FAMILY FEUD: National Mechanical Widget Corp. (“NMW”)

NMW manufactures specialized industrial widgets. It has been in business for about 50 years and its sales have been flat at approximately $75 million (inflation adjusted) for a decade, with pre-tax income averaging $2,500,000 per year.

The Company was founded by two brothers. The eldest brother, Paul Patriarch, held 51% of the stock. Juan, his son, is CEO. The Company has never issued any additional shares. None of the children of either of the brothers had any inclination to get involved in the Company business, and indeed none have ever developed any expertise either in the industry vertical or by bonding with the engineering or manufacturing staff of the Company, even through “summer work” in college or upon graduation. The “children” on each side of the family are now themselves at or somewhat beyond normal retirement age. All are reasonably solvent but all have their own children and grandchildren whom they would like to benefit through a liquidity event.

The history of the Company has been contentious. Children of the younger founding brother resent the control held by the majority (although dividends were always paid pro rata and no majority-side family employees were accused of syphoning out profits unevenly). About ten years ago, the animosity bubbled over; the CPAs recommended switching from a C Corporation to an S Corporation, which then (as now) made eminent sense; just because it was proposed by the majority, the Board (which according to ancient Bylaws is 50-50) deadlocked.

In the midst of this internal family strife, about twenty years ago the senior engineer, Harry, an iconoclast with poor communication skills and a dictatorial bent, was made president. He in turn hired a chief financial officer who is wholly under his thumb. They receive ample compensation, leveraging the fact that they are the only people who know what is going on. They provide the Board with only skeletal interim financials.

The Certified Public Accountants have uncovered no management impropriety, but the President is constantly telling both groups of shareholders that the Company “cannot be effectively sold, we have to keep going and we will keep distributing dividends.” These dividends are subject to double taxation. Minority sides with the President.

70% of the Company gross over the last 25 years has been with one major customer (“Strategic”). The President is the only person who meets with this primary customer, aside from lower-level technical and production people. Recently, Patriarch suggested that he meet with the senior people of this customer to at least explore a strategic liquidity event. NMW’s president categorically refused to establish the meeting.

In order to break the log jam without offending the minority, and to achieve a liquidity event, Patriarch has convinced Mickey Newblood to join the Board of Directors as “lead director.” (Under the bylaws, each side of the family can add directors, the only caveat being that each side can maintain a 50% Board representation, and the minority named Harry, the President, whom they support and protect). Newblood will chair today’s meeting.

Who Are You?

The newly constituted Board of six is now meeting in executive session. If you were an independent seventh director, what would you decide?

NMW Board

“Majority” Board Members Shares Minority Board Members Shares

Juan Patriarch (family) (CEO) 26 Tom (family) 16 1/3

Newblood – new director (lead) 0 Dick (family) 16 1/3

Minnie (family) 25 Harry – newly named director 16 1/3  
 (President and employee)

Agenda/per Newblood

1. Amend By-Laws - Board elected by majority vote of shares.
2. Bring in John Expert, as President - Harry remains COO with a $20,000/year raise.
3. Consent to convert to an S corporation
4. Name Special Committee to Explore liquidity options
5. For Next Meeting - Invite CEO of Strategic to meet our new lead director at Pier Four in Boston (they have great shrimp).
6. Newblood Compensation Package (negotiated with CEO): $50,000 per year, and grant of new common stock option to 5% of fully diluted company, vesting 1% immediately and 1% at end of each year of service or accelerating on “sale” of company.