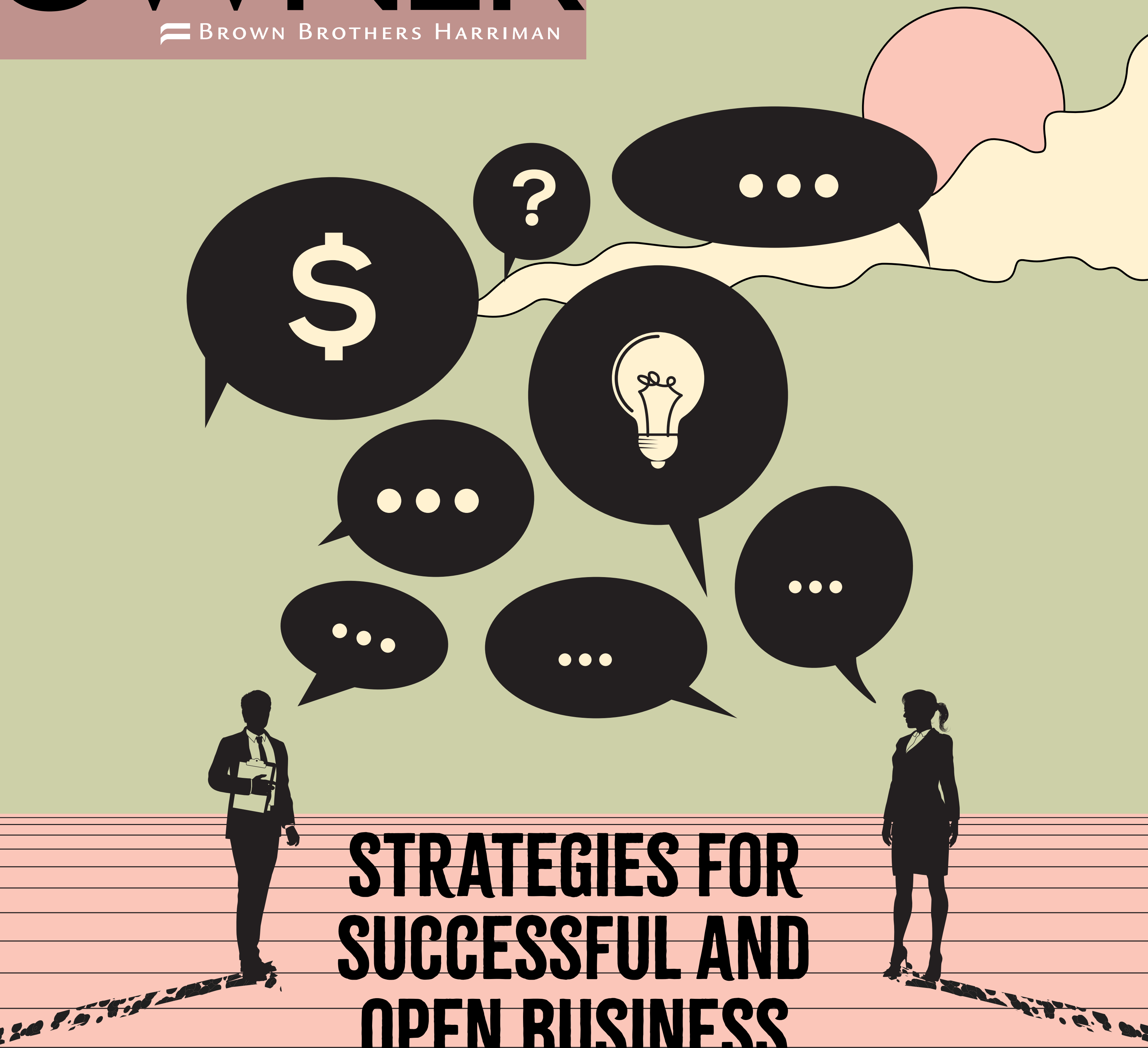
Fall 2023

OWNER TO OWNER

Brown Brothers Harriman



STRATEGIES FOR SUCCESSFUL AND OPEN BUSINESS COMMUNICATION

OWNER TO OWNER

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Brown Brothers Harriman

Jeff Meskin / Partner

Dear clients and friends,

Earlier this year, BBH conducted an inaugural Private Business Owner Survey. The respondents represented 400 U.S. private businesses with enterprise values from $10 million to $500 million and more. Of the owners surveyed, 87% represented family-owned enterprises; 74% were male, and 26% were female. We asked about how the business affects their family, how they think about the future, what might happen when they step away from the business, and how business strategy might be changing due to economic conditions.

The results were fascinating:

- Business owners report that they have estate plans (98%) but haven't communicated them (94%).
- They have endured family disagreements about the business (84%), yet it is very important for most (85%) to keep the business in the family.
- While all have taken some steps to prepare the next generation to lead the business, most have not yet defined the roles of next generation leaders or not communicated their plans fully (75%).

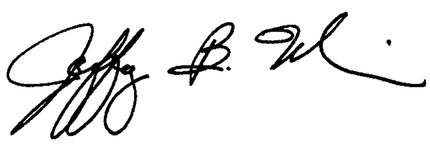
One key theme of our findings was that of communication – its importance, and the challenges to communicating effectively. For example, among those surveyed, 46% reported that the possibility of work disputes damaging family relationships was a key challenge of running a family business, and 43% faced issues choosing a successor knowing it would cause family conflict. While business owners reported being nervous about the impact of such business discussions on their family, having these conversations is imperative to ensure the longevity of the business. In this issue's feature article, Ben Persofsky, executive director of the BBH Center for Family Business, discusses four strategies that private businesses can develop to improve communication.

Another topic on business owners' minds is the market environment – which today is riddled with uncertainty, including rising interest rates, a tight labor market, and the possibility of a looming recession. In the midst of this volatility, many business owners are asking themselves, "Is now the time to sell?" In fact, in our survey, 76% of U.S. private business owners said that every time they navigate economic uncertainty, they lean more toward selling their business. In this issue, John Secor, Kyle Gordon, and Carson Christus from our Corporate Advisory & Banking team discuss family and business factors that come into consideration when debating whether now is the time to sell the family business.

We also include a roundup of the survey's key highlights – what the results reveal about common challenges for business owners and how they are planning for the future. And as always, Michael Conti, Grant Smith, and Christine Hourihan provide an overview of the economy, the credit markets, and the private equity and mergers and acquisitions markets.

We hope you enjoy this issue. If you have any questions about the topics covered in this edition, my colleagues and I would welcome the conversation.

Sincerely,



Michael Conti, CFA / Investment Research Group
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The Business Environment

In each issue of *Owner to Owner*, we review aspects of the business environment on three fronts: the overall economy, the credit markets, and the private equity (PE) and mergers and acquisitions (M&A) markets. The following article examines the state of the economy amid signs of potential slowdowns in growth expectations and un-inverted yield curves, a temporary pause in rate hikes, and declines in PE dealmaking, exit activity, and M&A activity.

