Choosing An Exit Strategy: A Case Study

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Case Description

The primary subject matter of this case is small business management, specifically developing an exit strategy for a small business owner. Secondary issues examined include entrepreneurship and family business succession. The case is appropriate for junior and senior level undergraduate courses. The case is designed to be taught in one class hour and is expected to require approximately three hours of outside preparation by students. The events described in this case are based on real world experiences, but all names have been disguised.

Case Synopsis

We outline the career of Ron Warner with its trials, hardships, and rewards in the oil fields of south Louisiana. Starting as an off-shore worker with Conoco, Ron gathered knowledge and experience in the drilling and production of oil and natural gas. After moving up through the ranks at Conoco and then at Florida Gas, Ron risked his entire life savings to open his own company along with partner Mike Naquin in 1981. As the company prospered and grew, the partners split into two divisions – Ron managed the production side of the company, while Mike led the drilling operations. The two sides combined made up the company, Phoenix Consulting. With approximately 250 employees, Phoenix Consulting serves as a provider of human resources for the oil industry. The company provides production operators and superintendents to operate and maintain oil wells both in-land and off-shore. After fifty years in the oil industry and twenty-eight years operating their own business, Ron and Mike begin to consider retirement and its implications for their employees and families.

Introduction

The cool morning mist swirled lazily off the bayou as the sun peeked above the eastern horizon and the cypress trees swayed gently in the breeze. It was a beautiful crisp and clear autumn morning as Ron Warner, co-owner of Phoenix Consulting, sat at his desk opening the mail and marveling at the beauty of his beloved south Louisiana. Ron had always lived close to the land, taking great pleasure in hunting and fishing. As the sun shone through the corner window, Ron thought to himself that he had enjoyed his career at work in the oil fields of coastal Louisiana and he was proud of the success of his company. He had earned a good living from the land that he loved, and did all he could to protect it. Although the oil business was full of hard and sometimes dangerous work, Ron had persevered through the difficult times and now was close to selling his company and enjoying a full retirement. In the midst of his reverie, the phone rang.

“Hello, Ron, I have some news for you that you may not like, but I am going to get right to it. I am sorry to have to tell you this, Ron, but the deal has fallen through,” the lawyer explained. “We were close to a deal, just a week away from signing.”

“We had agreed on the sale price and I know that Oil Field Operations Company really wanted to purchase Phoenix Consulting because Oil Field does not have production capabilities,” replied Ron.

“Yes, Oil Field Operations Company has drilling expertise, but they wanted your production knowledge,” the lawyer reiterated.

“What do you think the problem was? Was it because Mike and I wanted to protect our employees? It is very important to my partner, Mike, and me to protect all of our employees. So, Oil Field would not agree to keep Mike’s drilling engineers on? That was the problem wasn’t it? I imagine that Oil Field might want to lay them off?” questioned Ron.

“Yes, they would not agree to our terms for all of our employees, although we had the price set for the deal,” responded the lawyer. “It would have put millions of dollars in your pockets.”

“The money would have been great and I have to admit that there have been a few times when I would have liked to retire, but there are too many people tied into this business and I do not want to let them down. Thanks for your call,” said Ron as he hung up the phone.

Ron leaned back in his office chair and studied the walls. Trophies from his international hunting trips decorated the office. He glanced up and saw the head of a buck from a trip to Mexico and the picture of a grizzly bear he had shot in Canada. “I really do enjoy my hunting trips,” he thought to himself. “I guess those trips will have to wait now.”

Entering the Oil Field

Ron Warner grew up in the oil industry as his father began working on oil pipelines when Ron was only nine years-old. Rarely staying in one place for more than a year, the Warner’s moved constantly to follow the available oil industry work, living across the central heartland of the United States in Texas, Nebraska, Mississippi, and Louisiana. Ron finished his high school education in Mississippi and attended college in that state. During his school days, Ron loved sports and played football, basketball, baseball, and ran track. Ron especially excelled at football and earned a college scholarship to play on the gridiron.

