TIME TO GO PRIVATE AGAIN?

Many family businesses that made the decision to go public several decades ago have been disappointed. **François de Visscher** explains why, though a complex and risky path, going private could be for the long-term benefit of the business

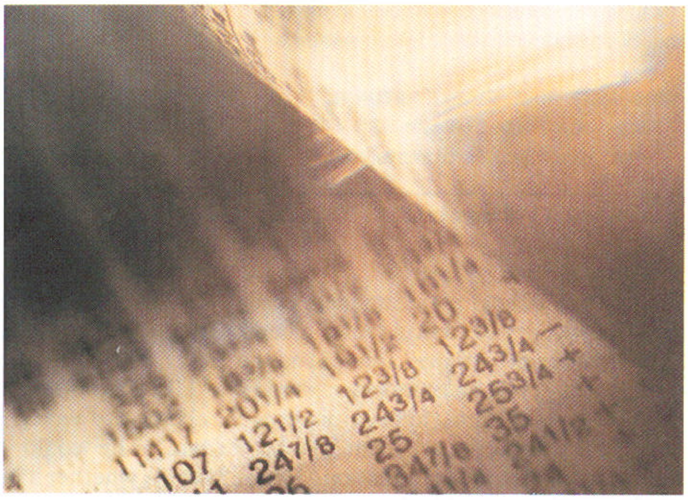
During the last 30 years, many family companies took advantage of the stock market boom all over the world by bringing the company public. They invited non-family shareholders to raise growth capital, to create a value benchmark for employee compensation, to create a currency for mergers and acquisitions, or to enhance liquidity of family shareholders' patient capital. By being public, those family companies experienced additional benefits, including increased commercial visibility, greater discipline with financial reporting and more transparent governance and compensation structures.

While many of those benefits survive, the public market has disappointed most family companies. There are four major factors contributing to this disappointment: lack of liquidity, more invasive financial disclosure, tougher governance regulations and an increasingly short-term market orientation. As a result, many family companies have been rethinking the benefits of private ownership.

LACK OF LIQUIDITY

Many family companies have become the poor children of the public market. While a $1 billion market capitalisation used to be the minimum threshold for stock analyst and institutional attention, in today's market $1 billion is barely a mid-sized company. In addition, a large quantity of shares owned by the founding family is generally not available for trading, rendering the remainder of the stock of little or no interest to public investors. This lack of liquidity has caused the stock price of many family companies in recent years to lag behind the broad market indices.

However, an undervalued stock price may be the very reason for owners of those family companies to go private. One recent example is the transaction announced in October by publicly traded Cablevision in the US, in which the Dolan founding family, announced its intent to go private.



MORE INVASIVE FINANCIAL DISCLOSURE

The Sarbanes-Oxley Act of 2002 (SOX) and similar regulations in Europe increased disclosure rules, raising costs and the risks of public ownership for many family companies. The same regulations also increased the potential legal liability of directors and officers.

Prior to SOX, public disclosure requirements were limited to financial information and some skeleton operational and ownership data. Today, anyone with an Internet connection can find much financial information on public and private companies. The real difference since SOX is that regulators now require public companies to disclose strategic facts and figures on issues such as segment reporting, as well as detailed data on compensation of executives and directors.

For family companies with long-term strategic orientation, the detailed disclosure of some operating facts can be extremely damaging to the ability of the company to create long-term value. The increased liability of directors and officers may also make it extremely difficult for family companies to maintain and recruit qualified outside directors. Furthermore, in a family business system, which survives on a fine balance between strategic growth and maintenance of patient capital, detailed compensation numbers could shake that balance.

Consider, for example, a family business that wants to enhance the legacy for the family, employees and community by retaining a past chairman on the payroll in some capacity. Outsiders may feel this is an unwise and unnecessary expenditure. Or a family company with a very effective family governance system may deem it important for the head of the family council to sit on the board of the company. Outsiders may view this as a waste of corporate resources, discarding the benefits of good communication between the shareholders and the management.