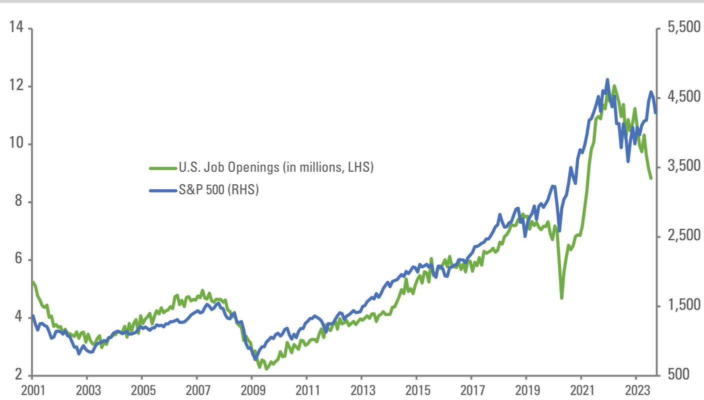
The Economy

U.S. GDP expanded at a quarter-over-quarter annualized rate of 2.1% in second quarter 2023, a slight deceleration from the revised 2.2% reported in first quarter 2023. The headline growth figure of 2.1% was driven by a deceleration in consumer spending, a downturn in exports, and a deceleration in federal government spending. These factors were partially offset by business investment, an acceleration in nonresidential fixed investment, and a smaller decrease in residential investment, resulting in an overall fairly solid pace of growth.

The personal consumption expenditure (PCE) component of GDP – which drives 70% of GDP over the long run – advanced 0.8%, following a 3.8% growth rate in the first quarter. Compounding this deceleration was housing, which contributes between 15% and 18% to GDP, as it fell 2.2%, its ninth consecutive quarter of declines. For the remainder of 2023, there are several factors on the horizon that may affect fourth quarter GDP, such as the resumption of student loan payments and reduced auto production due to the ongoing United Auto Workers (UAW) strike.

Meanwhile, the number of U.S. job openings continues to trend downward: It is now 20% below its all-time high recorded in March 2022, although it remains roughly 34% above the pre-pandemic levels of January 2020. While the stock market is forward-looking, job openings often reflect current economic conditions and signal a potential slowdown in growth expectations.

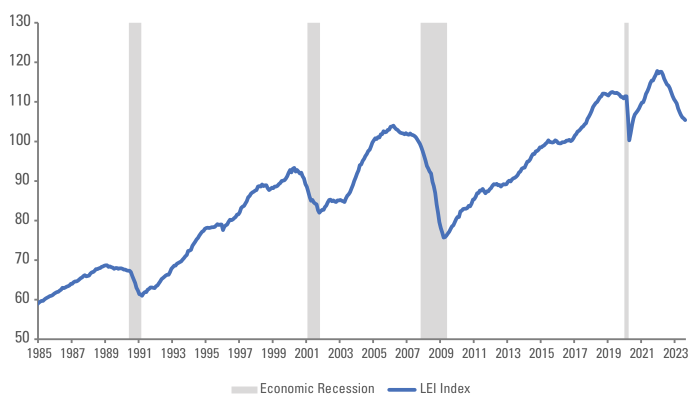
Job Openings Have Declined Sharply from Their Peak



Data as of September 30, 2023. Latest available data for job openings is August 2023.
Source: Bloomberg.

Switching to forward-looking indicators, we believe that The Conference Board's index of 10 leading economic indicators (LEI) provides the most balanced, forward-looking gauge of economic activity. While many economic indicators display more noise than signal, the LEI has proved to be a valuable forecasting tool over multiple economic cycles. In the prior three recessions (excluding the COVID-19-induced recession in 2020) that started in 1990, 2001, and 2007, the LEI began declining between 12 and 22 months prior to the start of the recession. As of August 2023, the LEI has declined for 17 consecutive months since peaking in March 2022. Given the narrowing in positive breadth of the LEI's subcomponents, it is possible to see further downside for the index into at least fourth quarter 2023. Momentum reversals have been swift in the past, but nothing about today's backdrop is suggestive of a near-term trough in leading indicators. There is no guarantee the LEI will prove to be as good a forward-looking indicator this time around, but given its history and the broad base of data it includes, we still believe this index is worth consulting.

Conference Board - Leading Economic Indicators (LEI)



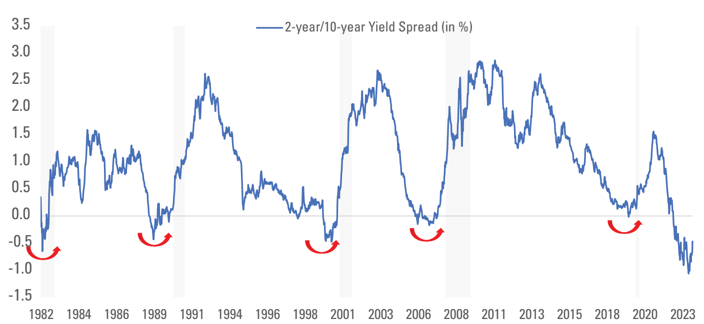
2016 = 100
Data as of August 31, 2023.
Source: Bloomberg.

Concerning monetary policy, the fed funds futures curve is pricing a 68% probability that the Federal Open Market Committee (FOMC) maintains the fed funds target range of 5.25% to 5.50% at its November meeting and for rates to remain at this target range for the remainder of 2023. This, however, is below the Fed's latest terminal rate guidance, which suggests that investors are underpricing the risk of the target range increasing to between 5.5% and 5.75%. The fed funds futures curve is also pricing in fed funds rate cuts to begin in July 2024, which is a push-back from the March 2024 estimate made at the end of July. In a hawkish move, the FOMC raised its fed funds target range in 2024 to between 5% and 5.25%, up from between 4.5% and 4.75%, effectively removing the expectation of two rate cuts.

While the fed funds futures curve suggests that rates will remain in the current target range, Treasury yields across the Treasury curve increased as the FOMC stated a possibility of one additional fed funds rate hike during the remainder of 2023 and an increase in its terminal fed funds rate projection for 2024. This, in turn, led to the 10-year Treasury yield to advance 46 basis points (bps) to 4.57%, breaching 4.6% at one point in September 2023 – its highest level since October 2007. Compared with 10-year Treasuries, most yield spreads are inverted – particularly the closely watched two-year/10-year yield spread (-47 bps), which has been inverted since July 2022 but has steepened significantly from its July 2023 low of-108 bps.

While an inverted yield curve is seen as a recession signal, we find the un-inversion of an inverted yield curve to be a more reliable signal that a recession is happening. There is much happening as we progress through the end of 2023 and head into 2024 – balance sheet runoff and potential recession, to name just a few – and we will be watching inflation and global growth developments closely. In addition, we are monitoring how the Israel-Gaza conflict might impact oil, the economic outlook, and the risk of any potential escalation provoking a market response.

Yield Curve Always Un-Inverts Prior to Recession



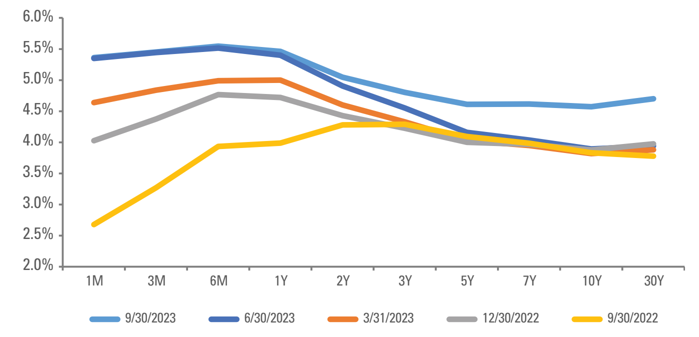
Data as of September 30, 2023.
Source: Bloomberg.

The Credit Market

As 2023 draws to a close, the Federal Reserve continues to prioritize achieving a stable long-run inflation rate of 2.0%, and while the FOMC voted to maintain an upper federal funds target of 5.50% during its September meeting, economic data will determine whether the pause in rate hikes is temporary. Among September FOMC meeting attendees surveyed, seven believe no further rate increases will be required in 2023, while 12 anticipate one additional upward adjustment of 0.25%.

