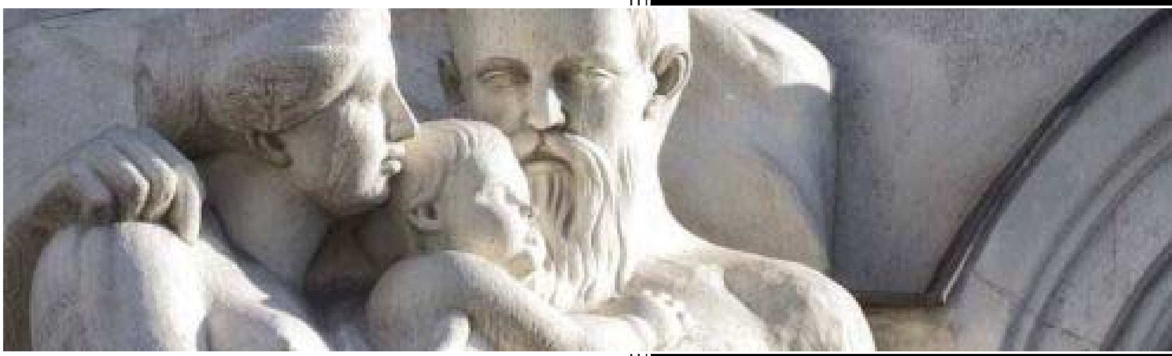
Value creation in listed European family firms (2001-2010)



BANCA MARCH
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EXECUTIVE SUMMARY

Dear reader,

Over the last few years we have been experiencing the worst economic recession since the end of the Second World War and even today there is no end to it in sight. In these difficult times many people are affected by the serious consequences of this crisis, yet it is also true that major changes are taking place in the economy and new opportunities are emerging for investors who take a long-term approach.

Here at Banca March we are committed to supporting the major contribution made by family businesses to creating value and jobs. This is why we have created *The Family Businesses Fund* for our customers, a global equity fund that only invests in listed family firms. The fact that Banca March is also a family business with over 100 years of history behind it puts us in a unique position to understand the dynamics of these businesses, which in our experience tend to be much more profitable in the long term.

We also decided to combine Banca March's experience with the academic prestige of an institution like IE Business School which is internationally recognised for the support it gives to entrepreneurs and family businesses. The result of this partnership is this first **Banca March-IE Business School** report, one of the most comprehensive studies about family businesses to have been conducted in Europe in recent years.

We hope that you will find it interesting and informative.

Yours faithfully,

José Luis Jiménez Guajardo-Fajardo

General Manager, March Gestión

March Gestión is the "boutique" fund management company of Banca March. With more than EUR 1,.9 bn of AuM and a team of 25 professionals, Its investment philosophy combines long-term value creation with wealth protection. Global Equity and Asset Allocation are the "core competences".

Banca March is one of the largest Spanish financial groups with one of the highest solvency ratios in Europe (Core Capital of 21%). It has been ranked nº ! In the banking stress test and has won the Best Private Bank award in Spain in 2010, 2011 and 2012 by World Finance . It is a family-owned institution with a heavy focused on Wealth Management, Corporate Banking and Fund Management.

IE Business School shapes leaders that promote innovation and change in organisations, equipping directors with an entrepreneurial mindset that generates employment, wealth and social wellbeing. Recognised as one of the world's leading business schools, IE Business School has an urban campus in Madrid and a faculty of more than 400 professors who teach students from 93 countries on its master, PhD and executive education programs. IE students use innovative online and presential learning formats, including the IE Communities platform where they exchange knowledge and experiences with 40,000 IE graduates that currently hold management positions in some 100 countries.

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CRISTINA CRUZ, Professor of Entrepreneurial Management and Family Business, IE Business School

Cristina Cruz holds a PhD in Economics and Quantitative Methods from Carlos III University, an Executive Development program qualification in Family Business from the Instituto de Empresa, a BA in International Economics from Manchester University and a degree in Economics from Murcia University.

