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## Small Business (A Special Report)

*Money...With Strings: Outside investors can bring much-needed capital to a family business; Just make sure everybody's on the same page*

BY ANDREW BLACKMAN

MARK NORDENSON was in a quandary.

It was the end of the 1990s, and the 100-year-old vacuum-pump company started by his great-grandfather was suffering. Nash Engineering had been growing fast, driven partly by strong sales in countries like Indonesia, the Philippines and Thailand. After the Asian financial crisis hit, however, new orders in the region dried up and existing ones were being canceled. Mr. Nordenson quickly found himself chairman of a company saddled with a costly global infrastructure and flagging revenue.

A possible merger was explored with a unit of Siemens AG that would help Nash avoid having to lay off employees. But Nash didn't have the capital to complete the deal. Further complicating matters were the disparate needs and opinions of Nash's more than 100 shareholders, including Mr. Nordenson -- all of them descendants of company founder Lewis H. Nash.

"We needed to do something to get back on track and grow," says Mr. Nordenson. "The business wasn't generating enough capital to provide liquidity to shareholders. We had to do something."

In the end, Nash found its solution down a road that can be difficult for a family-owned business to choose: It decided to pursue private-equity investment.

In a private-equity deal, outside investors plow anything from a couple of million to a few hundred million dollars into a company in return for a sizable equity stake, often even a majority stake. Such transactions are booming: Private-equity investment deals of less than \$100 million jumped to \$9.2 billion last year from \$5.4 billion in 2003, and for this year totaled \$7.8 billion through mid-August, according to the invest-

ment-banking research firm Dealogic LLC.

But even private-equity experts warn that bringing in outside investors is not something the owners of a family business should take lightly.

While the extra capital can help a company pursue new opportunities or give owners large cash windfalls, it can also lead to conflicts between the outside investors and the owners. While the former are focused on short-term returns -- their aim is usually to sell their stake in five to seven years at several times its initial value -- the latter usually have a

"You can craft an elegant business solution, but the keys to implementation are locked up in the psychology of the family," says David Bork, founder of Aspen Family Business Group, a family-business consulting firm in Aspen, Colo. "The first hurdle is getting over the secretiveness that many founders have as it relates to their finances," he says. "Often they'd rather talk about their sex lives than their finances."

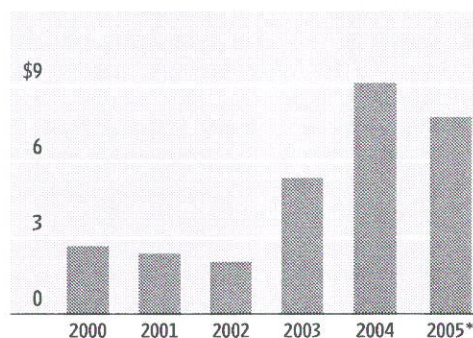
Vincent Constantini, managing partner at Roseview Group, a Boston-based advisory firm for entrepreneurs, says: "Tension and friction are built in on day one. Private-equity firms are loyal to their equity investors. They get rich only if they deliver a multiple of the capital back to their investors. A founder, on the other hand, is loyal to many things -- his family, his employees, his customers, suppliers."

Family owners have to recognize that an equity investor is there to create value, and that benefits all shareholders, says Francois de Visscher, founder of de Visscher & Co., a consulting firm in Greenwich, Conn., that specializes in family businesses and also runs a private-equity fund. "The short time frame can also help a company really focus on the urgency of certain things. There might be projects the company has been thinking about doing, and a private-equity firm will come in and say, 'Let's do it now, not have another meeting about it.'"

For Nash Engineering, control was a big issue. While the family had agreed to sell a majority stake and was considering selling out altogether, it wanted to control the process. "The important thing for the family owners was to find a group that was willing to work with its partners and not just have them along for the ride," says Mr. Nordenson. "That's quite rare. Some private-equity funds will want to run everything themselves."

### Finding Funding

Total value (in billions) of private-equity deals of less than \$100 million



\*Through Aug. 18

Source: Dealogic

longer-term outlook, and can find the loss of control hard to accept.

If a family has been running a business for decades on its own, inviting outsiders in can bring up a host of issues. What's more, family members may disagree not only with their new partners but among themselves. Maybe one sibling wants to invest in growth, while the other just wants regular dividends. Or maybe a parent wants to keep longtime suppliers and employees, and the children want to restructure.

Mr. Nordenson began by approaching de Visscher. Through de Visscher, Nash was introduced to about 60 private-equity firms, from which Nash chose Audax Private Equity, part of New York- and Boston-based Audax Group, to be the purchaser of a majority stake.

Though the family's stake was reduced to around 40% from 100%, there were few changes in the day-to-day running of the business, Mr. Nordenson says. The infusion of capital allowed the company in 2002 to complete the merger it had desired with the Siemens unit, creating the firm nashelmo Industries. Then, although Audax's involvement was to have lasted for five years or so, the integration went so smoothly that after just two years the family and Audax accepted a complete buyout from Gardner Denver Inc. of Quincy, Ill. In September 2004, Gardner Denver bought nashelmo for \$223.5 million in cash -- an almost fourfold increase in value in four years.

