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SCHLESINGER GLOBAL FAMILY ENTERPRISE CASE COMPETITION (SG-FECC)

PREMIER REAL ESTATE DEVELOPMENT

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Premier Real Estate Development

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Abstract: Premier Real Estate Development is a family business started by a father and son-in-law in Latin America. Now focused on prime real estate, luxury homes, and premium multifamily buildings, Premier started as a small single homebuilder in 1988. With time it added key nonfamily managers and professionals with core skills, two of whom received significant equity stakes during their tenure and are now managing partners or co-owners. The addition of these two managers now makes the company a three-family-owned business. Multiple-partner-families that own a business are a common occurrence in Latin America, Asia, Europe, and other parts of the world. The three owning family groups are unrelated. Even though the founding partners had a relationship by marriage, the elder founder is deceased, and his ownership was consolidated with his son in-laws' to now form one family group. The founding vision and the opportunities it generated for all three partners kept the partnership growing and healthy.

As the next generation grows into adulthood, differences in outlook and career objectives between the three families pose a challenge to both continued shareholder loyalty and to the successful continuity of the business under control of the three owning families. One of the two owner-partners added by the founding family finds himself in a tough spot when his own children demonstrate interest and capability in the business and encourage him to consider them in the continuity plans of the business. If that scenario is not acceptable to the other two owner-partner families, these next-generation members would prefer that their father leave Premier and help them with the founding of a new real estate development company. The startup capital for this new venture would have to come from a sale of his stake in Premier. Next-generation members of the other two families are either uninterested or too young to work or be involved. Can three unrelated families successfully plan for generational transition and continuity of the business the way single family businesses do? What long- and short-term options do they have? With an aim to address the interests of the three families and the continuity of this valuable and thriving enterprise, what would the continuity plan for the chosen options entail?

Frank Porras, owner-partner, and father of the entrepreneurial next-generation members expressing an interest in a future in real estate development, contemplated: "*My partners Adam Lugo and Jon Gross, are like my brothers. We have worked together to grow the company for 35 years. Together, we have developed, constructed, and sold over 100 real estate projects with more than 300,000 homes in six cities in Mexico."*

The partners currently disagree on some of the day-to-day management of the company and its vision for the future. As a result, in 2021, and just months before the upcoming owner-partners' meeting, Frank wondered if it was time to retire from the company as a partner and employee in 2024 when he turns 60. He would have completed 30 years working with his owner-partners at Premier Real Estate Development.

Frank’s intention would be to capitalize on the experience gained at Premier and support his children in a new real estate development company that is managed with the levels of dedication and commitment now lacking at Premier; that is, with the same strength and drive of the founding partners. He acknowledges the challenges of creating a new business, but he sees it as an opportunity to mentor his children in the industry. He recognizes that post-start-up, it will be their responsibility to show if they have the skills and commitment to undertake this new real estate company on their own. In this difficult initiative, in addition to the business challenge, they will have to overcome the difficulties inherent in family relationships.

But as Frank prepares for the owner-partners’ meeting he is wondering whether a continuity strategy for Premier Real Estate Development that includes his children as successors would be a better alternative for himself and his family. If continuity that welcomes his children into the business is not an option, Frank would have to sell his ownership stake in Premier to finance the start-up, and he would also have to assume all the risks associated with a new venture in his late fifties. Would his owner-partners agree with this new vision for the company?

History of the Company

Premier Real Estate Development was founded in 1988 by Mr. David Goodman and his son-in-law, Jon Gross. The company was thus founded by a two-generation team. Shortly thereafter, Jon hired Frank Porras, a civil engineer, to build the first homes. Three years later, Adam Lugo, a law student and close friend of Mr. Goodman’s children, started as an in-house legal counsel. The financial results of the company have consistently been positive. Over time, Frank Porras and Adam Lugo received equity-based compensation and became owner-managers.

During the early years, the management team worked under the direction of Mr. Goodman (now deceased) and Jon (currently aged 66). Fifteen years ago, because of family security concerns in Mexico, Jon relocated to the US. Since then, Adam (currently aged 52), and Frank (currently aged 58), have provided the day-to-day leadership of the company, while counting on the consistent support of Jon. Frank Porras says that *“the trust and generosity of Jon in the team residing in Mexico is what allowed Premier to grow and consolidate its position in the marketplace”*.