The results of her research, which focuses mainly on entrepreneurial management and family business, have been published in leading international academic journals including the *Academy of Management Journal*, *Administrative Science Quarterly*, *Journal of Business Venturing* and *Entrepreneurship Theory and Practice*. Her academic work has been internationally recognised on numerous occasions. For example in 2009, her article entitled Socioemotional wealth and Corporate Response to Institutional Pressures: Do Family-Controlled Firms Pollute Less? received the Best Paper Award in the Corporate Governance Division at the European Academy of Management Conference. In recognition of this research work, IE Business School gave her its Research Excellence Award in 2010, a prize that the school presents to its best researchers.

Professor Cruz brings the results of her research to the classroom, where she instils in future generations the need to preserve and pass on entrepreneurship in business families. Her teaching on MBA courses and in Executive Education is always highly rated by students and internationally recognised as well. In 2011 she was one of the lecturers selected by the Family Firm Institute (FFI) to present their innovative teaching methods in family business issues at the Family Business Research & Education Symposium. She is also the author of numerous cases studies involving successful family entrepreneurs and businesses.

LAURA NÚÑEZ LETAMENDIA, Professor of Finance, IE Business School

Laura Núñez has a degree in Economics from the Autonomous University of Madrid and a PhD in Finance (specialising in Banking and the Stock Exchange) from the same university. Her doctoral thesis about investment in listed companies was given an award by the Caja Madrid Foundation.

She began her career working as a financial market analyst and portfolio and fund manager at Bestinver SVB, GVC SVB and Norwich Union. She then joined the IE Business School where in addition to teaching on various programmes (MBA, Executive MBA, LLM, PhD, DBA and MiM) she also served as Director of Research from 2001 to 2007. In recent years she has been a Visiting Scholar at Bentley University in Boston and has done specialised courses at Harvard Business School.

Her research is mainly into capital markets and investment and risk management as well as improving quantitative analysis techniques. One of the issues she is passionate about is using artificial intelligence techniques to select stock market, financial and economic indicators in order to anticipate market movements and limit risk. Her research has been funded by competitive public programmes such as the EU Framework Programme and Spain's National R&D Plan, and her findings have been published in international journals with anonymous peer review and recognised impact in the *JCR* (*Journal Citation Report*), *Energy Policy*, *Soft Computing*, *IMA* ***Journal of Management Mathematics*****,** *Computational Statistics & Data Analysis*, *European Journal of Operational Research*, *Int. J. Data Mining, Modelling and Management* and *Managerial Finance*, as well as in international books (*Studies in Computational Intelligence* - Springer 2012, *Lecture Notes in Computer Science* - Springer 2012) and domestic journals.

VALUE CREATION IN LISTED EUROPEAN FAMILY BUSINESSES

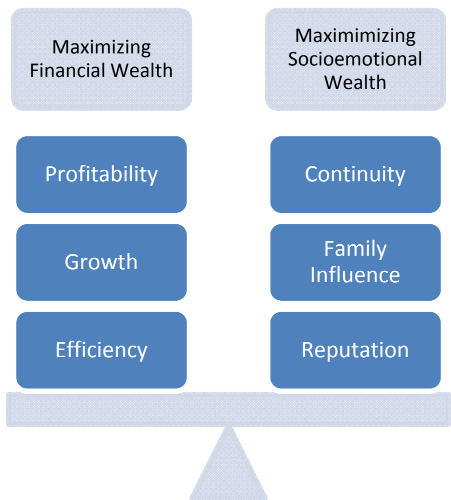
The importance of family businesses is undeniable. Although results vary depending on what is meant by family business, statistics show that they account for 50-80% of GDP in most economies.[1] Yet despite this importance, there are no conclusive findings about the relationship between family businesses and value creation. Against this backdrop, this first BANCA MARCH-IE[2] study is a major contribution to the analysis of this relationship. This is because it takes a new and more complete approach than previous studies in this field by covering both a larger number of indicators and also a longer time frame that makes it possible to examine the long-term creation of value.

The study sample consisted of a total of 2,423 companies listed on various European stock markets during the period 2001-2010.

What is a family business?

The BANCA MARCH-IE report defines a family business as one in which an individual or family holds at least 20% of the company's shares and at least one family member is on the Board of Directors.

