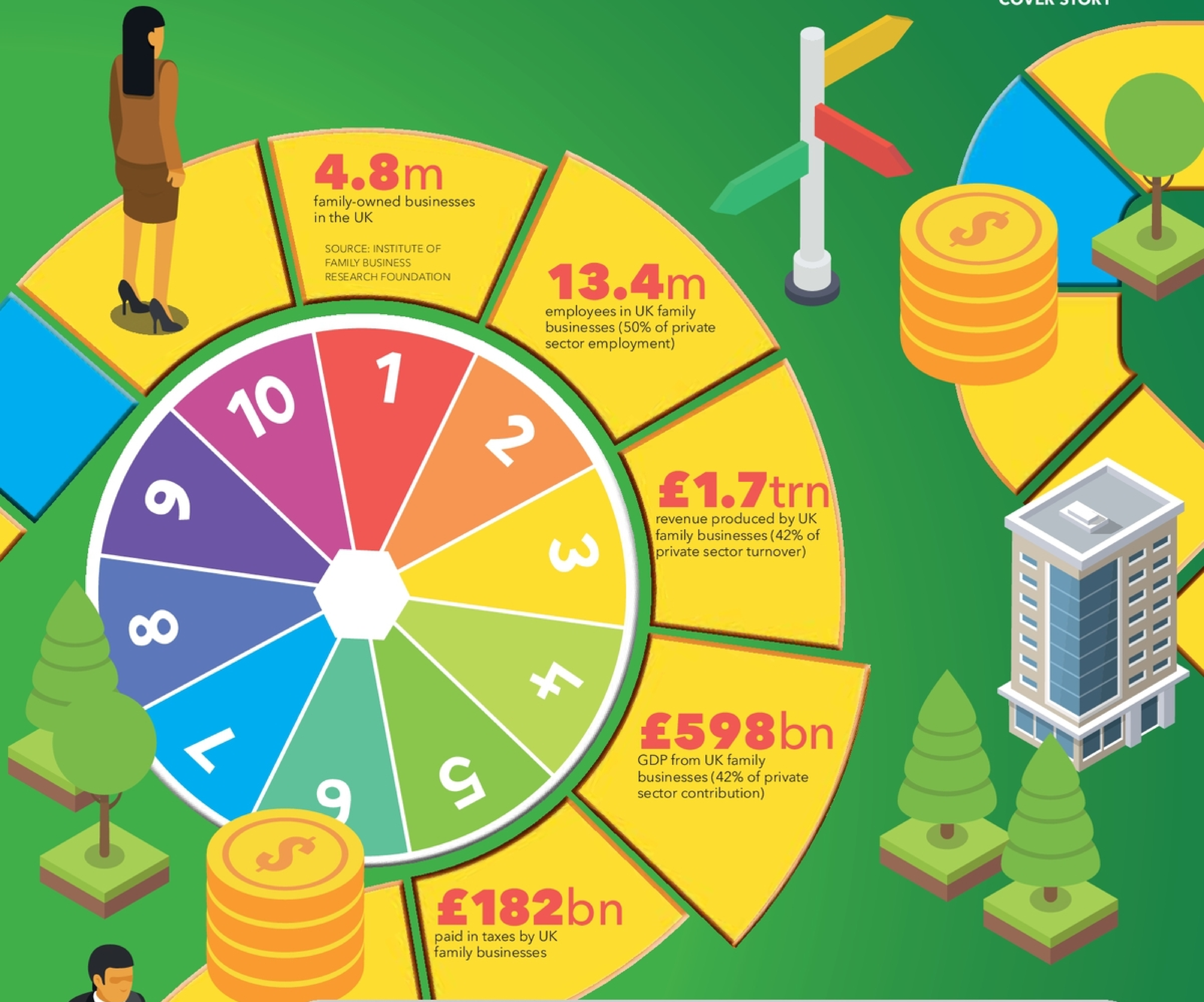
FAMILY FORTUNES

The UK's family businesses have had a good decade. Since 2010, gross value added has increased almost three times faster than other private companies, while employment grew nearly seven times faster. Grant Murgatroyd explores the role of corporate finance in ensuring the next decade is as prosperous



If small and medium-sized enterprises (SMEs) are the backbone of the economy, then family businesses are the vertebrae. There are 4.8 million family-owned businesses in the UK, according to the Institute for Family Business (IFB) Research Foundation. Businesses that are family controlled employ 13.4 million people (50% of private sector employment), generating £1.7trn of revenue (42% of private sector turnover), contributing £598bn to UK GDP and £182bn in taxes in 2017.

