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CAPITAL THINKING ON FINANCING FAMILY BUSINESS GROWTH

ARTICLE | 17 SEPTEMBER, 2019 10:00 AM | BY BRUNO PICHARD

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Opening the capital of a family company to third party shareholders or offering share capital is a major step for any family. Before commencing the process, it is important to quantify and understand the reasons that may justify the undertaking.

For example, profit-sharing of employees, exit of cash for the benefit of shareholders or, on the other hand, a need for funds. It is also necessary to examine the risks the company is taking by opening its capital, especially with regards to control by the family. Finally, where risks are identified, it is crucial to determine how to limit their impact. I'll discuss the main principles of taking on third party shareholders in family companies, without pretending to be exhaustive. These observations should be adapted according to individual circumstances as appropriate.

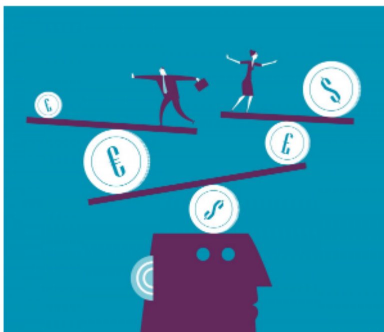
Reasons for opening the capital

There are typically four main reasons which drive this process. The first is the need to open capital to certain key employees who are not members of the family. Some family businesses can struggle to recruit high-level employees outside the family. Such employees may fear that due to not belonging to the family, their progression in the company will be capped. Offering them shares can reassure them of their place and give them an opportunity to increase their income.

Secondly, as part of its development, a family business may need financing. This need can be met through a capital contribution via private equity funds. In order to grow, the business may also need to open its capital by association with another competing or complementary company.

Thirdly, some family members may wish to divest their holdings. If the other members of the family do not have the means or the desire to buy their participation, a third party (often also a private equity fund) will be able to make this repurchase and to enter in the capital.

Finally, in the same vein, members of the family—while remaining in the capital—may wish to get access to cash, which can be done via an entry into the capital of a third party, by buying a portion of their shares.



The risks

The risks are diverse. In the first place, the opening necessarily leads to a partial loss of control, which will be more or less significant depending on the percentage of participation of the third party in the capital. Again according to this percentage, the new shareholders may ask to be represented in the management bodies, in particular in the board of directors (or similar bodies). These new shareholders may also ask

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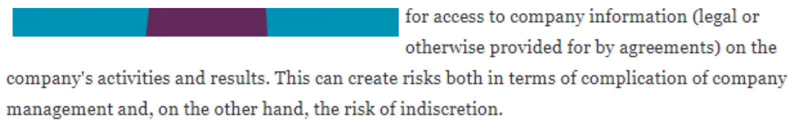

for access to company information (legal or otherwise provided for by agreements) on the company's activities and results. This can create risks both in terms of complication of company management and, on the other hand, the risk of indiscretion.

Furthermore, there can also be a danger of total loss of control. In particular, if there are disagreements between family members, the third party and some family members may be tempted to take advantage and to sell the family company to this third party. This danger also exists if the third party has entered the capital for a limited time period. A common scenario often seen is for the third party to request at the end of this period that either their participation be bought or that the entire company be sold.

Limiting these risks

The first and most crucial step is to thoroughly assess the risks the business is facing. Once identified, one solution will often be to give family shareholders rights greater than what their mere equity participation would give them (for example through multiple voting rights for their shares or increased rights to participate in management bodies, with for example, the right to appoint directors with the exception of a minority to be defined). This would allow family shareholders to stand united in front of new shareholders. This can be done through the formation of a family holding company grouping the shares of all members of the family. The outside shareholders and this holding company would then become the sole shareholders of the family company. However, in the event a holding company is not created, family unity can also often be protected through shareholders' agreement or special provisions in the company's articles of association.

Finally, if the entrants in the capital are in position for a limited time, it is important to plan for their exit from the start of the period, and in particular for its financing, to ensure smooth transitions.

Opening the capital of a family company can be a valuable opportunity to grow and develop the company. It can also be a source of difficulties, but with good preparation these can be considerably reduced.

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