- The key differentiating factor about family businesses is the fact that profit maximisation (financial wealth) in these organisations exists side-by-side with achieving other non-economic objectives (socioemotional wealth) which are important to the owner family.
- The family interest in achieving these non-economic objectives can have positive effects (e.g., greater commitment and long-term vision) and also negative ones (nepotism, conflict of interest with other shareholders or resistance to change) which affect value creation.



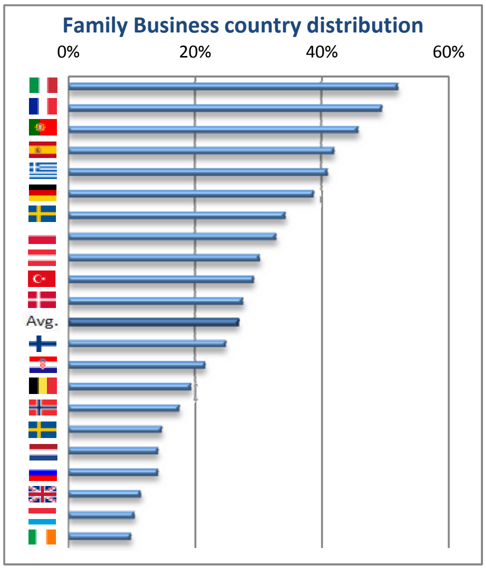
[1] Figures from the Family Firm Institute website www.ffi.org

[2] The complete BANCA MARCH-IE report can be downloaded from: http://entrepreneurship.blogs.ie.edu/2012/06/19/la-creacion-de-valor-en-la-empresa-familiar-cotizada-europea/

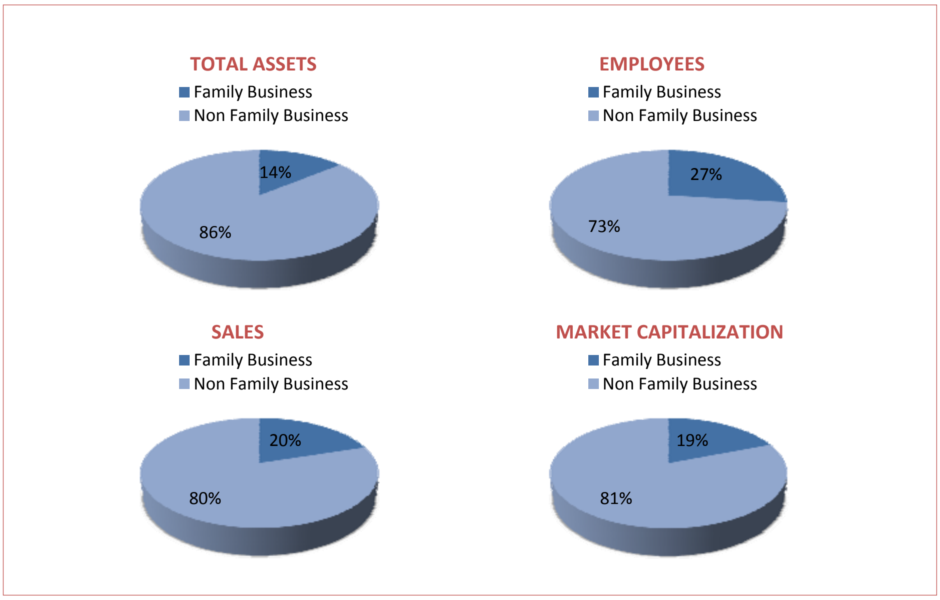
MAIN FINDINGS OF THE STUDY

What is the profile of listed European family businesses?

- **27% of listed European companies with over €50 million in market capitalisation are family firms**, although this percentage varies between countries. Italy has the highest proportion of listed family businesses compared with non-family firms (52%), followed by France (49.6%), Portugal (45.83%) and Spain (42.11%). At the opposite extreme are the UK, Luxembourg and Ireland where these firms make up barely 10% of total listed companies.



- **Family businesses are smaller than non-family firms. However, the average number of employees is similar in both types of enterprises.** In fact while family firms account for less than 20% of assets, sales and market capitalisation, they provide 27% of jobs in listed companies.

