THE VEGA FOOD COMPANY

CASE 5

In February 1997, Francisco Valle, Jr., president of Industrias La Vega, organized the first family council meeting in the owning family's history to address problems he was having with his youngest sister, Mari, a shareholder in the company. He felt that the problems were not of his making and were interfering with his management of the company. Francisco, 45, had worked closely with his father, Francisco Sr., since 1976 and had become president of the company in March 1994, when his 72-year-old father was killed in an automobile accident. Industrias La Vega was a Spanish meat-processing business that produced hams, sausages, and other delicacies for domestic and export markets. The $104.8-million-a-year business was demanding, of course, but Francisco Jr. felt most challenged by the family conflicts that often overwhelmed him.

The ownership structure of Industrias La Vega had been updated just months before the tragic accident involving Francisco Sr. At the request of Francisco Jr., who was concerned about the possible loss of control of the enterprise he had comanaged with his father for years, Francisco Sr. and his attorneys had created two classes of stock. The voting A shares did not pay dividends. The nonvoting but dividend-bearing B shares had a par value 10 times higher than that of the A shares.

Except for brief stints, none of the Valle daughters had worked in the business prior to their father's death. Ana, the second eldest daughter, was an artist, and she had been instrumental in designing the image and logo of a new premium product line. Working alongside her father, she had created the look for the Gold Label line of meats and cold cuts, Francisco Jr. had not been particularly enthusiastic about this new line.

Mari, 27, the youngest of the Valle siblings, was concerned about her future and the security of her own young family after her father's death. She worried about how her interests as a shareholder would be protected. She had trusted her father completely, but she was not sure she had the same faith in Francisco Jr.

She did admit to being a little more optimistic now that Francisco was making an effort to get closer to the lower-level employees and be more of a leader in the company. As it turned out, Francisco was his father's successor not only in the company, but also in politics. His father had won a Senate seat in the last elections before his tragic accident. Francisco campaigned for and won the seat, and served what would have been his father's term. Mari and his four other sisters chided Francisco about being so effective in his political campaigning and yet unable to instill a team spirit among the company's employees. He was, in fact, still spending 3 to 4 days a week on political endeavors.

The farmers and cattle ranchers of whom Francisco Sr. had been a lifelong customer trusted him. As a major customer for their products, he had had much influence with them. His successful run for the Senate at the age of 72 was evidence of the degree of this influence, even outside business circles. In the food-processing industry, good relations with the government represented an asset for the Valle family, from which both generations derived competitive advantage.

THE VALLE FAMILY

The Valle family was wealthy by the standards of the small town in which they had most of their production facilities. Francisco Valle, Sr., was a self-made entrepreneur. He married Isabel in 1947 and had five daughters and a son (see Figure E). In 1997, Valle family members included Isabel, 71, Francisco Sr.'s widow; Rosa, 47; Francisco Jr., 45; Ana, 42; María, 38; Tere, 33; and Mari, 27. Of these, only Francisco Jr. and Tere worked in management positions at the family company, and Tere had joined only three years earlier.

Relations between family members were warm, particularly among the women, though several next-generation members had created very different lives for themselves. Rosa and Maria lived overseas but visited Isabel two or three times a year. The only son, Francisco Jr., had studied agribusiness overseas and then returned to run the family business.

In a traditional display of primogeniture, Francisco seemed preordained to be the successor to his father. He took his responsibilities toward his mother and sisters seriously, although they all complained a little about not being involved enough, not being kept sufficiently informed, and not being treated the same way Francisco was treated by the company. Francisco received a reasonable CEO salary, bonus, and benefits package. But the sisters' dividends were nowhere close to his take-home pay, and Francisco, with his expensive tastes, seemed to flaunt the difference. A palatial home, luxury car, helicopter, boat, and assorted other "toys" all seemed essential to Francisco in his executive post. A couple of the sisters were divorced and had additional financial responsibilities toward their own children. Even Isabel lived in a more modest house and drove a less expensive car than Francisco did.

Family members characterized themselves as being "hermetically sealed," meaning that they were not great communicators. This was particularly true on the subject of money; the few conversations about finances that took place were one on one and had the quality of family gossip. Tere remembers one of her sisters saying, "Is it true that you receive 1 percent of the company's profits and Francisco gets 10 percent? That is robbery!" Francisco was often the target of the gossip, but mostly he ignored it, except for telling himself and his advisors, "After all, I have been the one working the business for more than 20 years now."