The majority of family firms are microbusinesses with fewer than 10 employees, but there are 120,790 small family-owned enterprises with 10-49 employees, 16,505 with 50-249 employees and 1,464 with more than 250 employees. The UK's seven largest family businesses by turnover according to *Forbes* are food and retail group Associated British Foods, steel trader Stemcor, conglomerate Swire Group, construction firm



Laing O'Rourke, Arnold Clark Automobiles, IT group SCH and cash and carry retailer Bestway.

In many ways, UK family businesses have been victims of the success of capital markets, which provided successful entrepreneurs with a route to cash out. In scale terms, they are dwarfed by foreign rivals, such as Walmart (US, $340bn capitalisation), Volkswagen (Germany, €84bn), Exor NV (Netherlands, €15bn) and Tata Sons (India, 28 listed companies with a combined capitalisation $145bn). However, a new generation of British business dynasties could technically be created by succession, as entrepreneurs such as Sir James Ratcliffe and Sir James Dyson near the end of their working lives. The general consensus is that having more than one family member in a director role puts a business in the 'family' category. And there is a nuance to advising them.

"There's a distinct element to advising family businesses which is different from advising large corporates," says Dominic Davis, a corporate finance partner at Burges Salmon. "You have to understand the family dynamics behind the deal. There are certain issues that come up time and time again with family businesses, so it's helpful to be able to advise how other families have dealt with them and the different ways you can approach them."

The key is remembering that you are advising the whole family. "These are complex relationships," explains Anna-Louise Shipley, a corporate finance manager at Buzzacott. "The most important thing for us is that we've got all the right people round the table and have everyone involved. You need to make sure you're not isolating anyone or giving anyone special privilege. You're working for all of them – not just who shouts the loudest."

Associated British Foods

Steel trader Steamcor, part of the Tata Group

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Volkswagen

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Doug Streatfeild-James, senior corporate finance associate, Burges Salmon

DOING DEALS

There comes a point in the lifecycle of every family business where a transaction is required, even if it is just managing the transition to the next generation. Doug Streatfeild-James, a senior corporate finance associate at law firm and Corporate Finance Faculty member Burges Salmon, explains: "Ideally, handing over the reins should have been addressed well before the event, but one of the things you find with family businesses is that they can be quite conservative and tend to stick to the status quo. It can be quite difficult to persuade people to review their structures until they absolutely have to. Leave it too late and you risk disputes, which can be difficult to resolve if feelings are running high."

Family business owners can be very focused on their own business and immediate competitors and less aware of trends in corporate finance. Matt Katz, head of corporate finance at Buzzacott, says: "Sometimes, the first part of our job is educating the family about the different options and finding out what it is that they want to achieve and then we help them decide how it is best to get there. Sometimes they are very clear about their options and are aware they can sell to a trade buyer, but sometimes don't realise that other options, such as MBOs or employee buy-outs, are available."

Preparation is even more important than for corporate businesses. Often, family empires are composed of seemingly unrelated operations, such as when a sibling or child with particular expertise has taken family support and funding to build a business in a different market. Similarly, the lines between business and personal assets such as properties and equipment can be blurred. If these issues are not properly addressed there will inevitably be problems.

In today's market, family businesses are not short of financing options. Tim Armstrong, lead advisory partner at PwC, says: "Traditional clearing banks have been operating with and lending to many family businesses for as long as those family businesses have been around. In terms of exit, trade sales are common. Where a family doesn't have family succession but has a management team who have been part of the business, an MBO can be a useful way to transition the values and core purposes of the business and release cash and value to the family.