The company traditionally operated under a shared management system. Each of the three partners did their work autonomously and specialized in different areas according to their skill sets and preferences. While Jon is now not involved in the day-to-day operations, he participates in the relevant decisions and acts as a friendly moderator when there are disagreements or differences in the partnership. His conciliatory attitude and the leadership he exercises even while outside the country, has made a major contribution to the company and to the relationships between its managing partners.

The company has a unique culture, which they have dubbed “The Premier Way”. Relations are based on respect and trust among the partners. Decisions are made by consensus rather than majority. Company-wide and individual manager objectives are set via open and vigorous give and take. The Board of Directors exists only on paper and does not formally operate. Good financial results and cash flow are the common goal posts.

The three families have been very constructive in their relationships with each other and intrafamily relations and communications are quite healthy and open. Very effective leadership by the three partners of their respective families made it possible to schedule the first meeting to discuss the future of the partnership with the confidence that each of the families would be credibly represented with “one voice”. This meeting would certainly require significant collaboration between three unrelated family groups.

Table 1. Premier Real Estate Development Ownership Structure Historical Timeline

1988-1994	**1995-2003**	**2004-2021**
100% Gross Family	75% Gross Family	50% Gross Family
	25% Frank Porras	25% Porras Family
		25% Adam Lugo

Top Management Today

The top management of the company currently consists of:

- Adam Lugo, an owner-partner, is the inside counsel and manages the legal team. He co-administers the firm with Frank Porras.
- Frank Porras, an owner-partner, works in the commercial area. He is responsible for site location and develops the design for each new project and site. He co-administers the firm with Adam Lugo.
- With the growth of the company, Frank's wife, María, 55, who was working with a large accounting firm, joined the company in 1999. She is the Treasurer, and a substantial contributor to the business.
- Jon Gross, one of the two founding partners, is the president and majority owner. He resides in the US but joins the owner-partners in Mexico during periodic visits and is in telephone contact around the clock.

Growth of the Business

With large increases in the cost of land, lots now had to be more efficient in terms of square-footage use. Premier Real Estate Development had largely replaced single-home projects with buildings of 150 apartments or more. In Mexico City's middle and upper middle-class real estate markets, buildings have 25 or more floors, large amounts of parking spaces, and common areas. Taller buildings represent a larger investment and greater financial and regulatory risks.

Urban development laws and regulations became more complex and unpredictable. The company’s lawyers often read and interpreted these a thousand different ways while the company was finalizing its plans to bring the lots to their maximum development potential. Tax burdens are very significant, and the complexity and variability of laws and regulations is endless. There are major changes in labor law, consumer protection rules, and infrastructure practices that significantly increase liability risks in new projects.

Development and construction costs are significantly higher today than in previous times. A flexible cost structure, which in the past cushioned risks, no longer makes the purchase of many lots feasible. Any error or increase can turn the business opportunity on its head and create significant losses. Competition, from buying the lot to selling the real estate, has increased tremendously.

In addition to the above factors, the behavior of the owner-partners has also changed. 25 years ago, the partners were willing to work 12 hours a day and to constantly look for ways to increase profits. Today, the partners engage in multiple business and philanthropic activities. Other activities have become very important and protecting the wealth acquired with so much effort, is now a priority. Especially given the security risks that have led one owner-partner to emigrate to the United States. Partners are contributing much less of the entrepreneurial energy than they once did.

In a recent partners’ meeting, Frank stated that he wanted to stop doing administrative work and only dedicate himself to architecture and new business. He also wants to give more time and financial support to the business he is developing with his wife and children. Frank added: *"This is a business that requires effort from dawn to dusk every day. And the partners no longer seem willing to give it their all."*

Frank and Adam still co-administer the firm's operations in Mexico and agree quickly on most strategic issues. However, their day-to-day leadership styles are very different. The differences are evident in the speed of decision-making, employee discipline, and planning and implementing the plan. Frank feels that Adam is continuously fire-fighting in the face of financial and operational challenges. Lately, these very different leadership styles have generated friction in the daily management of the company and created doubts about the future among employees.

The Owner-Partner Families: A Question of Vision

If Premier is such a successful and established company, why would Frank and his wife María embark on the risky venture of creating a new company at this stage in their careers? Why not dedicate that effort to Premier so that it builds on its success and creates opportunities for their children?

Frank's dissatisfaction with the current management and Adam's different way of seeing things, have generated great uncertainty about the viability of the business for Frank's own family in the future. And, as he approaches 60, his active partners will be 68 and 54, respectively.

Jon Gross's nuclear family does not live in Mexico and there is little interest in the business among next-generation members who have promising careers of their own. Many years ago, his father-in-law David Goodman, told his children that "he was working very hard to make enough money so that when they grew up, they could do whatever they wanted to do." Adam Lugo's family lives in Mexico. His children are young and know very little about the business.

