SEAT AT THE TABLE

CASE

All in the Family – A Board in Conflict

Strategies When Owners Don’t Agree

**The Sapphire Company**

**Background**

Established in 1969 by David Engles and his brother Sam, Sapphire is a leading industrial manufacturer of precision parts for the automotive industry. After twenty-five years of growing the business together, Sam elected to sell his interest to David. David happily agreed and brought his two sons and son-in-law into the business to help him continue its growth.

David’s philosophy on management was one based on a “survival of the fittest” model, predicated on internal competition for resources. Each of the sons, Tom and Joe, and son-in-law Gary, were given an individual product line to lead. Approaches to the market were done as siloed business units and it was not uncommon for “fights” to ensue over how resources were allocated and which team members belonged to each business unit.

This continued for fifteen years and — thanks to a robust market and long-standing relationships with a large Tier 2 supplier — the Company financially prospered. Relationships, however, did not.

It should be noted that David also had three daughters. Eva functioned as the Chief Financial Officer. Helen — whose husband Gary is in the business — and her sister Mildred were not directly involved in the business but assisted in driving community related activities.

Throughout David’s tenure, the Board was comprised of himself, his two sons, his son-in-law and Eva (the CFO). Decisions were made by David, however, who dictated how the business would be run.

**The Patriarch and the Next Gens**

At a certain point, David’s health began to deteriorate and he elected to step down as CEO and leave it to his children to determine who should step into his role. His parting words were “you all should figure it out as you will have to live with the decision — not me.” At this time, he transferred his voting shares to his children as follows:

* Two Sons (Tom and Joe) – 23% each
* Three Daughters (Eva, Helen and Mildred) – 18% each

As one might expect, there were varying opinions on who should lead the Company going forward. At the first board meeting after David decided to step down, the eldest son Tom took the seat at the head of the table and “announced” that it was obvious that he would succeed Dad as CEO. Tom, unfortunately, had a less than stellar reputation within the Company, in the general market and within the family.

Willing to cut corners to make a dollar, Tom usually promised the world and then under-delivered — only to be bailed out time and time again by several long-term employees. Board meetings dragged on with no decisions reached and alliances amongst the shareholders were beginning to form.

**Breakdown in the Family Relationships**

Fortunately, the Company remained profitable, yet operating decisions were being made within the siloed units and strategic decisions about the future direction of the Company stalled. Tensions and arguments accelerated, and relationships completely broke down.

Professional advisors were brought in to consult with the various family members and, after lengthy deliberations, a decision was made that three members of the family would sell their interest to the other two.

**Purchase of Exiting Family Members’ Shares**

Buying shareholders included Joe and Helen (her husband Gary was the son in law involved with the business). Selling shareholders were Tom, Eva and Mildred. The deal dragged on but was finally closed in September 2013. The Company was doing so well it was able to fund the purchase from operating cashflow and minimal debt.

Joe and Helen involved their spouses every step of the way in the purchase of the business. Joe’s wife Lucy was a successful business women in her own right, who had taken time out from her career to raise their three sons (who were now in college). Helen’s husband Gary had now worked in the family business the majority of his career.

The ownership structure Joe and Helen agreed to was that Joe and Lucy would own 50% of the voting shares and 52.6% of the non-voting shares — in recognition of the original additional ownership interest Joe held in the business from his Dad. Agreement was reached that Joe would serve as the Company’s CEO and Gary would continue to run the operating unit he had been responsible for since joining the business.

**An Unexpected Death in the Family**

Two months after the closing and prior to the first Board meeting, Joe suddenly became ill and passed away. In shock, the family quickly reconvened to determine next steps. Gary was selected as President and was tasked with running the business. Lucy cannot bring herself to name him CEO, the title held by her deceased husband.

**New Leadership**

Fast-forward five years and the business continued to grow under Gary’s leadership — driven primarily by momentum in the automotive sector and their leading customer, who today represents a signification percentage of their more than $60 million in sales, with limited customer diversification. Growth, however, remained in the single digits with double digit growth occurring once in the recent past solely based on upticks in the lead customer’s business.

Lucy also stepped in as an active member of the Board and now serves alongside Helen. Gary’s role at the Board meeting has been as President, reporting on the overall health of the business. Three “independent” Board members have been added. Two of Lucy’s three sons, as well as Helen and Gary’s two sons, have now entered the business.

**Current Situation**

Lucy has become increasingly concerned about Gary’s lack of strategic thinking, unwillingness to aggressively pursue customer diversification and complete aversion to risk of any kind. The Company, with a history of very positive cash flows, has little debt. In addition, Gary and Lucy disagree on how best to develop the NextGen leaders and the timing of succession planning for Gary as he approaches his 65th birthday.

**For Discussion**

1. With equal voting shares held by Lucy and Helen (who supports her husband’s decisions) how do the following issues get resolved?
   1. Lucy feels Gary’s unwillingness to take on some risk in expanding the business is the wrong decision. Helen believes that Lucy has received increasing distributions since Gary’s tenure as President and she should leave him alone.
   2. After living through her father-in-law’s sudden departure and her husband’s untimely death, Lucy is frightened that the business and family will be faced with the same issue again. Helen and Gary, however, think that succession planning can wait.
   3. Lucy, Helen and Gary have differing views of how NextGen development should occur. Gary believes that if NextGens move from department to department, they

will learn all they need to know. Lucy is much more supportive of a robust leadership development program. She completely disagrees with Gary’s sons reporting directly to him and is of the opinion (validated by independent assessment) that one of Gary’s sons is actually creating an unhealthy culture for other team members.

* 1. The “independent” Board members are increasingly being asked to spend time individually with Lucy and her children and Helen, Gary and their children are also asking for the same. An attempt to win over Board members is ensuing. How should this be addressed? One Board member, in particular, is aligned to Helen and Gary (he is their personal accountant) and Lucy would like to see him removed from the Board. Lucy only controls 50% of the vote. Board effectiveness is rapidly diminishing.

The Sapphire Company

Cast of Characters

SAM ENGLES: Founder of the Sapphire Company with brother David.

DAVID ENGLES: Founder of the Sapphire Company with brother Sam. Has five children: Tom, Joe, Eva, Helen, and Mildred.

TOM: David’s eldest son. Brought into business by David to run a product line.

JOE: David’s son. Brought into business by David to run a product line. Husband of Lucy. Passes away in 2013.

EVA: David’s daughter. Brought into business as CFO by David.

HELEN: David’s daughter. Wife of Gary. Has two sons.

MILDRED: David’s daughter.

GARY: David’s son in law. Brought into business by David to run a product line. Husband of Helen.

LUCY: David’s daughter in law. Wife of Joe. Has three sons.