"While there is sometimes less of an obvious fit with private equity, it is not out of the question, particularly to support an MBO with funding, for example. We are also seeing more investment from family offices, who typically have slightly longer time horizons than private equity."

Anna Faelten, an EY partner and head of TMT, says private equity has become increasingly attractive to family businesses: "They're often very savvy, very knowledgeable and do a lot of improvements to the business. A family-owned business might be more inclined towards some sort of employee or management led buy-out, but you often need a financial backer for that."

OUT OF THE WOOD

Not many family businesses trace their lineage back to a founder being duped by a conman. Seven decades ago Giles De Lotbiniere's grandfather fell for a compelling sales pitch for a new type of concrete block made of wood, sand, cement and a magic ingredient. The retired engineer agreed to start production before realising the magic ingredient was a fraud.

But there was magic to one of the ingredients: wood. In building bricks, the addition of wood makes them light, smooth, warm, able to manage moisture and perhaps surprisingly – good in a fire. Today, Lignacite's wood-enriched cement bricks lock up so much CO_2 that a block can be transported 100 miles and still be carbon neutral. Lignite bricks have been used in the Gherkin, the Olympic Stadium, and both Heathrow and Stansted Airports.

De Lotbiniere's sons, sister and cousins all work for the business, which also employs multiple generations of other families. In the downturn, directors took a 50% pay cut and the workforce 10%, helping the business through difficult times and positioning it for growth afterwards. In 2019, the company featured in *The Sunday Times'* Profit Track 100.

SPEAKING FAMILY 2 FAMILY

"The nature of a family business is that the family has this fantastic degree of trust among each other, and they expect to have similar trust with their advisers," says Jim Keeling (pictured), chairman and chief executive of advisory firm Corbett Keeling (CK), which he co-founded 25 years ago. "They can spot it a mile off if you don't have integrity."

How does integrity manifest itself? "We may meet with a family business and they say they want to sell, but an hour later we're telling them that would be a mistake as they obviously have some preparation to do. As our fees are largely contingent on the transaction happening, it's clear we are putting their interests first."