There was plenty of evidence of love, caring, and tenderness in the family. There was less evidence of respect for titles, organizational structure, hard work, reporting relationships, institutions, and formality of any kind. The family seemed ill-equipped for financial responsibility. In the past, dividends had been distributed infrequently. Individual family members' needs were brought to the attention of Francisco Sr., who usually granted requests, as a generous father would. For Mari, the youngest daughter, who grew up surrounded by evidence of the family's wealth, and for other siblings who needed money for new houses or trips, asking was often akin to receiving.

FAMILY COUNCIL MEETING, FEBRUARY 1997

Francisco took the initiative in sponsoring this first family council meeting. It followed a day-long shareholders' meeting, at which financial information and the state of the *figure* **E** | **Valle Family Tree**

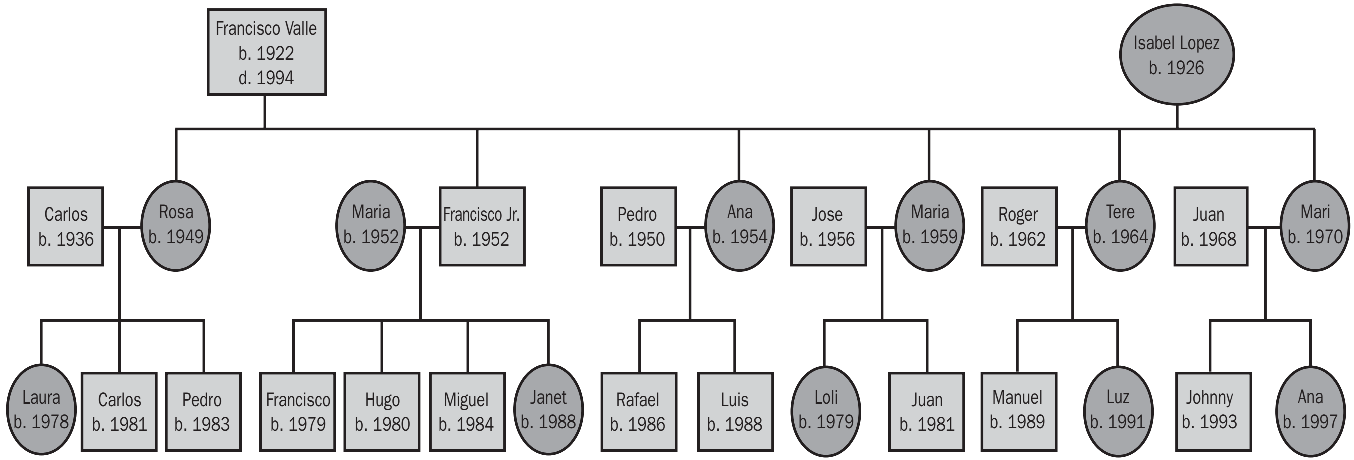

table **A** | **Financial Results for Industrias La Vega, 1992–1999**

	1992	1993	1994	1995	1996	1997	1998	1999
Sales	42.5	51.7	57.4	69.4	84.1	104.8	112.6	109.7
Cost of sales	32.1	36.6	41.1	52.6	62.6	78.2	79.6	74.9
Gross margin	10.4	15.1	16.3	16.8	21.5	26.6	33.0	34.8
Administration expenses	5.6	10.2	11.9	13.3	19.6	18.8	22.4	22.7
Interest expenses	0.0	0.0	0.0	0.0	0.0	3.1	4.4	5.6
Net profit	4.8	4.9	4.4	3.5	1.9	4.7	6.2	6.5

business were discussed with shareholders. The news for shareholders was not great. Although company sales had continued to increase, profits had plummeted in the past couple of years, and dividend distributions had been cut (Table A).

With Tere's help, Francisco had interviewed and selected the family-business advisor who facilitated the family council meeting. The consultant had conducted a private meeting with every member of the family. A few days prior to the meeting, Mari told the family business consultant,

> *It is important that each of us know what we have, what we don't, and what we can and cannot do as shareholders. We have to speak clearly about these things. Right now, bringing up the subject is taboo. We need more transparency in all of this. We need to recognize that we are all siblings here.*

