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Small Business (A Special Report)

Money...With Strings: Outside investors can bring much-needed capital to a family business; Just make sure everybody's on the same page

BY ANDREW BLACKMAN

MARK NORDENSON was in a quandary.

It was the end of the 1990s, and the 100-year-old vacuum-pump company started by his great-grandfather was suffering. Nash Engineering had been growing fast, driven partly by strong sales in countries like Indonesia, the Philippines and Thailand. After the Asian financial crisis hit, however, new orders in the region dried up and existing ones were being canceled. Mr. Nordenson quickly found himself chairman of a company saddled with a costly global infrastructure and flagging revenue.

A possible merger was explored with a unit of Siemens AG that would help Nash avoid having to lay off employees. But Nash didn't have the capital to complete the deal. Further complicating matters were the disparate needs and opinions of Nash's more than 100 shareholders, including Mr. Nordenson -- all of them descendants of company founder Lewis H. Nash.

"We needed to do something to get back on track and grow," says Mr. Nordenson. "The business wasn't generating enough capital to provide liquidity to shareholders. We had to do something."

In the end, Nash found its solution down a road that can be difficult for a family-owned business to choose: It decided to pursue private-equity investment.

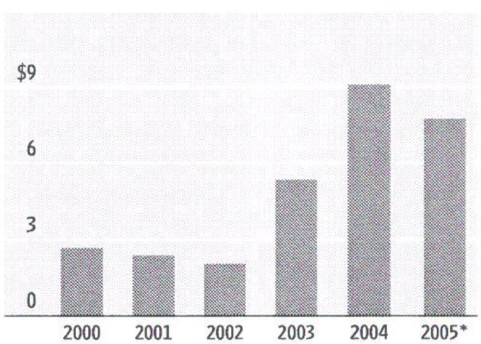
In a private-equity deal, outside investors plow anything from a couple of million to a few hundred million dollars into a company in return for a sizable equity stake, often even a majority stake. Such transactions are booming: Private-equity investment deals of less than $100 million jumped to $9.2 billion last year from $5.4 billion in 2003, and for this year totaled $7.8 billion through mid-August, according to the investment-banking research firm Dealogic LLC.

But even private-equity experts warn that bringing in outside investors is not something the owners of a family business should take lightly.

While the extra capital can help a company pursue new opportunities or give owners large cash windfalls, it can also lead to conflicts between the outside investors and the owners. While the former are focused on short-term returns -- their aim is usually to sell their stake in five to seven years at several times its initial value -- the latter usually have a longer-term outlook, and can find the loss of control hard to accept.

Finding Funding

Total value (in billions) of private-equity deals of less than $100 million



*Through Aug. 18

Source: Dealogic

If a family has been running a business for decades on its own, inviting outsiders in can bring up a host of issues. What's more, family members may disagree not only with their new partners but among themselves. Maybe one sibling wants to invest in growth, while the other just wants regular dividends. Or maybe a parent wants to keep longtime suppliers and employees, and the children want to restructure.

"You can craft an elegant business solution, but the keys to implementation are locked up in the psychology of the family," says David Bork, founder of Aspen Family Business Group, a family-business consulting firm in Aspen, Colo. "The first hurdle is getting over the secretiveness that many founders have as it relates to their finances," he says. "Often they'd rather talk about their sex lives than their finances."

Vincent Constantini, managing partner at Roseview Group, a Boston-based advisory firm for entrepreneurs, says: "Tension and friction are built in on day one. Private-equity firms are loyal to their equity investors. They get rich only if they deliver a multiple of the capital back to their investors. A founder, on the other hand, is loyal to many things -- his family, his employees, his customers, suppliers."

Family owners have to recognize that an equity investor is there to create value, and that benefits all shareholders, says Francois de Visscher, founder of de Visscher & Co., a consulting firm in Greenwich, Conn., that specializes in family businesses and also runs a private-equity fund. "The short time frame can also help a company really focus on the urgency of certain things. There might be projects the company has been thinking about doing, and a private-equity firm will come in and say, 'Let's do it now, not have another meeting about it.'"

For Nash Engineering, control was a big issue. While the family had agreed to sell a majority stake and was considering selling out altogether, it wanted to control the process. "The important thing for the family owners was to find a group that was willing to work with its partners and not just have them along for the ride," says Mr. Nordenson. "That's quite rare. Some private-equity funds will want to run everything themselves."