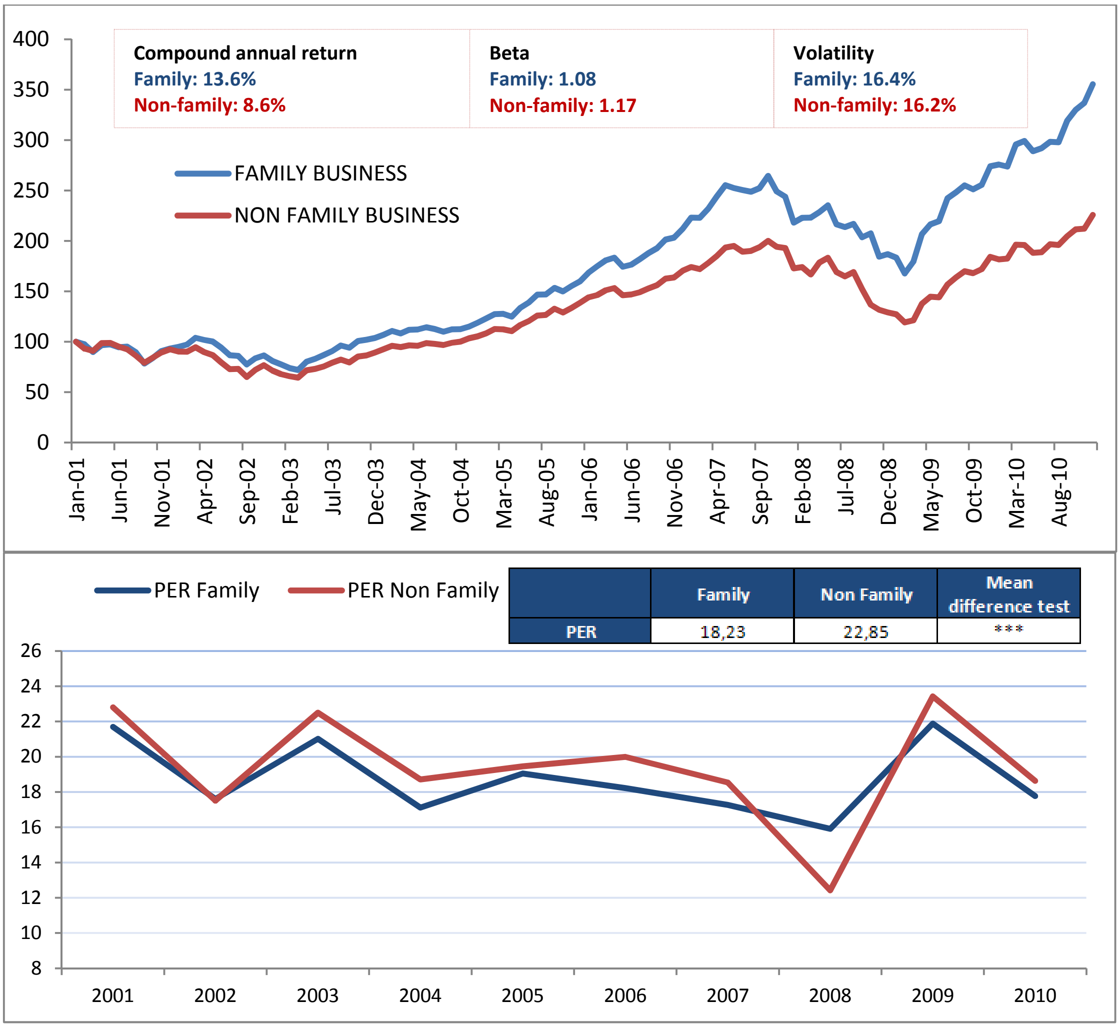


- **Family businesses are older** (average age of 60 years versus 43 for non-family firms). 20% of family businesses are over 100 years old.

Did listed European family businesses create more value for shareholders in the last decade (2001-2010)?