Tere observed, in her meeting with the advisor,

> *The reason for these meetings is that we need Industrias La Vega to continue as a family business. In order for that to happen, Francisco needs to be supervised. There has to be more balance between Francisco and the sisters. Those inside the company have to live by corporate rules, manage with transparency, and meet the needs of the inactive shareholders. There has been too much centralization by Francisco. Financial information about the company has to be sent out regularly and explained in such a way that all shareholders understand it. Without this education, there will be no sense of justice. But don't get me wrong; we love each other a lot. We have grown in family unity. My mother is a very strong woman and a very steadying influence.*

Isabel expressed her own expectations of the meeting this way:

> *In the interests of the family and the business, everything has to come out well defined and organized. Things have to be clear for everybody, after some discussion and reflection, so that there is no second-guessing later.*

The meeting started with the setting of meeting goals and behavioral norms for constructive problem solving and conflict resolution. Feedback from the conversations with the family-business consultant was provided for family members to discuss, clarify, and then use to build an agenda that responded to the identified needs, problems, and opportunities. Selected as the two top-priority items on the agenda were: (1) the lack of clarity and organization in the ownership structure, estate plan, and financial reporting mechanisms for shareholders, and (2) the lack of a well-organized family forum and board of directors. Board meetings existed only on paper, and only family members were on the board. Although a mini–family-business presentation made by the consultant early in the meeting may have influenced the selection of topics, both Tere and Francisco had attended a family-business course for next-generation members and had been convinced of the need for both of these governance bodies. Obviously, their opinions had significant influence in the larger shareholder group. Other topics selected for discussion included the need to define the responsibilities of shareholders toward the business and of managers toward shareholders, the need to define the rules guiding relations between members of the family acting as suppliers or subcontractors to the company, and the third-generation scholarship fund.

By the end of this first family council meeting, an action plan had been drafted that directed various family members to review the ownership structure and the possession of stock certificates, retain a valuation expert to perform a company valuation, review and account for the family benefits that individual members had been granted in order to make appropriate decisions regarding family benefits in the next shareholder meeting, and continue to schedule open conversations about what shareholders wanted from the business—things such as higher dividends, more reinvestment for long-term growth, and liquidity of shareholdings via buy–sell agreements. An agreement was reached among family members that the company hierarchy would be respected, and any information required by shareholders regarding the company and its finances would be directed to Francisco, the president, and not to accounting department personnel. Francisco, in return, agreed to respond to such requests in a timely manner. Shareholders also reached agreements regarding the other expectations they had of management and what management could rightfully expect of shareholders.

Finally, a discussion of family-business boards produced a consensus on the desirability of a board with independent outsiders and a list of board responsibilities. These responsibilities were to promote the continuity of the business, review the strategy of the business, review and approve financial reports and budgets, review the compensation of key executives, and provide oversight on large capital investment decisions. The criteria for selecting board members were to be developed by a task force made up of Francisco, Tere, and Rosa. The selection of independent board members themselves and the holding of the first board meeting were deemed to be the responsibilities of Francisco, though shareholders wanted to be consulted.

FAMILY COUNCIL MEETING, SEPTEMBER 1997

The next family council meeting was held in September 1997. This meeting addressed three new topics: (1) the family foundation (a study of its various projects in the past 5 years had been done), (2) college scholarships for members of the third generation, and (3) the possibility of selling a couple of parcels of company farmland. The bulk of the meeting was focused on following up on the action plans drafted at the February meeting. While there had been much progress on many fronts, shareholder information, company valuation, and liquidity concerns had not been addressed by the time this second meeting was held. And a new board of directors or advisory board had not been assembled.

MARI BRINGS IN THE ATTORNEYS

The semiannual family council meeting was scheduled to take place in May 1998. Mari felt sick, and checked herself into a hospital for observation. This precluded her from attending the meeting. Instead, she sent two attorneys whom she and her husband had retained to put pressure on Francisco for fuller disclosure of corporate financial information. The family council meeting was canceled after a brief conversation with the attorneys to determine the nature of their involvement.

Francisco was very upset and quite worried that if the company's accounting and financial records were scrutinized, they would be found lacking and this would create more chaos and family disharmony and possibly even result in legal ramifications. The business, as a result of a very strong entrepreneurial culture and unsophisticated financial and administrative systems, had very unsophisticated accounting procedures. Francisco Sr. had never been very concerned about establishing such systems. Now, the responsibility for historical reconstruction of financial information had fallen on Francisco Jr. He said,

> *That was the reason that I could not be any clearer with shareholders about the books than I was. I was not hiding anything; they had the same information I had available to me. But I knew how shrewd those two attorneys that Mari hired were, and I was very worried for the family and the business's reputation.*

In the aftermath of the family council meeting, Francisco stayed very close to his mother, Isabel, and consulted her often on what to do. But, of course, all of this was very hard on her, as she did not want this to be the legacy of her very successful late husband. Francisco respected Isabel's wisdom and her ability to influence her daughters. Mari had hired the lawyers, but most of her sisters were secretly rooting for her. They too wanted to better understand what they considered to be rightfully theirs. Isabel talked to her daughters on many occasions during that period about the importance of preserving the family and about the need to give Francisco time to run the company, get things in shape, and show them what he could do. But her arguments did not dissuade Mari, who continued her inquiry through her attorneys.