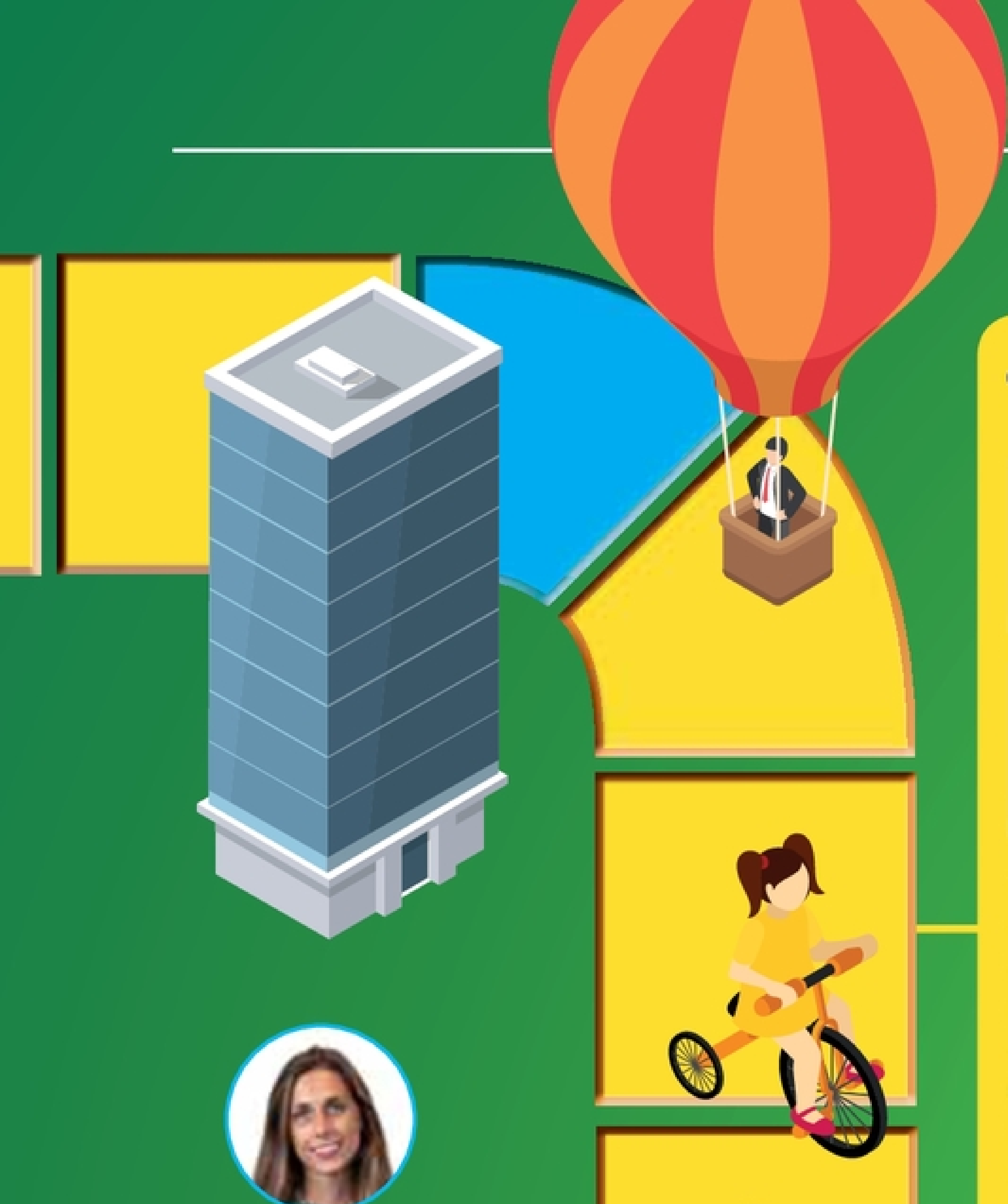
Sector expertise particularly resonates with family-owned businesses, says Keeling. CK has 26 sector specialists, who both advise and originate deals. These specialists cover six broad sectors: consumer, healthcare, financial services, industrial, support services and TMT.

CK focuses on the three Cs – cash, chemistry and certainty. "Often, business owners will have an idea of the cash proceeds they want in the end. There will need to be some chemistry with the eventual buyer, because they want to trust that the family legacy is left in the right hands. And then there is certainty – once started they want to know the deal will be completed."

Family businesses are often known to Corbett Keeling's sector specialists. Gee Lawson, a London-headquartered family-owned distributor of life sciences ingredients, for example, was introduced by the firm's chemicals sector specialist. In 2016, the firm advised on the sale of Air Charter Services, another family business. Its founder chairman Chris Leach had been looking for the best exit route for a long time. The sale of a 30% stake to Alcuin Capital Partners allowed Leach and his wife to cash out and their son to stay in the business.

In December 2018, CK advised John and Maxine Murphy on the sale of their East Anglian-based restaurant chain, Arbuckles, to an employee ownership trust. "The employee ownership route to exit actually plays very well with family businesses, as it gives the seller a 'good feeling' about selling the business on to staff, who often will have helped them build the business and to some extent feel like family."

The last thing that resonates, says Keeling, is that CK is a family business too – his wife Emma is COO and his brother Simon is a non-exec. "We empathise. Often there is a lot of emotion caught up with a family business sale – are they the generation that let it down? They need reassurance."



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Anna-Louise Shipley, corporate finance manager, Buzzacott

GUARDING THE FAMILY SILVER

Honest and open communication is difficult at the best of times. When it's about money, that difficulty increases exponentially. But families avoid these conversations at their peril. "The decisions you make around a family business and making an exit from it have repercussions that can last decades," says Keith Sheehan (above, top), wealth director at Brewin Dolphin. "I've seen a number of different situations where these decisions were made incorrectly and families were wrecked."

As important as selecting and structuring an exit or investment is making sure that family members' objectives and objections are known. "What do they want? Do they want to pass it on as a going concern? Do they want to create simplicity and not pass the burden of a business down to the next generation?" says Sheehan. "The big thing is understanding people's aims and getting them to think about different scenarios."