Thus far during 2023, the FOMC has instituted four rate increases totaling 1.0%, moderating its pace from 4.5% during 2022. The Fed's efforts to curtail inflation through monetary policy appear to be succeeding, though progressing incrementally. Core inflation (which excludes volatile food and energy prices) has eased from a high of 6.6% in September 2022 to 4.3% as of August 2023 – still higher than its 2% target. Positively, the Fed's second objective of its dual mandate is being achieved, with U.S. unemployment rates remaining near record lows at 3.8% as of August 2023.

Yield Curves Over Time



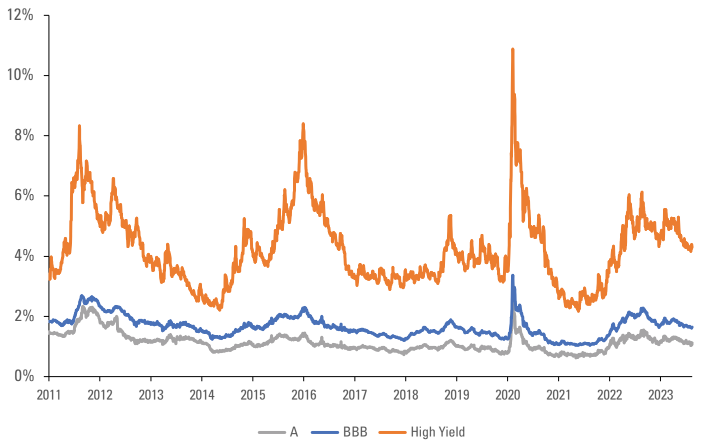
Data as of September 30, 2023.
Source: Bloomberg.

While the FOMC sets short-term risk-free borrowing rates through the federal funds target, it influences long-term rates via the purchase and sale of Treasury and mortgage bonds; however, market expectations of future growth and inflation tends to be more influential. The Fed continues to shrink its holdings of Treasury and mortgage bonds in an effort to reduce its approximately $8 trillion balance sheet. As of September, the Fed has successfully trimmed nearly $500 billion this year. These actions, along with shifting market expectations, have increased long-term risk-free rates, as shown in the nearby chart.

> “While an inverted yield curve is seen as a recession signal, we find the un-inversion of an inverted yield curve to be a more reliable signal that a recession is underway.”

U.S. 30-year Treasury yields have shifted upward by 75 bps between June 30, 2023, and September 26, 2023. The FOMC will continue to monitor the implications of its decisions and the economy’s outlook in assessing its monetary policy going forward.

Corporate Spreads by Quality

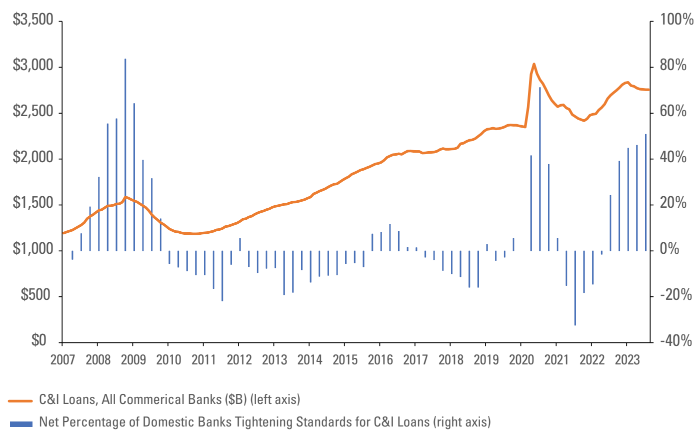


Data as of September 29, 2023.
Source: Bloomberg.

Corporate spreads provide information on how the market values risk and credit quality through the additional return required for providing capital to incrementally riskier borrowers. Spreads for corporate bonds across rating classes have eased during 2023. As of September 29, 2023, spreads for high-yield, BBB, and A bonds were up 4.3%, 1.7%, and 1.1%, respectively. This is below their respective 25-year historical averages of 5.5%, 2.0%, and 1.3%, suggesting the bond market is cautiously optimistic about the prospects of corporate borrowers in this economy.

The nearby graph shows commercial and industrial (C&I) loans outstanding to U.S. companies overlaid by the net percentage of U.S. banks tightening or loosening credit standards for loans to large and middle-market firms. Second quarter 2023 was the fifth consecutive quarter where domestic banks tightened standards.

Amount of C&I Loans vs. Bank Standards



C&I loan data as of August 1, 2023. Net percentage figures as of July 1, 2023.
Source: Federal Reserve of St. Louis.

The net percentage data is based on the Fed’s quarterly “Senior Loan Officer Opinion Survey on Bank Lending Practices.” Additional highlights as of the second quarter include:

- A net 51% of domestic banks tightened standards vs. 24% during the same period last year, suggesting that domestic C&I lending has transitioned to a less borrower-friendly environment.
- Most banks reported increasing the cost of credit lines through widening the spreads of loan rates over the costs of funds (68%) and increasing premiums for riskier loans (62%).
- A significant portion also tightened loan covenants (33%) and collateralization requirements (25%).
- A moderate share of banks reported having tightened the maximum size of credit lines to companies and shortening the maturity of loans.

> "Direct lending, co-investments, and innovative deal structures have helped the financing gaps caused by the pullback in syndicated debt financings."

Almost all banks that reported tightening standards or terms on C&I loans cited a less favorable or more uncertain economic outlook and reduced tolerance of risk as important reasons for doing so. Among all banks, 59% cited a deterioration in a bank's current or expected liquidity position as a somewhat or very important factor in tightening credit standards or loan terms. Additionally, 54% reported increased concerns about legislative changes, supervisory actions, or changes in accounting standards when making lending decisions.

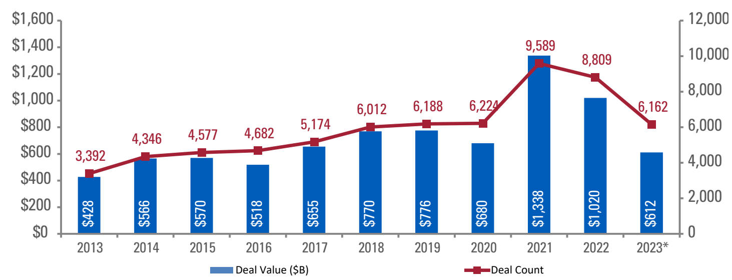
Unsurprisingly, the aforementioned concerns resulted in a 2.6% decline in the amount of C&I loans during 2023 through August. While many U.S. banks pull back their exposure, borrowers are turning toward additional debt capital providers. Private debt funds continue to attract investors, with an estimated $200 billion of new capital anticipated to be raised during 2023. Nonetheless, certain banks, such as Brown Brothers Harriman, remain active in growing their corporate loan portfolios.

The Private Equity and Mergers and Acquisitions Markets

The PE and M&A markets continued to struggle through third quarter 2023. Investment managers continue to be met with a persistent inflationary environment, continued pressure on public equities, bank failures and government interventions, rising geopolitical tensions across the globe, and a number of complex and burdensome new laws and regulatory proposals. These conditions have made dealmaking and fundraising exceedingly competitive, and general partners (GPs) are battling these headwinds in the search for allocations from investors who are struggling with the denominator effect and a lack of liquidity across their portfolios.[1]

U.S. private equity dealmaking continued its slowdown through third quarter 2023. For the first time since COVID-19, deal value fell below $200 billion. Quarterly deal flow has now been flat to down for six of the last seven quarters, including a 7.2% and 18.1% decline by count and value, respectively, in the latest quarter.[2] Nonetheless, with creativity and persistence, deals are getting done. Lenders are adjusting their balance sheet exposures. Direct lending, co-investments, and innovative deal structures have helped the financing gaps caused by the pullback in syndicated debt financings.[3]

U.S. Private Equity Activity Deal Flow by Year



As of September 30, 2023.
Source: PitchBook.

