Case: “Should I Stay or Should I Go: I’m an External Board Member of a Dysfunctional Family Business.” David Karofsky, The Family Business Consulting Group

**Country Management Company**

Country Management, started 50 years ago by Jeff Smith, consists of two divisions, retail and manufacturing. A budding entrepreneur, Jeff had a no quit, take it or leave it attitude. He treated his employees well and was very well respected among his peers in the industry. Jeff and his wife raised three children, Denise, Scott and Mike in Minnesota before moving his entire operations and family to California in the early 80’s.

Jeff raised his children to be entrepreneurial, competitive and fight for everything they can get. This included among themselves. In fact, when the children were young, Jeff would to leave them on various street corners and whoever made it back to the house first won $20. If Scott and Mike were fighting, they didn’t solve it with words, they used boxing gloves. Communication was not a strong suit among the Smith family.

Fast forward to 2018, Jeff is now 80 years old. Denise, Scott and Mike are in their early 50s and the business has become a powerhouse generating over $100 million in revenue with high margins. The business has created a lot of wealth for the family and a sense of entitlement among the children along with it. Jeff’s way of handing disputes among the children was to throw money at the problem including lending Scott $2 million out of the business to build a new home which Scott does not intend to pay back.

Scott, the brightest and most creative among the three, is increasingly becoming a problem and starting to show narcissistic tendencies along with addiction issues.

The board of directors is rather perfunctory with Jeff serving as chairman, a close friend of Jeff’s, Gary, as vice chairman and Denise, Scott and Mike serving as directors. According to the shareholder agreement, Jeff needs to be in the majority for any and all decisions to be approved, essentially rendering the board of directors useless as far as a decision-making body. Jeff had complete and utter control of the business with no intention to letting go.

Both Scott and Mike were in leadership roles in the company, with Scott running manufacturing and Mike running the retail division, and were increasingly at odds with each other. Their conflict escalated on a few occasions to physical altercations in the board room. It was getting to the point where the two of them could not physically be in a room together.

Enter 2020… Consistent with everything else in the world in 2020, Country Management was met with an extraordinary surprise that would throw the business and the board into a tailspin.

Jeff went into the hospital for a routine procedure of inserting a stint into his heart. Unfortunately, this was not possible as his heart was too clogged and unable to accept the stint. He needed a quadruple bypass immediately. Although the surgery was a success, Jeff was unable to recover and passed away only three weeks later.

Not only was the sudden loss of Jeff a blow to the family and the business, it left the shareholders and board of directors in disarray. In addition to the shareholder agreement providing total control to Jeff, it also was written that in the event Jeff passes away, his ownership is divided among his three children as follows:

 Scott – 49%

 Mike – 49%

 Densie – 2%

The shareholder agreement also made Scott the chairman of the board and was written such that Scott and Mike must be in the majority for major decisions to be approved in the business. (see Addendum B for a list of decisions)

This put tremendous strain on the board of directors and essentially dead locked all decision making as Scott and Mike were unable to effectively communicate with each other.

This also put Gary, the only outside board member, in an incredibly difficult position. He was torn on what to do. He was Jeff’s longtime friend and cared deeply about the family yet was the victim of extraordinary verbal abuse from Scott and getting caught in the middle between two dysfunctional brothers.

You are Gary…

* What options do you have?
* What are the risks associated with those options?
* As a fiduciary to the shareholders and corporation are there some options that can be explored?
* How would you advise the family and the business?
* Should you stay, or should you go?

# Addendum B - Country Management Shareholder Agreement

Following the time that Jeff ceases to be a director of the Corporation, and during the time that Mike and Scott continue to be directors of the Corporation, the foregoing actions shall require the approval of the majority of the directors of the Corporation provided that both Mike and Scott are in such majority.

1. the declaration or payment of dividends or distributions upon the Shares, unless otherwise provided for in this Agreement;
2. the entering into, modification or termination of any lease, contract or agreement by the Corporation or a Subsidiary that pertains to real property with a term of five (5) years or more or the entering into, modification or termination of any lease, contract or agreement by the Corporation or a Subsidiary that pertains to personal property with a term of five (5) years or more;
3. the sale, transfer, hypothecation or lease by the Corporation and/or a Subsidiary of any capital asset having a value in excess of $250,000 other than in the ordinary course of business;
4. the borrowing of money or obtaining of any term loan credit facility by the Corporation or a Subsidiary in excess of $500,000 from a bank or other financial institution or the borrowing of money or obtaining any revolving credit facility by the Corporation or a Subsidiary in excess of $500,000 from a bank or other financial institution;
5. the making by the Corporation or a Subsidiary of any loan or advance in excess of $50,000 to any person, corporation, partnership or other entity;
6. the guaranty by the Corporation or any Subsidiary of any obligation or Debt of any third party;
7. the making of any capital expenditure by the Corporation or a Subsidiary of $50,000 or more;
8. the making of capital expenditures by the Corporation and/or a Subsidiary which aggregate $250,000 or more within any fiscal year;
9. the hiring of any employee by the Corporation or a Subsidiary for a salary in excess of $125,000 per year;
10. the adoption of an operational budget for the Corporation or a Subsidiary or the material modification of any operational budget established for the Corporation or a Subsidiary;
11. the amount of bonuses to be paid to the officers of the Corporation or a Subsidiary;
12. any distributions to be made by the Corporation to its Shareholders unless otherwise provided in this Agreement;
13. the sale or purchase of any real estate by the Corporation or a Subsidiary; and
14. the removal or appointment of officers of the Corporation or a Subsidiary.