Frank Porras' family lives in Mexico and the business is a frequent topic of conversation. María, Frank's spouse, and their two children are aware of his tentative plans to retire from Premier and of his commitment to help them with the startup of the new venture. As the CFO of the company, María has much influence.

Neither the company nor the families have shareholder agreements or family constitutions to regulate what would happen in case of retirement or absence of an owner-partner. Partners, at this time, do not even know what would happen or could happen with the shareholdings of each family. Therefore, any scenario is possible. This is another great concern for Frank. He adds: "It is well known that the problems come with the spouses, children, and in-laws of the partners, especially the next-generation members or their representatives. We have all heard the refrain: Shirtsleeves to shirtsleeves in three generations."

Frank Porras lacks the financial resources to buy out his partners. And no company valuation has been performed in recent years as the bulk of the company financing is done against real assets held without regard for total enterprise value.

What would happen in case of retirement, departure, or death of one of the owner-partners? Could Frank buy-out a retiring or deceased partner on an instalment basis and increase his ownership stake on behalf of his children and their interest in the business? For Frank, *"having an answer to these questions is of vital importance to the future of the company and to decisions I need to be making regarding my family's future*. However, I think *my partners will only start thinking about this when they turn 90."*

The First Future-of-the-Partnership Meeting

Stimulated by an educational module that facilitated the discussion of another family business case on succession and the need for the current generation to promote the development of responsible owners and shareholder loyalty in next-generation members, the partners proceeded to tackle the subject of partners vision on the agenda. With a target date in mind, they could begin to address some of the questions posed by Frank. Maria contacted Luis Pérez, a family business advisor, to help with this project. Feedback from interviews with all owner-partners conducted by Mr. Pérez helped create the agenda for this meeting. In the first meeting they settled several of the raised issues, including: (1) Electing a single CEO to replace the co-leadership model the company had been using; (2) Creating an Owners Council, whereby ownership subjects that were not addressed in the partners' meetings or during the day-to-day management of the company would be addressed; and (3) Making the board of directors, that existed only on paper, a real governing body and committing to adding two independent members to the board's membership. The latter decision was made with the goal of including outside members that would help the owner-partner members to analyze options more objectively. The first meeting was scheduled to last a day-and-a-half only because of other commitments. One short meeting could not do justice to the development of a new partnership vision or tackle all the questions and issues raised. Instead, partners agreed to meet again to specifically flesh out their partners' vision.

The Second Future-of-the-Partnership Meeting

The three owner-partner families, represented by two members from each family, met for an intense three-day shareholder agreement drafting session. This in effect constituted the first meeting of the Owners Council created during the partners meeting discussed above. Luis Pérez, Premier Real Estate Development's family business consultant and the company's experienced outside legal counsel facilitated the deliberations and the drafting of a preliminary shareholder agreement that addressed the following subjects:

1. Membership of the board of directors.

2. Policy on a family member as supplier or supply chain partner to the company as part of the family employment policy.
3. Policy regarding capital contributions by the three partner families going forward.
4. A company valuation policy and a buy-sell shareholder agreement.
5. Dividend policy.

These enumerated subjects of this second Owners Council meeting still did not include the more nuanced and complicated subject of the partners' vision. At the time of the second meeting, it seemed sensible to tackle smaller and more concrete, if not less important, ownership and governance issues. The overriding assumption of the owner-partners was that Premier Real Estate Development would continue across generations of owner-partners. But the differences in their individual family circumstances, the different aspirations of next-generation members of each of the three owning families and the geographic dispersion precipitated by a worsening security situation for the owning families, remained challenges to continuity of this business. A week or so before this second Owners Council meeting, dividends were distributed to the partners. This distribution, along with progress in both Owner Council meetings, created momentum and a sense of opportunity. Will it last?

Build a case for or against continuity at Premier Real Estate Development as a three-family partnership. If continuity seems feasible and desirable to you based on the facts of this case, what initiatives beyond those described in the case do you recommend be launched to promote a positive transition to the next generation? If continuity seems unlikely to you, describe more promising alternatives.

What advice would you give Frank Porras and his partners as they discuss the long-term future of this company? What actions do you believe are most needed in the short term?

What best practices for continuity have already been launched by Premier business owners? What other best practices or next steps do you recommend be used to help the partners achieve a satisfactory outcome?

What do you think will ultimately happen in this case? Explain your answer.