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Business

PERSONAL FINANCE

Families Investing in Other Families

There is a comfort level in helping firms with generations of legacy at risk from the pandemic.

Wealth Matters
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Charles Widger invested in a fund that makes loans to family-run businesses because "I can relate to what these people are going through." He added, "I wasn't a big conglomerate."

Charles Widger, 76, sold his investment firm, Brinker Capital, shortly after the pandemic took hold. After decades of building the firm, Mr. Widger, whose name adorns Villanova University's law school, ended up with several hundred million dollars.

But as he watched the economy come to a near stop and then haltingly reopen, he noticed previously healthy family businesses struggling to continue. He worried that many of these companies would not make it through the pandemic.

So, Mr. Widger said, he decided to invest in a new fund, Family Legacy Capital, which makes loans to struggling family-run businesses. "I can relate to what these people are going through," he said. "I understand the challenges. I wasn't a big conglomerate."

The way he sees it, family businesses get needed help, and "there's an opportunity for discerning investors to help these family businesses and get a good return."

Wealthy families were interested in deals with other families before the pandemic set in. Many wealthy families had a lot of money to invest but weren't interested in traditional investments or funds that charged high fees. They also understood firsthand how family businesses work and how family dynamics can influence them, for good or bad.

They had a range of investments to choose from: buying a stake in a family business; buying another family's business outright; or banding together with other wealthy families to invest in a business, with a knowledgeable family taking the lead and all families bypassing funds' management fees.

For some of the family businesses in need, assistance from the wealthy has often been their last hope. "Banks are not lending to these businesses," said Kirby Rosplock, the founder and chief executive of Tamarind Partners, a consultant to wealthy families. "They're very tight on credit."

One of Family Legacy Capital's first investments was in a group of high-end hotels on the West Coast that had tapped out its bank loans. The company had been owned by the same family for decades but was in danger of closing as guests disappeared in the pandemic. One of the fund's members found the investment. The owner didn't want to be identified for this article or to discuss the situation.

Investments like this keep family businesses in the family, avoiding a sale to a larger entity. This is often a major motivation among wealthy family investors, who can see some of themselves in the businesses they're helping.

"A lot of times, the owners don't want an exit strategy," said Jennifer Pendergast, executive director of the John L. Ward Center for Family Enterprises at the Kellogg School of Management at Northwestern University. "What they need is money. A lot of times, investors have realized the secret sauce is the owners. You're giving up part of the value of the business if they go away."

From the perspective of a wealthy family, there are pluses and minuses to the different ways of investing in family businesses.

Buying an ownership stake has the potential for unlimited appreciation. But since the investment is in a family business, not a public company, the investors have to understand the family and be comfortable with the way the family does business.

When investors agree to make a loan — what's known as private credit lending — their returns are going to be capped at whatever was agreed to. But as a lender, not an owner, the investors don't have to deal with any family issues.

"A lot of families are doing the debt infusion so they don't have to wrestle with someone giving something up," said Bobby

Stover, the family enterprise and family office leader for EY Americas. "It's easier to negotiate the terms for debt than an equity investment where you worry about dilution and ownership."

A debt investor "can be a patient partner and not worry as much about the culture," he said.

If something goes wrong, the debt investors are higher up in the rankings of who gets repaid, which means they'll be ahead of any equity investors.

"If it goes well, no one complains and everyone is happy," said Thorne Perkin, the president of Papamarkou Wellner Asset Management. "Where I've seen problems arise is when things are not clearly stated upfront. Someone says, 'I want my money back,' but the borrower says, 'I don't have the money.' These things happen all the time."

Family Legacy Capital structures its investments, which are all in the United States, as loans to family businesses that have $25 million to $100 million in revenue. The investments range from $10 million to $50 million and will last three to five years, though the fund expects many of the families to pay back the money in half that time as their businesses improve.

The fund expects annual returns in the low double digits, which is far higher than the investors could get with regular debt investments. But the higher returns take into account the higher risk that comes with investing in struggling businesses. Still, since the investments are secured by assets of the businesses, the fund's investors have recourse should families struggle to repay loans.

"The low risk is a critical component for the families that invest in these companies," said Hendrik Jordaan, chairman and founder of Family Legacy Capital. "We're bringing not only the capital but the family ethos."

Mr. Jordaan also runs One Thousand & One Voices, a similar private equity fund that focuses on investments in Africa. Investors include the family of John Coors, a great-grandson of the founder of Coors Brewing.

Mr. Jordaan said bringing together families for a fund that was going to help other family businesses seemed like a natural response to the pandemic.

"Imagine if you have one of the world's largest consumer manufacturing families in your investor base and you ask them, 'What family-owned companies in your supply chain have you done business with for decades but they're in trouble because of Covid?'" he said. "If you know your partners are a community of families and you place value on your legacy being preserved, you're more likely to partner with a family. Our families want to know if their capital has made a difference."

Mr. Widger said the Family Legacy Capital fund — which includes three other wealthy families, who asked not to be named — does research before making an investment. It asks questions about what the company is trying to create and how it is doing it. But the fund also wants to evaluate the family behind the business and understand what that family needs to keep its business operating successfully.

Culture is key, Mr. Widger said. "Families can get dysfunctional, but family businesses tend to have a really attractive culture," he said. "It's human nature to bring your children into your business. There's something in the chemistry of working with family members. But you've still got to be able to have a good vision."