The Family Business Advisor

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Family Business Ownership Succession: Learning from Others

By: Rob Sligh, The Family Business Consulting Group

On January 23, 2020 Bloomberg reported that Fairway Market was planning to file for bankruptcy... again. It was sad for the three-generation, 14-store family grocery chain in New York and its customers. If only the family could turn back the clock. Were there other options? If so, what lessons can they offer for family business continuity?

The Story

Bloomberg Opinion writer Joe Nocera noted that Fairway, a treasured New York institution, was founded in 1933. By 2007 it had grown from one store on Manhattan's Upper West Side to four stores, three in New York City and one on Long Island. The stores were supermarket size, but eclectic, with 50 brands of olive oil, dozens of varieties of olives, cheese, smoked salmon, imported beer and who knows what else. It was quintessential New York. On a per-square-foot basis, the four Fairways were among the highest grossing grocery stores in the country.

Howie Glickberg, grandson of the founder and CEO, was one of three partners who owned the majority of Fairway Market. The other two were ready to cash out. Others in management who held small equity stakes were also looking for a payday. Glickberg needed to find a source of liquidity. He made a deal with Sterling Investment Partners, a private equity firm.

Sterling invested $150 million into the company in return for an 80% ownership stake. The majority of that investment was debt that landed on Fairway's books. Three Sterling partners joined the Fairway board and they hired a new CEO. None of them had grocery experience.

Sterling had big ambitions for Fairway, planning to turn it into a national chain with hundreds of stores that would compete with Whole Foods and Trader Joe's.

By 2012, Fairway was up to 12 stores, including some in suburban New Jersey, where the company's urban cachet didn't necessarily translate. The expansion eviscerated company profits while adding millions in debt to its balance sheet.

To raise cash, Sterling turned to the public markets in 2013, raising $177 million. More than $80 million went to pay dividends to Sterling preferred shareholders and an additional $7.3 million went to management.

By 2014, Fairway was up to 15 stores. The company was a mess. It took months for suppliers to get paid. Scalable processes and systems were absent. Fairway's vaunted revenue-per-square-foot numbers dropped by a third.

The stores were looking shabby because the company couldn't afford to keep them up.

By 2016, saddled with $267 million in debt, Fairway filed for Chapter 11 bankruptcy. Although Fairway managed to reduce its debt by $140 million through the bankruptcy process, it didn't use bankruptcy to close stores or break any of its expensive leases. Sterling walked away. Another private equity firm, the Blackstone Group Inc., took over.

In 2018, Blackstone exited and the company was purchased by two other private equity firms: Brigade Capital Management LP and Goldman Sachs Group Inc. They hired a turnaround CEO with grocery experience. He was the company's fourth CEO in six years.

By 2019 Fairway was once again in deep trouble. The company had limited alternative sources of liquidity as virtually all tangible and intangible assets were pledged to their existing credit facilities. In a court supervised process, Fairway sold several of its stores and a distribution facility to other companies. They continued to operate in a handful of stores. It's unclear whether any part of Fairway can survive its latest bankruptcy.

Were there other options back in the day?

Probably.

In 2007, third-generation Fairway CEO Howie Glickberg had an ownership succession issue. His two partners wanted liquidity and so did others in management who owned small stakes.

The Importance of Liquidity

It's reasonable for owners to expect a competitive return for the risk undertaken and liquidity when desired or needed in a manner that considers and protects the financial health of the business for now and the future. Producing competitive returns in the long run is possible when a company does a good job serving the needs of its employees, customers and suppliers and is engaged in the communities in which it operates.

Family businesses can protect all owners and the business itself with a Shareholder Agreement that includes provisions for how the value of company stock is determined and requires that the stock be offered first to the company at the determined value on terms specified in the Shareholder Agreement. The terms protect both company and individual owner interests and typically include an initial cash payment followed by principal and interest paid over a period of years.

There might have been several options available to Fairway for accomplishing the desired owner-liquidity. Even in the absence of a Shareholder Agreement, a company buy-back of stock could have provided to owners wanting to exit some cash up front followed by principal and interest payments over a period of years. Or the company could have raised cash for buy-backs by taking on bank debt or selling a minority interest to an ESOP. Or an individual investor or family office or private equity firm with relevant experience and common values could have been invited in as a minority investor to raise cash to buy other owners out. But Fairway sold controlling interest to a private equity firm with no relevant experience and self-centered values.

The Role of Good Governance

It's not clear whether Fairway had a Board with independent directors at the time when ownership succession issues were being considered. Typically, talented independent directors can help owner/CEO's like Howie Glickberg identify options and they can relate experiences that shed light on the pros and cons of options. Families that establish a Board with independent directors often say years later that it was one of the most important business decisions they ever made.

Maybe Howie felt forced into the decision to sell controlling interest to a private equity company. Trouble is, the private equity company he engaged paid themselves first and took the high-flying risk of rapid growth knowing that even if high-value was never achieved and Fairway ran out of cash, they'd already gotten their money back.

Planning Ahead and Learning from Others

In hindsight, there were probably other ways for Fairway to address ownership succession in a way that was fair to owners who wanted liquidity and better for other stakeholders. It's important for family business owners to build wealth outside the business through retirement and health savings accounts and diversified, outside investments. In general, planning for both ownership and leadership succession in a family business is carried out over years and takes into account the probability of the unexpected.

We can't go back in time. We all make mistakes. The best we can do is learn from Fairway's story: Establish and nurture a Board with independent directors. Maintain shareholder agreements with clear valuation and buy-back processes. Make sure potential investors share your values. Plan ahead for ownership and leadership succession.

Rob Sligh is a consultant with The Family Business Consulting Group.

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