TOUGHER GOVERNANCE REGULATIONS

The aftermath of various corporate scandals has led international stock exchanges such as Euronext to beef up their standards to protect minority shareholders. Among other things, the tougher regulations include increased governance requirements, such as a greater role of independent directors with greater responsibilities. For instance, increased personal liability standards on directors are intended to make them more accountable and require them to take a greater role in governance structures such as the audit and strategic committees.

This is understandable for widely held companies, to prevent insiders from taking advantage of minority shareholders or worse yet, to prevent insiders from looting the corporate assets. However, stricter governance rules are a difficult pill for family companies to swallow. After all, not only would family directors, who are not independent, be unlikely to destroy value for minority shareholders, they are the greatest long-term holders of capital.

INCREASINGLY SHORT-TERM MARKET ORIENTATION

The more prominent presence that large financial institutions, including hedge funds, wield in the market, and the lightning speed at which information flows, have put a greater burden on public companies for quick and fast disclosure. Quarterly financial information is now viewed as outdated. Financial analysts seek to predict what the company's performance will be in the coming weeks or days, not months. This increasing emphasis on short-term performance clearly goes against the grain of well-run family companies that are pursuing a sustainable long-term, profitable strategic growth.

QUANTIFYING THE WAVE

With the growth in the private equity and debt market over the last five years, and the relative under-performance of family company stocks in the public market, the wave of 'going private' transactions for family companies is not surprising.

In the US, for example, the number of companies that went private in the early 1990s was in the single digits, with total dollar value offered less than $1 billion. By 1997, 35 companies went private, with combined dollar value of more than $5 billion. The following year, the 70 companies that went private offered total value of almost $11 billion. Five years later, 124 companies went private, for a similar total value. That year, the ratio of companies going private to those going public spiked to more than 25%, compared with about 10% in 1998. In 2004 the 98 companies that shed their public ownership offered total value of more than $25 billion.

THE RISKS

Many companies might be surprised to learn that going private can be as complicated, risky and almost as costly as going public. So if the economics seem to make this option attractive, it pays to proceed with great care.

Going private usually involves some kind of tender offer for the public shares or a reverse merger of the company to buy back the public shares. Depending on the control structure of the company, the tender offer may invite hostile, unsolicited bids from unwelcome suitors. In fact, those very suitors may even exploit potential divisions in the family and may court certain dissident members of the family to vote against the tender offer and go along with their own bid.

Another risk is that the regulators may not approve the transaction. Disclosure must be extensive, including thoroughly documenting all meetings and actions of management, directors and advisors involved in the process and timely release of information to the public. The valuation of the offer made to the public shareholders must be viewed as fair and therefore the independent directors will most likely require a fairness opinion from the board's financial advisors to support the value offered to the public shareholders.

There are also significant costs associated with going private, including investment banker, legal and accounting fees. After the transaction, the company may also need, in some cases, to redesign management compensation and benefit plans to accommodate the lack of public stock.

THE REWARDS

Although the path to going private is complex and risky, the benefits can be profound.

For one thing, your company can get off the quarterly reporting treadmill and focus on creating long-term value. While the one-time costs of going private can be considerable, the ongoing costs of public ownership will be history. While future private financiers may still require disclosure of detailed financial information, your competitors, vendors, employees and other outsiders will no longer be privy to your internal and strategic information. And while multiples will still be subject to market forces, your stock price will no longer be at the mercy of the public exchanges.

By becoming a private company again, a family company no longer has to concern itself with regulatory disclosures and executive compensation will become a private matter. This creates a friendlier operating environment, enabling the company to focus once again on its long-term growth for the benefits of all stakeholders.

Management should also welcome the opportunity to be private again. Typically, the team would benefit from some private options, equity participation and liquidity-event incentives. Finally, running a family company for long-term cash-flow growth, as opposed to quarterly earnings per share, will facilitate the ability of the company to pursue its strategy of sustainable, profitable growth.

If you jumped through all the hoops to go public, you should not worry that going private will render that investment of time and money wasted. Your company will likely emerge much stronger, with more discipline in record keeping, more savvy working with outside advisors and board members, and more experience working with public stakeholders including vendors, the press and the financial community. ■

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