There are many private-equity deals that don't end in a sale. Often, owners simply want to take some chips off the table but retain a major stake in their business and keep on running it.

The deals are usually driven by owners seeking liquidity and diversification, says David Gellman, managing director and co-founder of private-equity firm FdG Associates in New York. "They're making good money for years, and one day they wake up and realize their business is now worth \$50 million," Mr. Gellman says. "And what's sometimes layered over that is providing liquidity to other members of the family who would really rather have the cash than have to wait for dividends."

Other times, families bring in private-equity investors for their management expertise. "Sometimes the company has grown to a size where the entrepreneur feels overwhelmed," says Mr. Gellman. "There are a lot more moving parts, and they realize they need to get help and professionalize the business."

Private-equity firms typically put people on the boards of the companies they invest in. While they may not have as much industry-specific knowledge as the family firm does, they can bring a broader business perspective. Their expertise also can extend to an ability to access capital markets, including assisting with initial public offerings if the conditions are right.

To find a private-equity partner, most experts recommend relying on word-of-mouth. Bankers, financial

advisers or general business contacts should be able to recommend someone to talk to -- and it's important to speak to as many as possible to be sure you're getting the best deal. Sometimes the firm that provides the most money may not be the best option: The top priority should be what they will be like to work with.

"There's so much private equity out there that it's not usually a problem of capital," says Mr. de Visscher. "The issue is what kind of capital. Questions to ask potential investors are things like: What is your investment horizon? Who are your underlying investors? What are your past investment experiences? What are your other investments right now and how would my company fit in with those investments?"

Experts advise that the family owners ask for references and talk to previous partners about their experiences, focusing on how patient or impatient the investors were when times got tough.

Indeed, one of the most common problems is a mismatch between the family's time horizon and that of the investors. "The issue is very simple: It's about an exit for the new capital," says Mr. Constantini. "You don't own that capital, you rent that capital. And the investors want it back, with a return, in five to seven years. The question for the family is, 'If I take \$50 million for a 25% stake in the business, how exactly do I pay that back, plus fair market value, five years from now?'" Sometimes it is possible for the family to regain full control; other times the equity investor's stake can be sold to new investors.

Private-equity firms generally look for a return of about 30% a year -- a tall order for many businesses. Yet many families are tempted to agree to very optimistic goals. If the company doesn't meet those objectives, typically the private-equity firm will have a clause in the agreement allowing it to take control. Then the firm may seek to increase its return by selling assets and sharply downsizing.

Families who aren't comfortable with these prospects may find debt a handier form of financing. Or, companies could solicit investment from rich individuals. "It's messier, but the investors can be more forgiving," says Mr. Constantini. Individuals also are often more willing to invest for longer periods than private-equity firms. The downside is that it can be harder to find such investors and to close the deal, because they are in less of a hurry to invest their money than private-equity firms.

Once a family-owned company decides the potential rewards of private-equity capital are worth the risks, a lot of preparation can be necessary. "There's a rule of thumb in the business that says for every 10 years you've been a private company, it takes a year to undo it," says Mr. Constantini. "Many firms have commingled family and business matters to a point where it's difficult to differentiate."

Such blurred lines are often an immediate red flag for investors. Mr. de Visscher, for one, says he would generally stay away from any family-owned business that doesn't have a firm corporate-governance structure.

"It becomes impossible to make the right management decisions if those decisions are being tainted by family sensitivities," he says. Clear succession plans are also key, and the management must have depth rather than rely on a few key players. Mr. de Visscher often recommends not only putting outside directors on the board, but setting up a family council for dealing separately with personal matters.

The Nash descendants created a family council several years before their company agreed to its private-equity investment. Mr. Nordenson believes that moving ahead with the plan would have been "almost impossible, and certainly very divisive," if there had been no council.

The family was so large and disparate by the fourth generation that Nash Engineering was the main thing they all had in common. So, with about a dozen representatives sitting in for different branches of the family, the council's discussions revolved around business from the family perspective. Key topics included how family members would feel if the business were to be sold, and how they would cope if the company had to stop dividend payments for a few years.

"In some of the family-council meetings we did scenario planning, like, 'In what circumstances would you be willing to see the company sold?'" Mr. Nordenson says. "For many years, even saying that out loud would have been considered heresy."

Eventually, when Gardner Denver made its acquisition offer, the decision to sell was almost unanimous. Mr. Nash and his extended family managed to retain some of their company's financial assets and North American real estate and are managing these assets through a holding company with the name Nash Engineering, of which Mr. Nordenson is

still chairman.

But it's not clear at the moment whether the tradition of a collective family enterprise will stay alive or whether all of the disparate cousins will now drift off to invest their windfalls separately.

"We still have to grapple with how we hold onto the legacy," Mr. Nordenson says. "Do we want to continue the tradition of being a business-owning family, or just look at it as a glorious piece of history? To be honest, that's something we still have to decide."

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