About this time, company and family attorneys finally unraveled the details of the estate plan. It was determined that upon Francisco Sr.'s death, Francisco Jr. held 50 percent of the voting A shares and 20 percent of the nonvoting dividend-bearing B shares. Each of his five sisters owned 15 percent of the B shares, and Isabel retained 5 percent of the B shares and the remaining 50 percent of the voting shares. Voting control, therefore, rested in the hands of the founder's surviving spouse and Francisco Jr., the successor president.

Hurt and disillusioned by Mari's actions, Francisco began the process of negotiating with Mari and her attorneys for a buyout of her shares. On the advice of her mother-in-law, an influential banker, Mari asked for $10 million, but she was offered $4 million. During the last round of negotiations, Francisco, concerned about the future of both the family and the business, agreed to $6 million on an installment basis—a price he considered exorbitant but worth the peace of mind and the ability to move on, both of which he so desperately wanted. Mari agreed to this offer, and sold all of her shares to Francisco, who, as a result, now owned 35 percent of the B shares.

FAMILY COUNCIL AND SHAREHOLDERS' MEETINGS, OCTOBER 1999

Family council meetings were not held for over a year, while the wrangling and negotiations were going on. In October 1999, family members held their next family council and shareholders' meetings. (Mari, who was no longer a shareholder, decided not to attend either meeting.) The agenda for the 1-day shareholders' meeting and the *table* **B** | **Dividends for Industrias La Vega, 1995–1999**

1995	$181,000
1996	$322,000
1997	$639,000
1998	$1,256,000
1999	$1,488,000

additional day for the family council meeting included discussion of a draft of a shareholder buy–sell agreement, discussion of the new dividend-distribution policy, and discussion of a draft of a family constitution. The family constitution included an emergency contingency plan naming Tere, the one sister active in management, as the successor if something should happen to Francisco.

THE PRUNED FAMILY TREE GROWS

All this upheaval and animosity did have several positive side effects. Francisco dedicated himself fully to the business. He fired several members of the top-management team who were hurting his efforts to professionalize the business, replacing them with competent key managers. Concurrently, he began to successfully execute a growth strategy that had been in the planning stages for several years. In 1998, revenues and net profit rose to $112.6 and $6.2 million, respectively. Then, in 1999, when revenues went down slightly, to $109.7 million, net profit rose to $6.5 million (see Table B). Starting in 1998, dividends increased significantly, which gained Francisco much respect with shareholders.

Francisco retained a financial consultant as the CFO and, to his delight, found that this CFO knew as much about business as he did about finance and was a great general manager. Francisco now had key nonfamily managers whose skills complemented those that he and Tere brought to the corporation. Together, they turned things around dramatically and increased company profitability.

While Mari achieved her goal of liquidity and personal oversight over her own inheritance, the other family members recommitted themselves to the business and stayed involved. The work of the family foundation continued. The foundation was successful in getting a highway named in memory of Francisco Sr., and all the family members got together to honor and celebrate the family's proud past. The increased participation by the Valle sisters in committees, task forces, the family council, shareholders' meetings, and the family foundation led to a greater sense of transparency and ownership. As they walked to a shareholders' meeting in the spring of 2000, Ana reflected on the changes:

> *A long time ago, my father gave one of my siblings $650,000 to buy a house. Francisco has been adjusting distributions to equalize us all with that gift. After that, we will receive our dividends based on our ownership stake and company profitability. Dividends have increased. We receive company information. We exert a great effort to be fair. We've come a long way.*

This case was prepared by Professor Ernesto J. Poza as the basis for class discussion rather than to illustrate the effective or ineffective handling of a family-business management situation. For permission to publish this case, grateful acknowledgment is made to the chairman and the executive vice president of the company. Note that while the case is factually and historically accurate, the names have been changed to protect the privacy of the family.