Platform opportunities have taken the greatest hit due to their greater dependency on leverage. Platform deals declined 20.6% in value from the prior quarter and 42.9% year to date. While the pace of add-ons has leveled off, they are still at a near-record high share of all PE buyouts at 76.1% year to date. Add-ons have been essential to keeping the cogs turning while credit has been tight, as they allow PE sponsors to continue deploying capital while taking down deal size and biding time until lending markets can support larger platform buyouts.[4]

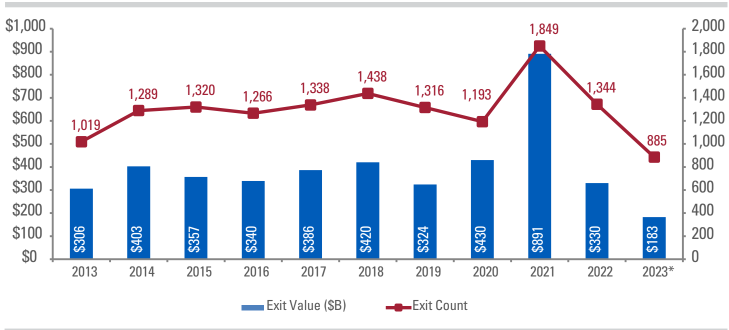
During the third quarter, U.S. private equity firms exited 275 portfolio companies worth $44.1 billion, representing a decrease of 6.9% and 40.7% quarter over quarter, respectively. The third quarter exit value marks the lowest recorded figure over 10 years (excluding second quarter 2020 during the onset of COVID-19 lockdowns).[5]

Exit activity is arguably the most important link in the PE chain of capital formation and a lead indicator of industry growth. Its cash flows

[1] *Debevoise & Plimpton.*
[2] *PitchBook.*
[3] *Debevoise & Plimpton.*
[4] *PitchBook.*
[5] *Ibid.*

recycle into fundraising that feeds into dry powder, fund deployment, and ultimately fund performance.[6]

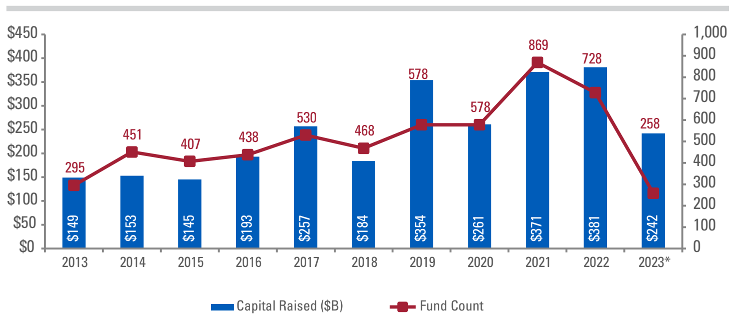
U.S. Private Equity Exits by Year



As of September 30, 2023.
Source: PitchBook.

PE fundraising through the first three quarters of the year is down approximately 13% from the prior year comparable period; however, this figure is better than anticipated, especially since 2022 was a record fundraising year for private equity. The average amount of time to close PE funds has risen to 15.6 months, the highest point since 2011. Middle-market funds seem to have taken advantage of the slowdown in megafund fundraising activity: The middle market's share of all PE fund closings has reached its highest level since 2009, standing at 58.7% through third quarter 2023.[7]

U.S. Private Equity Fundraising by Year

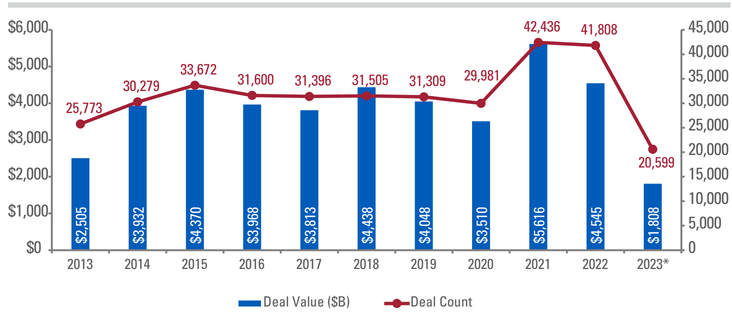


As of September 30, 2023.
Source: PitchBook.

M&A activity in North America continued its slowdown through second quarter 2023. An estimated 4,276 deals closed or were announced for a combined value of $466.5 billion, representing quarter-over-quarter decreases of 4.5% and 5.5%, respectively. The tally from the first half of 2023 of $960.0 billion is below the levels in the first half of 2022 by 28.5% and below the pre-pandemic average from the same timeframe by 16.2%. Major factors dampening deal activity include the disconnect between buyer and seller valuation expectations, higher financing costs, and tighter credit availability relative to the same period in 2022.[8]

However, a lot has changed since the beginning of 2023: Inflation is slowing down, interest rates may be near their peak, many banks have failed, and the U.S. debt ceiling crisis has been averted. The buzz swirling around artificial intelligence (AI) may create opportunities and the right conditions for a more active M&A market in the near future.[9]

Global M&A Activity



As of June 30, 2023.
Source: PitchBook.

Conclusion

As we near the end of 2023, we remain on the lookout for a potential recession while also monitoring fed funds rate cuts and the un-inversion of inverted Treasury yield spreads. The full effects of the resumption of student loan payments and ongoing UAW strike also have yet to be seen, while the downward trend of U.S. job openings further signals potential slowdowns in growth expectations.

In the credit market, the Fed continues to shrink its holdings of Treasury and mortgage bonds to reduce its balance sheet and as of September has trimmed nearly $500 billion from $8 trillion this year. Several banks continue to tighten lending standards, citing less favorable or more uncertain economic outlooks and reduced risk tolerance, and borrowers are turning toward additional debt capital providers. Meanwhile, third quarter 2023 saw slowdowns in PE dealmaking, exit activity, and fundraising. However, changing conditions – including slowing inflation, peaking interest rates, and buzz around AI opportunities – indicate potential for a more active M&A market in the future.

[6] *Ibid.*
[7] *Ibid.*
[8] *Ibid.*
[9] *"Global M&A Industry Trends: 2023 Mid-Year Update." PwC.*

STRATEGIES FOR SUCCESSFUL AND OPEN BUSINESS COMMUNICATION

By Benjamin Persofsky, Executive Director of the BBH Center for Family Business

Private businesses that seek to endure across multiple generations must have thoughtful, effective methods to prevent and resolve conflict and promote open communication. Yet our 2023 Private Business Owner Survey results suggest that many private business owners are anxious about conflict when it arises within businesses they operate or own. Nearly half (46%) of owners surveyed said that the possibility of work disputes damaging relationships was a challenge in managing a family business.

What's driving concerns about discussions of strategic matters with the family? Owners voiced several reasons for the hesitation, including that:

- Family members would make decisions based on their own personal interests rather than what's best for the family and/or the business (41%).
- The discussion could negatively affect family dynamics and strain relationships (38%).
- Such discussions tend to get heated and emotional (36%), and owners had previous bad experiences having these discussions with family (35%).
- Owners were unsure how to start these conversations (34%).
- Some family members seem uninterested in the business (32%), and it's uncertain if they understand the business enough to weigh in (27%).

