cutting through complexity

Family Business Story

Case Study 2
Financing growth

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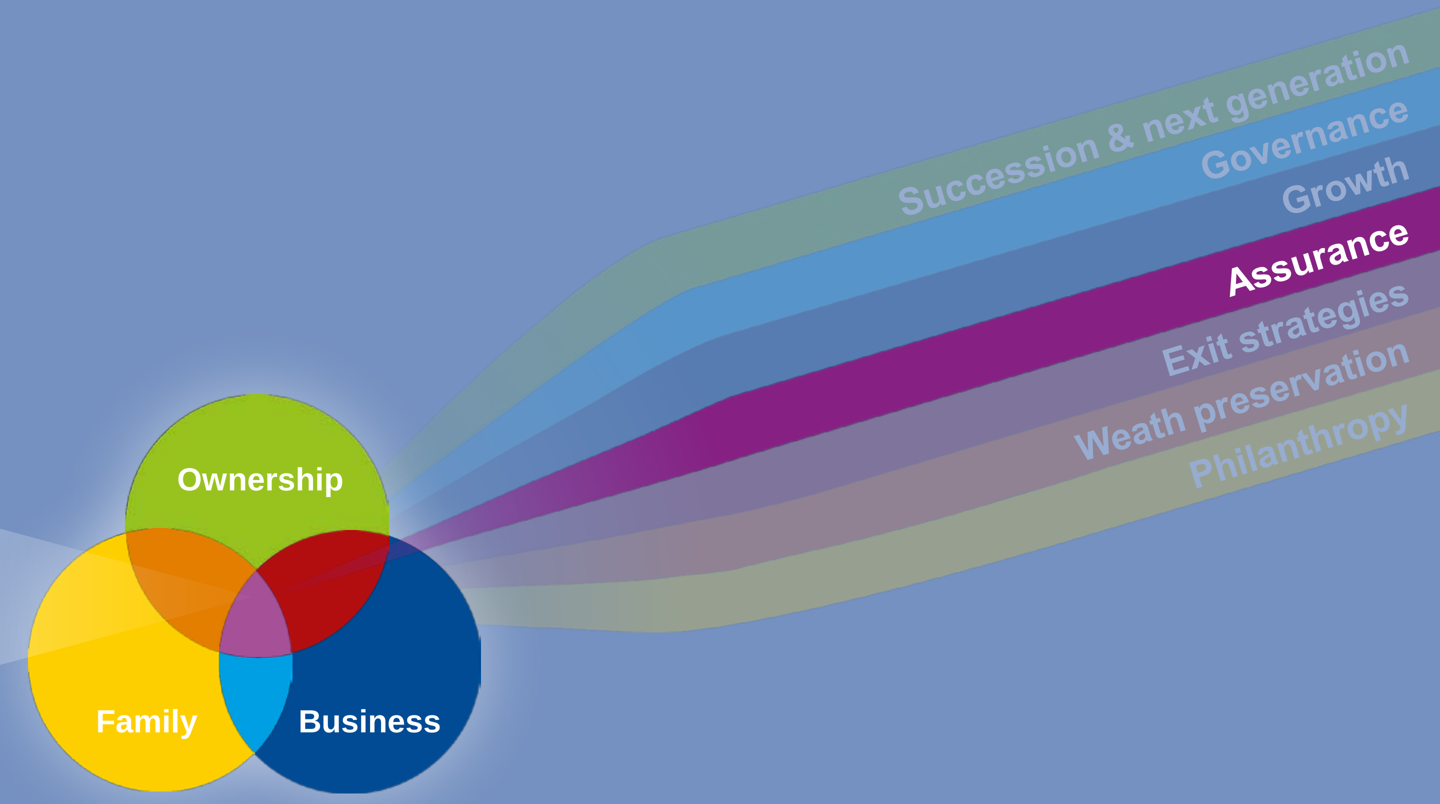
Part 2:
Key learning points

Case Study 2



Part 2: Key learning points

Financing growth

1. Financing growth can be achieved in many different ways

- **Self-financing** with the cash generated by operations is the first source of finance, and is usually preferred by family businesses; they often keep the dividend level at a minimum.
- **Debt** is generally the second choice. Family businesses tend to have a lower debt level than non-family businesses due to being self-financed, which may help them secure bank financing.
- **Real estate** can be a significant source of cash. In the case of the Sages group, real estate is significant (the stores and their grounds). The company can either sell some real estate, or set-up a "lease-back". This requires the sale of real estate to a buyer who then leases it "back" to the seller. Leasing leaves the option of purchasing the asset for a residual price at the end of the leasing period.
- **Joint ventures, franchises, etc. are all options.** Joint ventures are often used for diversification or geographical expansion. Financing is shared, and competences can be complemented. Franchises are used in retail and allow the upfront investment to be minimized. In order to protect the brand and quality, some stores need to stay within the main business.
- **Financial investors** can contribute to expansion either through bonds/ convertible bonds or equity. Permitting external capital investment is a major step for a family business and requires long-term planning.
- **Family offices** are often the investment vehicles of wealthy families who have a longer-term perspective. Their wealth often comes from a family business (still in existence or sold), so they like to invest in other businesses.
- **State subsidies** can be granted in some regions against a commitment to provide employment