Planning for what to do with the proceeds should start as soon as possible, says Paul Martin (bottom, left), an investment management and financial planning director at Brewin Dolphin. "Any deal will start with a number; this might have been offered by a potential buyer or it might be a number that the family have always had in mind – the latter will not always have a methodology behind it."

But once a reasonable estimate has been agreed, what that number translates into in terms of replacing lost income and providing a capital base will influence decisionmaking. "This can provide some flex should a reduced purchase offer be made during negotiations," adds Martin.

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HARE AND TORTOISE

Family businesses can pursue a longer-term strategy than public and private equity-owned companies. "A lot of family businesses weathered the downturn well," says Hannah Harris, UK family business leader at PwC. "At one of the respondents to our annual survey, the family directors took quite a significant pay cut to avoid closing a plant when their competitors were closing theirs and they've now emerged as the leader in their industry."

This longer-term approach is highlighted in PwC's 2018 *Global Family Business Survey*. Top of a list of challenges for the next two years are the need to innovate (66%) and access to skills and capabilities (60%). Hot areas such as digitalisation (44%), cyber security (39%), data management (39%) and AI/robotics (22%) are in the list of concerns, but not given the same priority.

"Talent is an area of concern far above Brexit and political uncertainty for family businesses," says Harris. "It's an issue for all businesses, but family businesses face a specific challenge attracting senior level talent and getting the relevant skills around the board table to address the changing world."

Families have to adjust to allow non-family executives to drive change and work out how to compensate them, such as by issuing different classes of shares, allowing the family to retain voting control and issuing growth shares tied to the performance of the business from the point of joining to new talent. PwC found the proportion of family businesses achieving double-digit sales growth fell from 42% in the first generation to 32% for the second generation, 27% third, 32% fourth and 22% for subsequent generations. Of course some of the decline can be explained by the growth of those businesses and the inevitable slowing down as the business matures.

But, as a group, UK family businesses have prospered since the global financial crisis. Employment at family businesses rose 38.2% and gross value added (GVA) 51.6% in the period from 2010 to 2018, compared to just 5.7% and 18.8% at non-family firms, according to the IFB.

DATA MANAGEMENT

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CASE STUDY: SEASALT

In September 2018, BGF invested £11.5m in Cornish clothing and lifestyle brand Seasalt, with £4.5m of debt provided by Santander Corporate & Commercial. Seasalt's turnover was £51m, with 50 stores employing 689 people. CEO Paul Hayes, who joined in 2013, said the investment would allow the company to go much further on all fronts.

Seasalt was born in 1981, when the Chadwick family bought a general clothing store shop. The Seasalt brand took form in 2001, when the three brothers, Leigh, David and Neil, took over from their father. Neil Chadwick's wife Sophie is the textile expert and print designer.

Relationships were crucial to the deal. Gary Partridge of Lexington Corporate Finance in Cardiff met the family five years ago. The aim was to find a deal that would allow two of the brothers to continue with the business and all three to realise some value.

"The key was not only to get the right financial terms, but to have an investor that shared their values, that wanted to work in partnership with them," explains Partridge. "BGF has refined its investment style and model, and has got some people who have a good bedside manner with family businesses."

NOT 'JUST BUSINESS'

One attraction of family businesses is their sense of values and purpose, a feeling that business isn't just business. In the PwC survey, 79% of respondents felt they had a strong sense of values and purpose.

For example, Mars Inc, a fourth generation family business with 115,000 employees and turnover of more than $35bn, is governed by five principles: quality, responsibility, mutuality, efficiency and freedom. "From one generation to the next, it was always about how we do business rather than what we do as a business," Victoria Mars, chair of the business from 2014 to 2017, told PwC.

"Purpose is – on average – more obvious within family businesses," says Harris. "A family business doesn't necessarily always articulate its purpose and spend as much time thinking about it as some large corporates do, but the purpose within them is often more obvious when you actually look at how the business operates in its community, and the way they look after employees and other stakeholders."

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Victoria Mars, former chair, Mars Inc

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