

Family-owned businesses and private equity - Maintaining the company culture and family values as a (contractual) condition

COOPERATION BETWEEN FAMILY-OWNED BUSINESSES AND PRIVATE EQUITY INVESTORS OFFERS BOTH OPPORTUNITIES AND CHALLENGES. BALANCING ECONOMIC GOALS WITH PROTECTION OF CULTURAL VALUES IS KEY: SUCCESSFUL COOPERATION BETWEEN FAMILY-OWNED BUSINESSES AND PRIVATE EQUITY IS POSSIBLE SUBJECT TO CAREFUL NEGOTIATIONS.



Characteristics of family-owned businesses

Family-owned businesses hold a unique combination of entrepreneurship and family values that are cultivated, developed and passed on over generations. The close ties between family members and the company not only characterise the management, but also influence the corporate culture and the long-term company strategy as a whole. Family values and traditions are incorporated into the daily business processes. The short decision-making paths promote the company's flexibility. In particular, long-term strategies and a strong value foundation are

closely linked to the way the company is managed and passed on to the next generation.

Long-standing traditions, family ties and a strong identification with the company and the location play a central role. Despite of necessary developments and changes over the generations, owners endeavour not to lose touch with the company's original roots.

This strong embedding in the family tradition creates a deep connection and a special sense of responsibility



towards the company and the family. Furthermore, this often results in a particularly strong bond with the employees and the location.

Family businesses therefore differ fundamentally from non-family-run companies. Due to their strong roots in family traditions, family businesses often find it difficult to open up to (financial) investors.

Historical scepticism towards private equity

Private equity is considered one of the most important forms of financing (inorganic) growth of companies. At the same time, there is considerable scepticism on the part of many family-owned businesses about admitting non-family members to the group of shareholder let alone, considering an (international) financial investor. The scepticism may be understandable at first glance, given the characteristics described above.

The concerns are manifold and often include both strategic and emotional aspects of the management and/or shareholders: in particular the different goals and expectations of family-owned businesses with a cross-generational approach on the one hand and private equity on the other, which often seek an investment period for “only” three to six years.

Family businesses that focus on long-term goals may worry that social and cultural corporate values could be pushed into the background. Shareholders who *solely* focus on EBITDA growth would contradict such goals.

However, the biggest concern many families have regarding involving financial investors is certainly the (supposed) loss of control over their business. Private equity generally aims to acquire majority stakes in order to secure a substantial say in the company’s strategic decisions. This often contradicts the family’s goal to retain responsibility, control and decision-making freedom.



Family businesses work successfully with private equity – secured by (contractual) agreements

This hesitant attitude of family-owned businesses is changing more and more. According to a study by PwC¹, only 18% of the family-owned businesses surveyed in 2011 could imagine working with a private equity investor. In 2023, this figure was 90%. This broad change in sentiment alone emphasises diminishing reservations and the (new) openness towards a financial investor as an external partner, capital provider and co-owner.

In addition to the general increase in capital requirements due to higher costs and global challenges, the reason for this change is the recognition that private equity investors, with their financial strength and often extensive entrepreneurial expertise, can also ensure the positive development of family-run companies. In addition, they can contribute outstanding experience with regard to inorganic growth opportunities through company acquisitions (“*buy and build*”). Private equity allows to tap growth potential that would otherwise hardly be possible to access. Last but not least, there are private equity companies that specialise in investing in family-owned businesses and that take their specific characteristics into account.

In addition, it is possible to preserve the unique characteristics of a family business by means of contractual

¹ PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Private Equity und Familienunternehmen – Ziemlich beste Freunde?, November 2023.



agreements and thus effectively address the scepticism described above. Corporate values, loyalty to the founding family and the area/city where the business is located, special consideration for employees, agreement on long-term strategies, buy-back options for family members, substantial participation of the family even after the entry of a financial investor of often almost 50% – these goals can be contractually secured and negotiated in the interests of the family. Thus, foreign financial investors, for example, will also take the spirit of the family-owned business into account.

