

## 01.2018 Family foundations – the holy grail of a succession in the Mittelstand?

The success of the German economy is to a large extent based on the Mittelstand. It is not only the most important pillar of the German economy, but stands also – more than in any other country – for entrepreneurship in the truest sense of the word. Quality of products and services among others are their strengths as well as creativity, flexibility and proximity to markets. The succession in the Mittelstand is a topic in Germany more than elsewhere and not just by accident. Typically the ownership and leadership are in the same hand of either one person or one family since the foundation of the company. It still remains the case, when the company grows into dimensions that require an extension of family members by external managers.

As soon as the succession of the lead in a company is due, the owner family is facing important decisions. Understandably, it is the wish of the family to assign appropriate candidates within the family. In an ideal world, there is a candidate with the right skill set who is capable to successfully continue the work of the previous generation. However, experience shows that this is rarely the case as the complexity of requirements increases from one generation to the next generation. The expectation of a successful leadership of the generation of grand children is therefore limited.

The trial to back talented family members, who should take over responsibility in future, might be helpful with appropriate actions at an early stage and in the case of a success to remain or even increase the entrepreneurial wealth. A wrong appraisal in this regard is not unusual as this might lack a more critical judgment by focusing only on keeping the status quo. In addition to this, there is another phenomenon: the young generation often has different targets than their predecessors, which they believe are not desirable.

A foundation is being often praised as a solution for such dilemma by keeping the company in the ownership of the family and keeping the spirit of the founder alive through appropriate articles of association. Non-executive boards comprise of family members as well as non-family members and secure the execution in line with the articles of association.

For various reasons reality is far away from this idea. Articles of association precisely reflect the will of the founder and therefore leave only limited room for the non-executive board while facing changing entrepreneurial requirements. Those who have made experience with the supervision of a foundation as the approving authority know about the timing and content problems in adjusting articles of association. In consequence, articles of association are either slowing down the success in the long-run, or even worse, lead to disputes within the non-executive board, which not uncommon leads to decisions that are contrary to the interests of the involved family members.

There are alternatives that are worth to consider during the lifetime of the founder as they offer more favorable options for the successors, who are not qualified to take over the lead of the company, than a foundation. These alternatives can with a high certainty ensure keeping the company within the following generations, to increase the wealth of the family and to provide liquidity to any family member who wants to step out without stressing the liquidity of the company.

Can a sale to a strategic buyer be a solution? Better not, as it typically leads into a full integration of the company. Realizing synergies will cost workplace and it does not necessarily take a long time to totally damage the lifework of a founder within a short time frame. This cannot be cured by an attractive purchase price and it further destroys any connection from the successors to the company. The sale of a company by the founder to a private equity investor avoids the aforementioned risks of destroying the identity of the company, but means also a cut of the family to the lifework of the founding generation. Corporate wealth converts to money that is now in the sphere of an asset manager with its success being as hard to assess as the performance of the non-executive board of a foundation.

This raises the question whether there is a model that has the benefit of all the advantages while excluding any of the disadvantages at the same time? A model that is close to this target should remain the company in substance, become open to capital markets, the family continuing to participate in the corporate development and finally enabling to provide liquidity to family members when required.

Lindsay Goldberg Vogel (LGV) has developed such a model. Its most valuable asset is the entrepreneurial experience of the partners of LGV, both, as successful leaders and responsible CEOs as well as active chairmen of supervisory boards of Fortune 500 companies across various industries.

In the LGV model – as evidenced by the investment in Wacker Construction Equipment AG – Lindsay Goldberg funds purchased parts of the shares from the family members in cash. LGV has steered the development of the company in close collaboration with the family. Contrary to the more passive involvement of the board of a foundation, the financial commitment ensures a synchronization of targets. Professional leadership leads to an increase of the enterprise value within a few years. In a second step, a public listing can open the entry to capital markets in order to further boost the expansion of the company. Qualified family members remain in the leadership of a now much more sizeable company. Family members with lower entrepreneurial engagement have the choice to either remain a shareholder of the company or to sell their shares without draining liquidity from the company. The successors of a company, not only limited to the first generation, have a fair chance of a successful engagement in the company where they are inevitably linked to with emotions and continue to remain so. It is highly unlikely that a solution with a foundation will deliver similar results.