Although he enjoyed playing football, Ron became restless with college life after a few years. Saturday morning classes, especially English, became too much to bear. Eager to earn his own way and gain independence, Ron decided to look for a job. The obvious choice for Ron was the oil industry, so he soon acquired a position with Conoco, one of the industry giants. The job required working fourteen days offshore and then seven days at home. So, in October 1959, Ron hopped on board a helicopter to Grand Isle and then took a boat offshore about seven miles to Freeport/Sulphur. Ron recalled, "At this point, the water got rough, I got seasick, and I wanted to go back to shore. The captain refused to go back and said that I would be alright. We ended up twenty miles offshore on a platform. When we pulled up to the platform, it looked like there was not enough work to do out there, but the captain said that I would find out soon enough."

Oil Drilling and Production

Ron gained valuable experience and gathered great knowledge of the oil industry at Conoco for over fifteen years. He gradually moved up the ranks from worker to foreman to middle management. To understand Ron's ascension through the ranks of Conoco, we offer a brief description of the industry in layman's terms. The oil business consists of two sides – drilling operations and production operations. Commonly, geologists study the site and determine a location where they believe oil exists. They designate the location for drilling, obtain leases around the location, whether it is on land or in the water, and contact a drilling company. Managers from the drilling company will go out and stake the wells and hire the rig for the geologists. Serving as an agent, the drilling company will make complete arrangements and then supervise the drilling of the well. According to Ron Warner, "Geology is not always an exact science, but many geologists are really good at locating oil."

Once an oil well is drilled, then production facilities are required to safely and continuously extract the oil from the earth. Oil, natural gas, and water are mixed together underground when formed by nature in reservoirs. There are two types of reservoirs; one is a water-drive reservoir in which the water will force out the oil and gas through the reservoir to the well. This type of reservoir will "water-out" and trap some oil and gas in the formation above the water level. The other type of reservoir is the depletion or pressure drive. With this type of reservoir, production engineers may be able to pump water in at a lower point in the reservoir and start the flow of oil toward the wellbore.

When the oil and gas reach the surface, the production company must separate them. Usually, there will be water mixed in as well, which should not go into the pipeline. The oil and gas flows out of the well and into separation equipment. The production company separates the oil, the water, and the gas, which is called a three-phase separation. In a separator, the gas goes to the top and the water is heavier, so it goes to the bottom, and the oil is in between. To get the gas and liquids to separate as the mixture flows into the vessel, V- shaped plates spread the flow out. As production equipment flattens the stream out, gas bubbles break out and the heavier liquids fall down. As long as the water is clean, it is dumped overboard as permitted by law. Much of the oil and gas is moved through pipelines from off-shore to onshore pipelines and refineries.

Florida Gas Exploration Company

In 1974, Ron Warner had been working for over fifteen years at Conoco. On the personal side during this time period, Ron met and married his wife, Jackie, and together they started raising a family, which grew to six children. The seven days offshore and seven days at home schedule began to take a toll on Ron's family life because it frequently meant missing important holidays like Christmas and birthdays. According to Ron, "My kids were getting older and I wanted to be there for them.... so I asked about a transfer, but all that Conoco had was some work in California." Pressed by the desire to have more time with his family, Ron considered leaving Conoco, "It was one of the hardest things that I ever did. In those days, the big companies had loyalty. You could have a job for life – there was loyalty both ways."

Through networking with some business acquaintances, Ron learned about an opening at the Florida Gas Exploration Company, interviewed for the job, and received an offer for employment. Ron accepted the offer and joined Florida Gas in 1974. By making the move to Florida Gas, Ron was able to work on-shore and maintain a normal family life.

Two further observations stand out in importance in relation to Florida Gas. One involves the top management of the company and the other relates personally to Ron. First, in regard to the top management of Florida Gas, Ron observed that the company operated in a socially responsible manner in respecting the law and maintaining high moral standards. The CEO of Florida Gas was Ken Lay, who later became president of Enron and embroiled that company in a series of very poor moral decisions. Whatever the later problems were for Lay, they did not occur at Florida Gas.