While these anxieties are plentiful, proactive communication around potentially contentious issues is quite important for long-term success. Here are four strategies for approaching and improving communication in business for those facing communication hurdles.

"OPENING A DIALOGUE WITH THE NEXT GENERATION NOT ONLY ALLOWS OWNERS TO GAUGE THE NEXT GENERATION'S INTEREST, BUT ALSO SHOWS POTENTIAL SUCCESSORS THE DIFFERENT ROLES THEY MAY BE ABLE TO ASSUME WITHIN THE ENTERPRISE."

Start by Building a Solid Foundation of Shareholders' Knowledge

Leaders' concerns about how to start difficult conversations with shareholders are understandable, as those involved in making the decision may have very different levels of understanding of the enterprise, business matters overall, and the potential implications of the decisions to be made.

The best way to thwart this problem is to start by leveling the information playing field: Work to help each shareholder understand what they own, why they own it (along with balanced risks), and the high-level issues needing consideration in making a decision in a manner that is free of bias.

It's important to share the company's documented core values and mission with shareholders, even if interpretations vary among them. Leading with values can establish opportunities for close agreement – if not consensus.

Properly Identify the Stakeholders Needing to Be Engaged – Including the Next Generation

The engagement level of the next generation varies from one enterprise to another. Some of the next generation of owners may have pursued careers away from the business, or perhaps they simply never expressed an interest in learning about the company.

Before assuming a lack of interest, leaders may find it beneficial to speak with potential successors about the business and possible ownership roles. Opening a dialogue with the next generation not only allows owners to gauge the next generation's interest, but also shows potential successors the different roles they may be able to assume within the enterprise.

In our experience working with private and family businesses, we have found that this dialogue has the potential to reveal that the next generation has indeed been interested all along but did not know how to start the conversation.

It may also highlight some of their interests outside of the business, which can be leveraged to engage them in future discussions. In cases where the next generation's level of interest is uncertain, it can be helpful for owners to provide more insight into what a potential future in the business looks like by explaining the role of ownership.

Alternatively, there is often implicit trust in the family members who are stewards of the business. The general ownership group might assume that those in leadership roles have everything under control, which may – unintentionally or not – result in less-involved family members being excluded from discussions in which they should have input. As business leaders know, there are certain situations, often where decisions about the business's future and upcoming transitions are involved, that merit every eligible party to be present.

How can leaders engage disconnected shareholders and family members so that they have the necessary level of information required to provide input where needed? We have seen a few key strategies that help make opening the door to these conversations easier.

- **Sharing key information about the business helps get disconnected stakeholders' feedback as owners around decisions of material nature.** Perhaps owners' seeming lack of interest stems from never being included in the important discussions. Sharing important information or involving disconnected parties in key decisions shows them that their input as owners is valued.
- **Helping withdrawn parties understand the big picture allows them to gain an appreciation for where it's important they have input (and where they can remain uninvolved).** Engaging disconnected parties in discussions around decisions and/or areas that can affect their personal situations allows them to be involved and relieves concerns about involving them in areas where they are not interested.
- **Finding a way to appeal to what they're interested in helps bridge the gap.** Connecting an element of the business to a passion or cause that interests disconnected parties often motivates them to contribute to or be present for conversations about the business.

Embrace Stakeholders Having Their Own Interests

Before engaging in discussions about the enterprise, it is essential that business leaders come to the table with the right mindset. A component of this is understanding that everyone involved in the discussion – both inside and outside the operating enterprise – has a right to come with their interests front of mind. This doesn't mean everyone is self-interested; it simply means that values – collective or individual – are subject to each person's interpretation and prioritization. The best leaders consider these perspectives for each stakeholder.

Consequently, they also reach best decisions when owners can openly discuss the alignment and divergence of their views and find ways that will balance the varying needs of the shareholders without unduly prioritizing one stakeholder's views over another's. It's not easy, and it requires patience, creativity, and resourcefulness to find common ground.

Consider the alternative: a situation where owners simply accept a decision where there is "tacit disagreement." In this case, those who are not overtly talking about differences may not be sharing what they really want. Maybe they are accepting an option thinking this is the best way to keep the peace, or they may not think their opinion or desires for the business are valued as much as others. This is a caution condition for leaders. Shareholders feeling as if they don't have a valued voice is often a precursor to future discontent in an ownership group.

Conversely, leaders who embrace the fact that it is okay for owners to have different views and needs will better their relationships with their shareholders and have the potential to increase shareholder commitment. The hard work upfront to find the most integrative solutions creates the greatest long-term stability.

Focus on Facilitating Agreement (and Avoiding Advocacy)

Before an important owner strategy discussion, leaders must critically and honestly ask themselves:

- Am I coming to the discussion with a preconceived outcome?
- Am I trying to defend a position, or am I listening to the other people in the discussion to develop a deep understanding of their interests prior to engaging in solution-finding?

The truth is that stakeholders participating in these discussions often have enough emotional intelligence (EQ) to know when they are being used as pawns or whether they are authentically asked to be collaborative in reaching a decision. Defense of a position or unguided advocacy increases the likelihood that the discussion will turn heated and emotional – which 36% of owners cited as a reason they avoided discussing the business with family.

A conversation between good listeners moves forward, finds solutions, and develops a strategy for acting on goals. A conversation between bad listeners goes in circles and exacerbates disagreements. If all parties are listening well, the conversation is likely to end successfully.

Conclusion

At Brown Brothers Harriman, we have helped countless business owners navigate complicated business discussions and achieve their objectives. If you are looking for further guidance, please reach out to our Center for Family Business.

Leaders can improve the outcomes of these conversations by taking on a role of neutrality and framing solution-finding as the optimal goal. Some examples of how to do so include:

- **Maintain a focus on understanding stakeholder interests fully, and resist the urge to think about any solutions.**
- **Avoid judging interests – the best counter is to recognize when a judgment is being made and ask questions that might dispel it.**
- **Have the discussion leader voice their view last, and to the extent possible, position their view authentically with peer importance to the others in the discussion (e.g., other board or council members).**
- **Consider having a third party viewed as neutral by all involved lead the discussion if the leader cannot genuinely maintain neutrality and a view that is equal weight with the stakeholders.**

“A CONVERSATION BETWEEN GOOD LISTENERS MOVES FORWARD, FINDS SOLUTIONS, AND DEVELOPS A STRATEGY FOR ACTING ON GOALS. A CONVERSATION BETWEEN BAD LISTENERS GOES IN CIRCLES AND EXACERBATES DISAGREEMENTS. IF ALL PARTIES ARE LISTENING WELL, THE CONVERSATION IS LIKELY TO END SUCCESSFULLY.”

IS NOW THE TIME TO SELL THE FAMILY BUSINESS?

By John Secor, Kyle Gordon, and Carson Christus, BBH Corporate Advisory & Banking

In a market environment riddled with uncertainty, including rising interest rates, a tight labor market, and the possibility of a looming recession, many business owners are asking themselves, "Is now the time to sell?"

In fact, in our 2023 Private Business Owner Survey, 76% of U.S. private business owners said that every time they navigate economic uncertainty, they lean more toward selling their business.

For family business owners, there is an added layer of complexity, as the company is truly more than just a job or source of income – owning a business results in a significant increase in the time family members spend together, defines the family's legacy in the community, and is often the source of great pride and emotional connection.

After years of building a business, the mere thought of selling can feel unsettling. While inertia or sentimentality can often lead to maintaining the status quo, there are many reasons why selling may be the best decision for the family.[1]

[1] References to selling in this article are meant to encompass a broader range of strategic alternatives in addition to an outright sale, such as partnering with a private equity firm or implementing an employee stock ownership plan.