Corresponding requirements for a cooperation can be addressed and agreed in shareholder agreements between the family and the new financial investor. In contrast to the articles of association, such an agreement does not have to be registered with the commercial register and can therefore be treated confidentially. In particular, due to customary call-, put- and/or buy-back options, notarisation is nevertheless often required.

The family values and conditions for the cooperation can be secured, for example, by granting buyback options, agreeing certain management measures requiring approval and (long-term) corporate strategies, defining information rights and provisions in the event of a later exit by the financial investor. A location protection clause that guarantees that the company will remain at its current location could also be negotiated.

It is also advisable to protect the values of the family business by introducing an advisory board. While the majority investor will also regularly expect to have a majority in the advisory board, family and investor can define certain substantial management measures that also require the consent of the family (e.g. important personnel decisions, the launch or closure of branches, location-related measures, etc.). The advisory board can thus act as a link between the family and the private equity investor.

The composition as well as the rights and duties of the advisory board can be defined in its bylaws and in the articles of association.

Of course, the above-mentioned instruments must be carefully defined during negotiations, and it is not always possible to reconcile the interests of the founding family and private equity. At the same time, experience shows that it is becoming increasingly common to successfully realise a partnership between a family-owned business and private equity.

Contracts can largely ensure that the corporate culture of the family-owned business is preserved.

Conclusion: Preserving traditions, seizing opportunities with private equity

When considering private equity, family-owned businesses face the challenge of realising their growth potential while at the same time preserving their unique corporate culture. Despite long-standing reservations, there is an increasing openness towards such partnerships. Contracts such as shareholder agreements and the establishment of advisory boards can effectively protect family traditions and values. Such measures enable family-owned businesses to benefit from the advantages of external investors without having to give up their family tradition and corporate culture.

Daniel Fehling, LL.M. (University of Auckland)

Lawyer

Hamburg

daniel.fehling@gsk.de



YOUR PERSPECTIVE.

GSK.DE | GSK-LUX.COM

Copyright

GSK Stockmann – all rights reserved. The reproduction, duplication, circulation and / or the adaption of the content and the illustrations of this document as well as any other use is only permitted with the prior written consent of GSK Stockmann.

Disclaimer

This client briefing exclusively contains general information which is not suitable to be used in the specific circumstances of a certain situation. It is not the purpose of the client briefing to serve as the basis of a commercial or other decision of whatever nature. The client briefing does not qualify as advice or a binding offer to provide advice or information and it is not suitable as a substitute for personal advice. Any decision taken on the basis of the content of this client briefing or of parts thereof is at the exclusive risk of the user.

GSK Stockmann as well as the partners and employees mentioned in this client briefing do not give any guarantee nor do GSK Stockmann or any of its partners or employees assume any liability for whatever reason regarding the content of this client briefing. For that reason, we recommend you to request personal advice.

www.gsk.de



YOUR PERSPECTIVE.
GSK.DE | GSK-LUX.COM

GSK Stockmann

Rechtsanwälte Steuerberater Partnerschaftsgesellschaft mbB

BERLIN

Mohrenstrasse 42
10117 Berlin
T +49 30 203907 - 0
F +49 30 203907 - 44
berlin@gsk.de

HEIDELBERG

Europaplatz 3
69115 Heidelberg
T +49 6221 4566 - 0
F +49 6221 4566 - 44
heidelberg@gsk.de

FRANKFURT/M.

Bockenheimer Landstr. 24
60323 Frankfurt am Main
T +49 69 710003 - 0
F +49 69 710003 - 144
frankfurt@gsk.de

MUNICH

Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174 - 0
F +49 89 288174 - 44
muenchen@gsk.de

HAMBURG

Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG

GSK Stockmann SA
44, Avenue John F. Kennedy
L- 1855 Luxembourg
T +352 271802 - 00
F +352 271802 - 11
luxembourg@gsk-lux.com

LONDON

GSK Stockmann International
Rechtsanwaltsgesellschaft mbH,
London branch
Queens House, 8-9 Queen Street
London EC4N 1SP
United Kingdom
T +44 20 4512687-0
london@gsk-uk.com

Registered office: Munich
Munich Local Court
HRB 281930
Managing directors:
Dr. Mark Butt, York-Alexander
von Massenbach