Looking at the situation from Ron's personal point of view, perhaps the most significant event during this period occurred about five years into his tenure with Florida Gas. At this point, the division engineer left the company for other employment and the vice president of Florida Gas looked to replace the engineer. The vice president of the company wanted to hire a new engineer, who was currently working for industry rival Amoco. Since Ron would be working with the new engineer, the vice president asked Ron to meet him informally for lunch to see if they could work together. Ron recalled that meeting and subsequent events, "So, I met Mike Naquin and we had a good lunch. It turned out that we had a lot of things in common, such as a love for the outdoors. We hired Mike and he stayed at Florida Gas for about a year and a half. During that time, we worked well together. Mike left to do some consulting and engineering work for a local firm. After he was there for a year or so, he needed some production help. On the weekends, I would go over and work with him. Things went very well for us."

Starting a New Business

Warner and Naquin quickly developed a good working relationship, built on mutual respect and trust. After working for many years in production and drilling positions at several large oil companies, the two friends decided to start their own business. In 1981, they established Production Systems and Services, at first operating out of Ron's garage with one secretary and one consultant. Ron and Mike based the company in south Louisiana, not far from the major offshore drilling operations in the Gulf of Mexico.

From the beginning, Ron directed the production side of the company and Mike led the drilling operations on a part-time basis. The business grew rapidly so that Mike was able to come on board full time in1983.

In 1985, the company bought some land in Schriever, Louisiana, which is located about 65 miles due west of New Orleans, and built a combination office and fabrication building. The company used this property to fabricate and refurbish surface production equipment. In 1987, after six years of steady growth, the partners broke the company into two divisions, the oil production side led by Ron, and the drilling side, which focuses primarily on oil drilling activities and is led by Mike. Although each partner focuses on his division of the company, the two sides remain together, aiding each other.

In response to the constant expansion and growth of the company, Ron moved his production division again in 1995 to Gibson, LA., which is approximately 15 miles southwest of Schriever. At the site in Gibson, Phoenix enjoys newer and larger offices and greater space for fabrication. The ten-acre site in Gibson has approximately 850 feet of bulk-headed water frontage for production barge fabrication.

Phoenix Consulting, LLC

Phoenix Consulting, under the leadership of Ron Warner, serves as a provider of human resources for the oil industry. Phoenix provides production operators and superintendents to efficiently operate and maintain oil wells. Phoenix is strategically located to serve the Gulf coastal area with offices in Gibson, LA, which is in Terrebonne Parish of south central Louisiana, less than 20 miles north of the Gulf of Mexico. Phoenix’s focus is to provide professional workers, including offshore production foremen, inland production foremen, lead operators, A, B, and C level operators, maintenance personnel, and mechanics, to operate existing oil wells in the south Louisiana area. Phoenix also has a compliance team ready to assist customers in implementing the latest regulations and recommended practices in the industry. The compliance team will audit reports and assist in inspections and paperwork required by state and federal regulatory agencies, including the Louisiana Department of Natural Resources, the Environmental Protection Agency, the U. S. Coast Guard, and the Mineral Management Service. Safety is a primary concern for Phoenix as the leadership of the company stresses strict adherence to safety procedures and practices to protect employees and the clients’ assets.

Phoenix’s drilling division provides professional drilling consultants and engineers to drill oil wells both inland and offshore. Phoenix’s drilling division has an office in Gretna, LA, which is in Jefferson Parish of the greater New Orleans area. The two-division format has proven to be a key to the company’s success. With the cyclical nature of the oil industry, the two sides of the business have served to even out the ups and downs of the business. When the industry is booming and oil prices are up, there is a greater demand for drilling services. When the industry is down and oil prices are low, the production services are still in demand.