Though market conditions are an important consideration, the underlying factors driving a sale are often rooted in family dynamics, the business itself, or some combination thereof. These factors should be evaluated openly and thoughtfully with key stakeholders and trusted advisors.

It is critical to objectively evaluate the business and understand and weigh the family's near- and long-term objectives and priorities. Considering this combination of factors will allow owners to then make an informed decision on selling the business.

Family Considerations

For family-owned businesses, particularly those spanning multiple generations with extended branches, two primary questions relating to family dynamics typically drive the decision to sell:

- Does the family have an heir apparent?
- Does the business provide sufficient return for shareholders?

Owning a business is a full-time endeavor and can be all-consuming. After years of operating, it is not uncommon for families or owners to feel a diminished drive for the daily grind of running a company and shift their attention to other passions, such as a new business venture or philanthropic cause, or simply retire.

Acknowledging and planning for this eventuality, as opposed to assuming the current owners will one day seamlessly pass control of the business to family members in the next generation, can preserve shareholder value. There is no guarantee that the next generation will have the acumen, drive, or skill set required to continue running the family business successfully, and not every child has the desire or ability to successfully take the reins.

Studies show that approximately 70% of family-owned businesses either fail or are sold prior to the second generation taking the helm.[2] In certain cases, the family may have a management gap, where the difference in age and/or experience between current leadership and the next generation is too wide. Options to bridge this chasm include hiring non-family management professionals, partnering with a financial sponsor such as a private equity firm, or pursuing an outright sale.

[2] Stalk, George, Jr., and Henry Foley. "Avoid the Traps That Can Destroy Family Businesses." Harvard Business Review. August 1, 2014.

> **SUCCESSFUL FAMILY BUSINESSES RELY ON HEALTHY COMMUNICATION AMONG STAKEHOLDERS ABOUT THE BUSINESS STRATEGY AND AN UNDERSTANDING AMONG THEM OF THE VALUE OF THEIR OWNERSHIP STAKE OVER TIME.**

As important as it is to identify the next generation of leadership and set up a succession plan, managing the ongoing and future liquidity needs of family members with ownership interests in the business is also critical.

The inability to meet the liquidity needs of shareholders often creates conflict that causes an eventual sale. Balancing reinvestment in the business and shareholder liquidity needs or preferences can be challenging depending on the number of family members involved, ownership interests and roles in the business, and the company's reinvestment needs. Successful family businesses rely on healthy communication among stakeholders about the business strategy and an understanding among them of the value of their ownership stake over time.

Shareholder communication and collaboration through efforts such as family meetings and a family council can help avoid family issues and value-destroying conflict that lead to suboptimal actions, such as a forced sale of the business due to an unforeseen liquidity need. Even for families who communicate effectively, liquidity needs can (and usually do) arise over time as shareholders have divergent goals and timeframes.

If the business is unable to meet these needs without hampering how the business operates, it may be prudent to consider a recapitalization or sale. In such situations, it is common for a family business to turn to a financial sponsor such as a private equity firm to make an investment in the company or a lender to provide a loan, thereby providing near-term liquidity for shareholders as needed. Of course, introducing a non-family owner is a major decision that should be weighed carefully.

Business Considerations

On the business front, the decision to sell is often driven by the underlying question, "Does the business in its current form have the ability to thrive in a highly competitive market?"

Staying competitive, particularly in a crowded or complex industry, is a challenge faced by all businesses, which require sound strategy and ample capital to compete effectively and grow.

In order to be competitive as industries evolve, companies should consider reinvesting in:

- Sales and marketing
- Research
- New technology or equipment
- Additional floor space or a larger facility
- Hiring and promoting employees

If the capital required for these initiatives is not available internally, there are several questions for the company to consider:

- Should the business raise external capital?
- Is there a strategic partner who can bring additional value in the form of access to new markets, improved relationships with suppliers, leadership talent, or other factors that may enhance the company's competitive standing?

Owners must also make complex capital allocation decisions. As businesses grow and evolve into new product lines, geographies, or even industries, the demands on management increase, and incremental operational capabilities may be necessary for the company to compete effectively. There may be a point at which the family recognizes it may not be well-equipped to steward the go-forward business to its fullest potential.

For instance, a company could develop a new product but then realize it lacks the distribution network or other corporate capabilities to maximize the product's potential. In such cases, it is not uncommon for owners to decide to divest this noncore part of the business (that is, the new product line) to another owner who can do better with it. The same

often holds true with industries that are in structural decline or parts of the business that have stagnated and would be better operated under new owners.

Timing is also an important consideration. While it is impossible to specifically time the mergers and acquisitions market, it is worth remembering that the best time to sell, in terms of multiples and dollars, is often when one does not have to sell. A sale process can be complex and emotionally challenging, so it is best for an owner to consider it while there is still "gas in the tank" and the business is performing well. Demonstrating a bright outlook for the business and being able to achieve projections is important in order to optimize the transaction outcome and close a successful sale.

Sometimes, the decision to sell is as simple as receiving an attractive offer from a potential buyer that an owner cannot refuse. Large institutionalized corporations typically develop a methodical growth strategy, including an aggressive acquisition pipeline. In a competitive environment, certain businesses become "must-have" assets for strategic reasons, resulting in buyers making outsized sales price offers. Family businesses would be wise to seriously consider such once-in-a-lifetime offers.

Conclusion

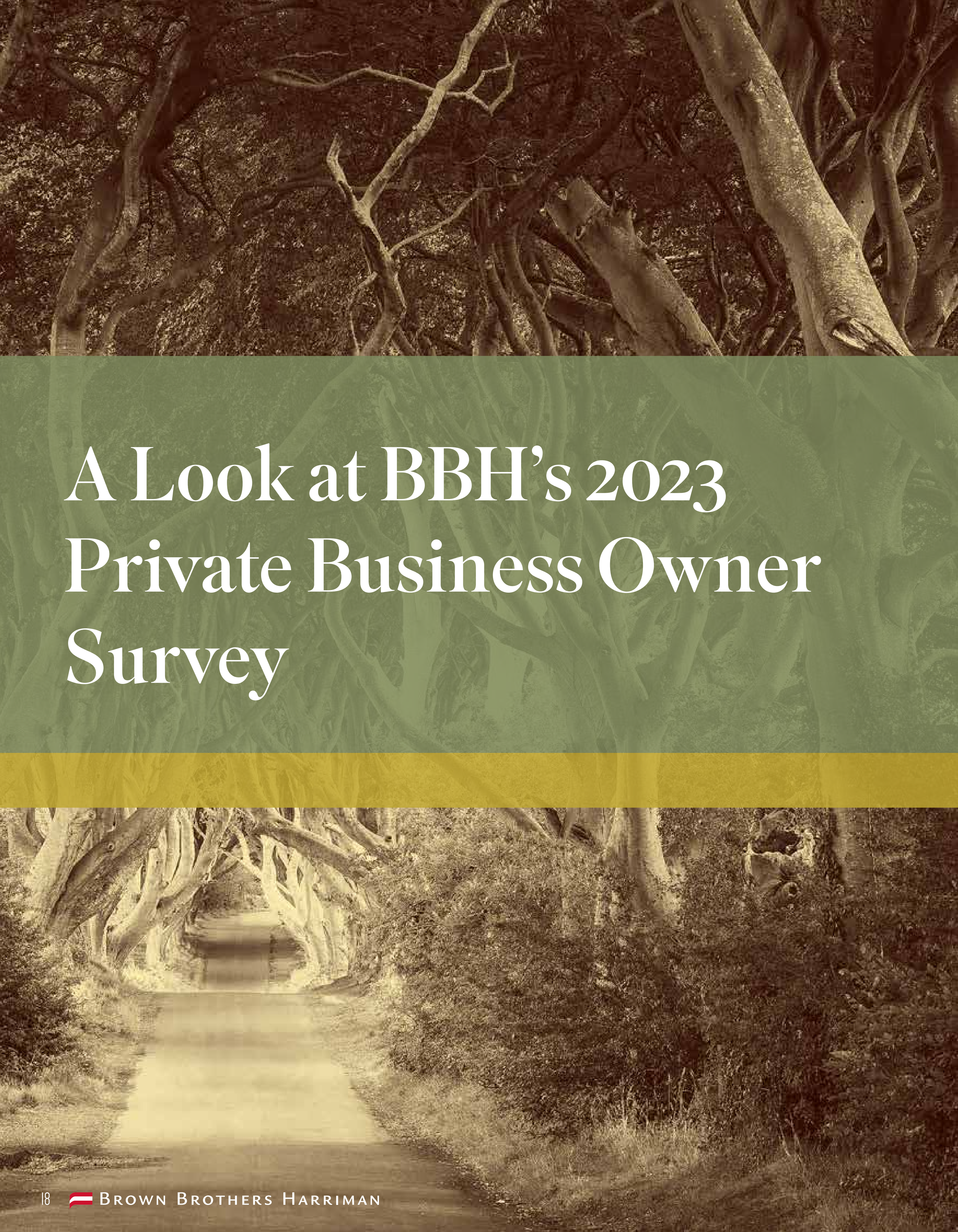
So, is now the time to sell? The answer to this question is nuanced and should take into consideration not only current market conditions, but also the family dynamics and business prospects of the firm.