2. The search for financing solutions is an opportunity for long-term planning

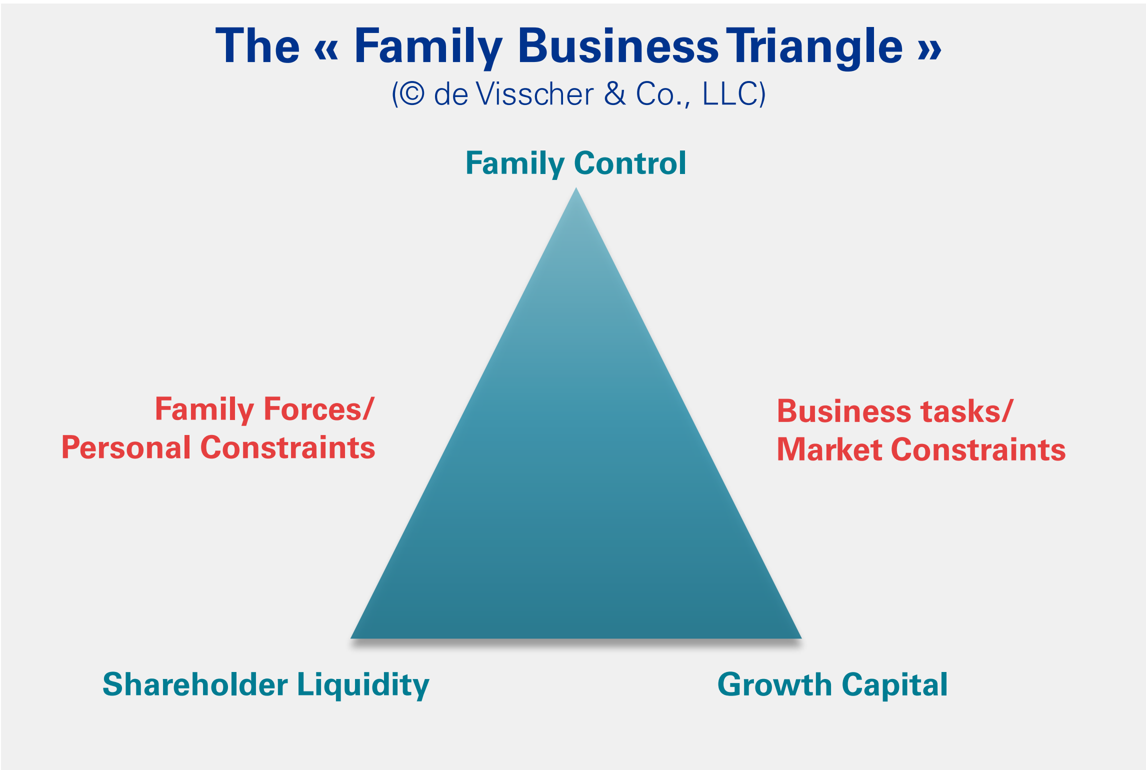
For instance:

- **The use of real estate** as a source of funds can trigger the development of a specific real estate business unit. A holding company can be created, encompassing the real estate unit, the operating unit, a unit for new ventures.
- **The arrival of an external investor, through equity or convertible bonds** can also give a whole new dimension to the business and needs to be carefully considered – including the impact on governance, expectations, and exit of the investor.

Part 2: Key learning points

3. Financing decisions have consequences on the ownership and family

Long-term sustainability as a family business means that financing growth must be done while ensuring some level of shareholder liquidity (e.g. dividends and the possible buy-back of shares) and retaining family control. This forces some careful long-term planning for both the business and ownership.



How did the Sages group decide to finance the purchase?

The board looked at several options and opted for the lease back of the franchisee's real estate as a way to complement the bank loan.

Thomas and Martina were very much against the idea of opening the capital of the business to an outside investor. They also felt that the stores should, at least for a few years, be managed by the group in order to restore their image and market share. Only after that would they consider whether to develop new franchises.

The lease-back option appeared low-risk and left open the possibility of buying-back the real estate at the end of the lease.