Expanding Offshore

For twenty years, Phoenix Consulting worked primarily on inland projects. Then, in 2000, a major customer of the company, BDA Company, bought into the offshore business. In order to serve this customer, Phoenix followed into the more complex and demanding offshore side of the business. Ron Warner commented on this situation, "There was a big learning curve for us because now we were working under the jurisdiction of the Mineral Management Service of the Department of the Interior. This is heavily regulated by the Federal Government. Now, we were subject to many regulations that we did not have in our earlier in-land water or land-based business. The regulations are much more stringent regarding safety and equipment." The U. S. government regulates offshore drilling and production to a much higher degree because of safety concerns for the workers and environmental concerns in the Gulf of Mexico. Quickly, Phoenix hired employees and consultants who had the knowledge necessary for offshore operations.

Having adjusted to the offshore business over the past nine years, Phoenix now faces an uncertain situation because the company's largest customer, the customer responsible for Phoenix's entry into the offshore business, has been sold to another firm. According to Ron Warner, "There was always a possibility that BDA would sell out again. When they sold out to SEC, just this past year on September 1, we were not sure how things would work out for us. We have had several people leave us and go to work for SEC."

Family Business Succession

Phoenix Consulting faces a complex environment as the company's largest customer undergoes an ownership change and the oil industry is turbulent. Coupled with such business concerns is the additional complicating factor of family in the business. Research reports that most family business owners want to pass their companies on to the next generation of family members. Approximately, 86 percent of family firm leaders expect their businesses to continue on to the next generation in the family (Mass Mutual, Kennesaw State, & Family Firm Institute, 2007). In Ron and Mike's case, two families are involved. "I try to treat everyone here like they are family," explains Ron. "I do have family members in the business. Our middle daughter, Cindy Lichenstein, is our head bookkeeper. Hank Melton, our longest tenured employee, is my brother-in-law. When we started the business in 1981 out of my garage, there was Hank, myself, and Debbie, my sister, who was our secretary...Mike Naquin's oldest daughter is our CFO in Gretna. She has an accounting degree and does a very good job. With the key employees being here so long, I try to treat them like they are my family. Also, I have a son and a grandson who work off-shore, and one grandson who works in our office."

According to many researchers, the person most responsible for the continuity of the family business is the founder or incumbent leader (Barnes & Hershon, 1989). Additionally, there can be no succession without an able and available successor. The attributes of owners that have brought them success in business may prove to be stumbling blocks in the succession process. Researchers have looked at the need for achievement and power (McClelland, 1975), an internal locus of control (Brockhaus, 1975), a desire for immortality (Becker, 1973), and a sense of indispensability with respect to the business (Handler, 1994) as characteristics of owners that may interfere with the succession process.

Success in starting a business does not necessarily imply that an entrepreneur is an excellent teacher of the next generation. Teaching is an art that requires patience and the loosening of control. Some entrepreneurs employ proactive or dictatorial management styles to achieve goals and control events. Founders such as this must set aside natural tendencies to educate and prepare successors (Aronoff & Ward, 1991). A good working relationship between the predecessor and the successor is vital to any transfer of power (Cabrera-Suarez et al., 2001). Additionally, the incumbent must be willing to let go of the control of the business (Dyer, 1986). The incumbent must delegate responsibility and allow the successor to make decisions and mistakes (Handler, 1990).

Some family business owners are reluctant to plan for succession (Ibrahim, Soufani, & Lam, 2001). This reluctance may stem from a desire to retain the position of prominence within the family. Some owners see retirement as a loss of power and status. Some owners value control of the business above all else because they have invested their lives to achieve their status, often at great personal cost. Some entrepreneurs are simply too busy running and controlling the firm to plan for the future (Bjuggren & Sund, 2001). Others refuse to train or coach their chosen successor, resorting to a type of undermining behavior, while some owners simply envy their children (Morris, Williams, Allen, & Avila, 1997). They search for fault in the successor and create reasons to fire them (Lansberg, 1988). Still others act as if they are immortal and need no successor (Bjuggren & Sund, 2001). Others determine that they will die in office (Howorth & Ali, 2001).