Thinking through the decision to sell requires time, thoughtfulness, and open communication among shareholders. The ultimate decision will be one that is specific and personal to the family and business. Engaging with trusted advisors and speaking with other family business owners who have been through similar journeys can help owners make the right decision.

BBH's Corporate Advisory team is dedicated to assisting family-owned businesses and providing strategic decision-making support across a broad range of corporate topics and business situations. We would be happy to discuss what's on your mind. For more information, please contact John Secor at john.secor@bbh.com. at john.secor@bbh.com

For families who decide that keeping the business in the family is the best option, our Center for Family Business works with family businesses to address myriad topics, from defining legacy and the future of the business to management and ownership succession planning to governance to capital policies, distributions, and family liquidity. For more information, please contact Ben Persofsky at benjamin.persofsky@bbh.com.

A Look at BBH's 2023 Private Business Owner Survey



Private businesses in the U.S. vary greatly in terms of size, sector, service, and product. So how do business owners plan for the future of their businesses and families based on common challenges?

- Governance structures
- Succession planning
- Long-term strategic objectives
- Capital needs
- Strategies to handle complicated family dynamics (in some cases)

We set out to unearth how business owners think and feel about those challenges and opportunities and how it shapes how they run their enterprises. The respondents represented 400 U.S. private businesses with enterprise values from $10 million to $500 million and more. Of the owners surveyed, 87% represented family-owned enterprises; 74% were male, and 26% were female.

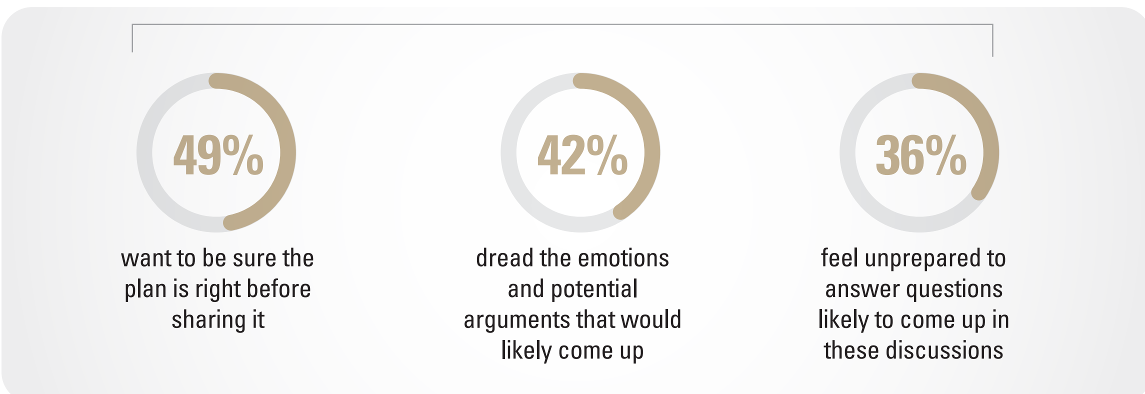
The responses were fascinating. Here, we share some of the key highlights.

Communicating About Your Wealth and Your Business

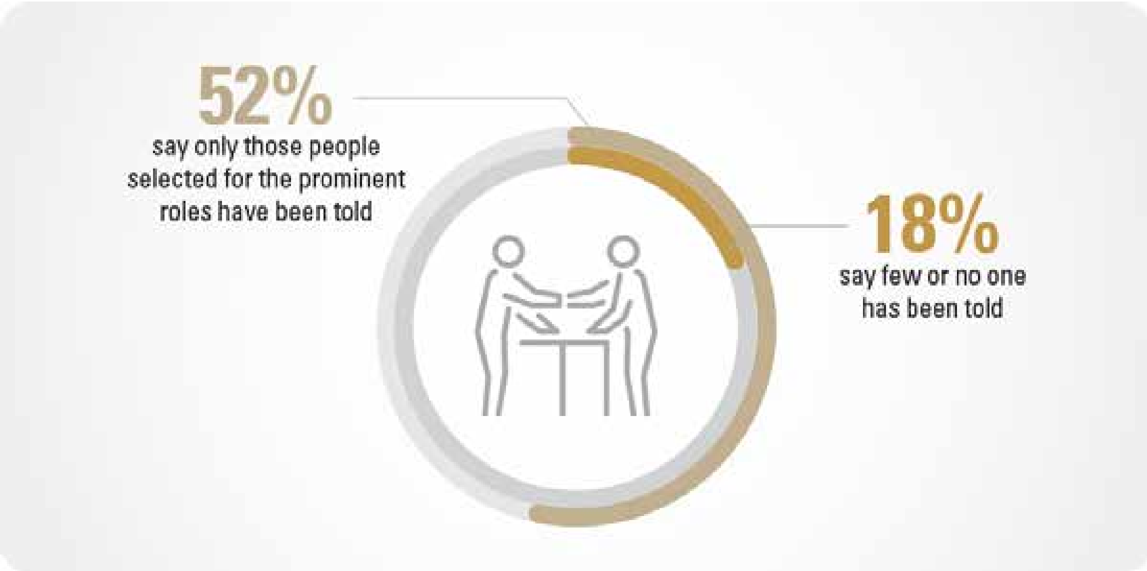
Starting with articulating what is most important – to you, your family, and your business – provides a north star for decisions about wealth and planning.

Estate planning is important, but communication of those plans is just as critical. However, most business owners are daunted by starting conversations with their families about wealth planning.