Ron and Mike Discuss Exit Strategies

Ron Warner greeted Mike Naquin with a warm handshake as Mike entered the front door of the Phoenix Consulting office in Gibson. “How was your drive over from Gretna, Mike?” asked Ron as the two oil field veterans walked back to Ron’s office.

“The traffic was slow going in the city, but once I made it past the Westbank Expressway and got on US 90, there were no problems. I made it in less than an hour and a half,” replied Mike.

“Come on back to the office. Would you like a cup of coffee?” asked Ron as the partners quickly arrived at Ron’s office and entered, closing the door behind them.

“Yes, thanks. Business is good, Ron, but we do need to talk about things and plan for the future, which is the purpose of my visit of course” mused Mike.

“Here’s your coffee. Let’s sit down and get the ball rolling,” said Ron as he settled in to his high-backed chair and leaned forward stretching his arms in front of him, placing his elbows on the desk, and resting his chin on his crossed hands. “This year I will mark fifty years in the oil business. It has gone very fast,” Ron observed. “As we enter retirement age, we should discuss our exit strategies and plan for our own future and the future of our employees. We have some very loyal employees. One employee has been with us since the first year (1981) that we opened and we have several others who have worked fifteen to twenty years for us. They all do an excellent job."

"Yes, I agree, Ron. We have some great people in both sides of our business and I would like to do something for them," Mike concurred. "We came so close with the sale falling through at the last minute a few months ago. It may be difficult to find a buyer willing to keep all of our employees on. Buyers do not like restrictions in purchasing a business."

"We do have several options available to us, namely we can sell our business to outsiders or we could sell it to insiders. As we know from our first attempt, selling our business to outsiders is not a simple task. Finding an interested buyer that is willing to pay a decent price is not easy. It requires us to let go of the control of the company all at once and may limit our ability to maintain employment for our employees," offered Ron. "I have a close circle of trusted managers on my side and I know you have something similar on your side of the company."

"Yes, we both have our trusted top management teams. I know that in your case those people are not family members. In my case, my daughter works for us, but the rest of my top management team is not family," replied Mike.

"As far as my family goes, I have a son who works off-shore, but he is not in the top management team. Also, I have a grandson, who is very bright and promising and is working his way up through the management ranks here in Gibson. Nick has just finished his degree at Nicholls and has been working with us only a few years. If I give him some more time and seasoning, Nick may be ready to step up into a top management role," explained Ron. "Sometimes, I am a little harder on my family than everyone else because I hold them to a higher level. I expect more out of them to show that they deserve to be part of the team. I want to build the business even though several of our key people are getting older, including me. Of our three key guys, one is fifty and the other two are sixty. After I retire, they could easily form a top management team and include our involved family members as well. The future for this business is not as bright as it was when I got into it fifty years ago, but there is still oil to be found offshore and out west."

"I can see that our situation is quite complicated and that there is no clear-cut, easy way out," Mike agreed. "If we encourage the formation of a top management team including our involved family members, we could direct and control the transition of ownership. There are three possible financial vehicles to manage this transition: a sale for cash plus a note, a leveraged buyout, or an employee stock ownership plan (ESOP). In the first option, we would get some money for our retirement upfront, but we would rely on the business to buy us out over time through the repayment of a note that we hold. In the second option, our employees would borrow money from a financial institution and pay us off immediately when we decide to retire. In the third plan – the ESOP – we gradually sell the stock of our company to our employees over time as we remain in control of the business until the employees purchase a controlling interest."

"It does appear that we have some real options besides just a straight sale to outsiders," Ron remarked. "Let me broach one other subject to consider. We have always felt that keeping the two sides of the company together in one overall business was the best thing for us. Do you think we should consider splitting the company in order to sell the two sides more easily?"

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Biographies

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