These factors include:



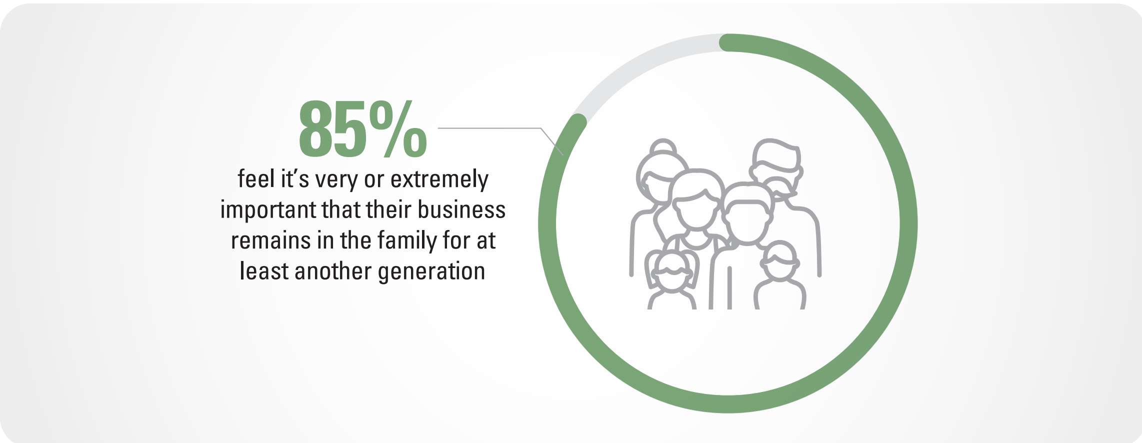
When specific family members are expected to take on a prominent role in the future of a family business, business owners have often not communicated that decision widely.

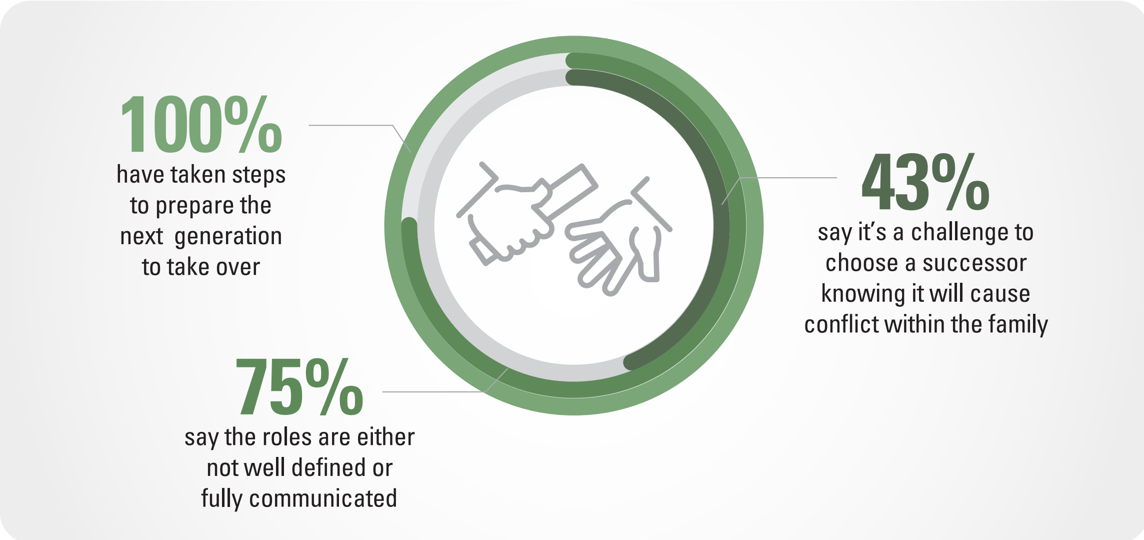


Keeping the Business in the Family

While most business owners wish to keep the business in the family, few have tackled the myriad complex issues around succession of ownership and management directly.

Planning for the future of a business can be both challenging and emotionally charged; however, proactive planning and open communication are the keys to setting up the business to succeed long term.





Charting Your Course: Navigating Today's Economy

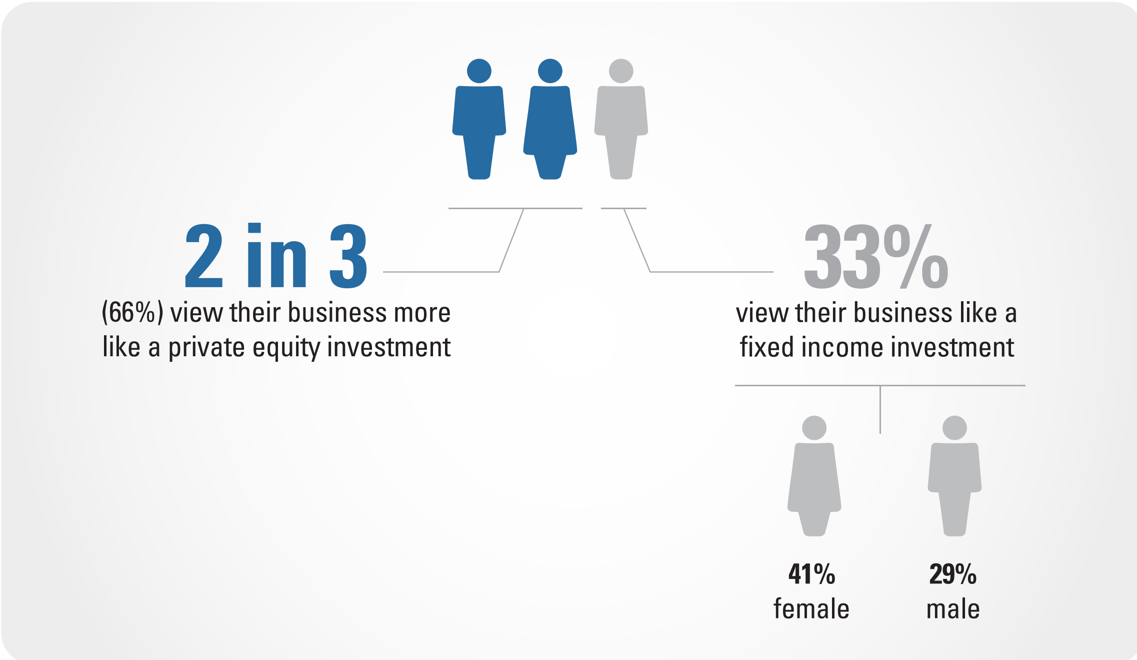
Private businesses are at the heart of the U.S. economy. Three years after COVID-19 shut down our economy and disrupted many industries, and in the current environment of decades-high inflation and months of talk of an imminent recession, private businesses – and their owners – continue to prove their resilience.

Recognizing the changing environment and adapting one's business in the short term for what could be a more prolonged recovery is critical. Private businesses are often in a strong position to respond quickly. The past few years have shown us what we can accomplish when we focus and take proactive steps to adapt. It's all about staying one step ahead of the game.

“Private businesses are, in many ways, the backbone of the U.S. economy. They have the opportunity to be truly long term in their planning, and our results highlight that even in challenging economic conditions and uncertainty, private business owners have a steady hand and lean into opportunities to reinvest in their companies.”

Val Carlotti, Partner

Businesses can represent many different things – and types of investment – depending on the owner.



Charting Your Course: Eye Toward the Horizon

After years of building a business, the mere thought of selling can feel unsettling. While inertia or sentimentality can often lead to maintaining the status quo, there are many reasons why selling may be the best decision for a business owner or family.

To sell or not to sell? That is the question.

75% say leadership-related reasons may lead them to consider selling their business

this includes:

36% who say there is a lack of talent/strong leader to take over

26% who say their children aren't interested in running the business

26% believe that, as current owners, they are not the right leader to guide the business through its next chapter

If you are interested in the full survey results, please visit bbh.com/2023businessownersurvey. In addition, we are happy to discuss the survey outcomes and what they might mean for you, your business, and your family, so please feel free to reach out to your BBH relationship manager.

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