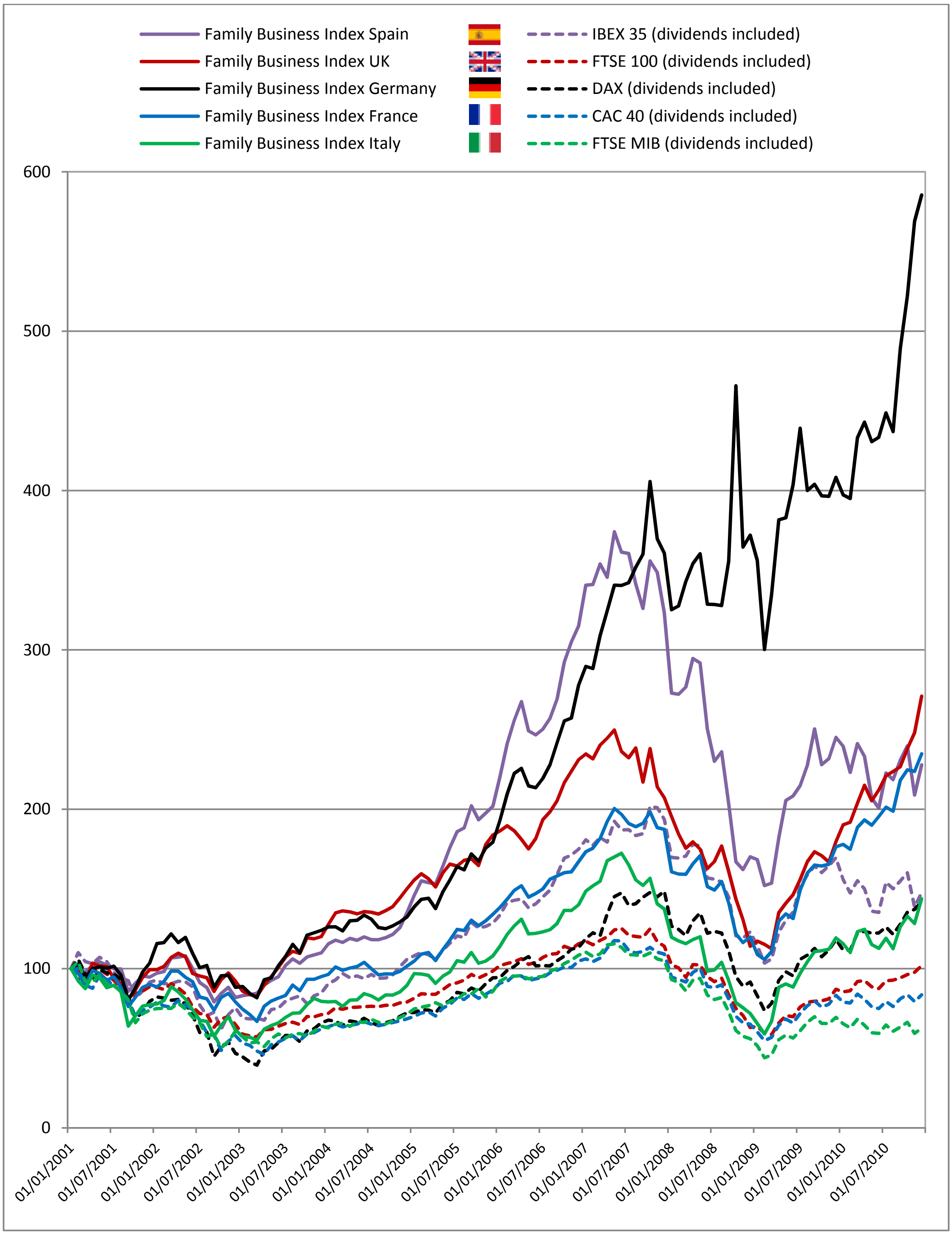
- **Family businesses do better than non-family firms in stock return**: €1,000 invested in 2001 in the market capitalisation-weighted portfolio of listed family businesses in Europe would have generated €3,533 by the end of the decade compared to €2,241 produced by the portfolio of non-family firm. This is 500 basis points of additional income per year.
- **Family businesses had a lower market risk than non-family firms**: the beta estimated for family businesses was lower than the beta for non-family firms.
- **Family businesses are quoted at a discount:** in spite of this greater return, family firms were still trading at a discount in 2010 compared to non-family firms, with lower PER values throughout virtually the entire period.

Trend in the stock return index and PER (2001-2010)



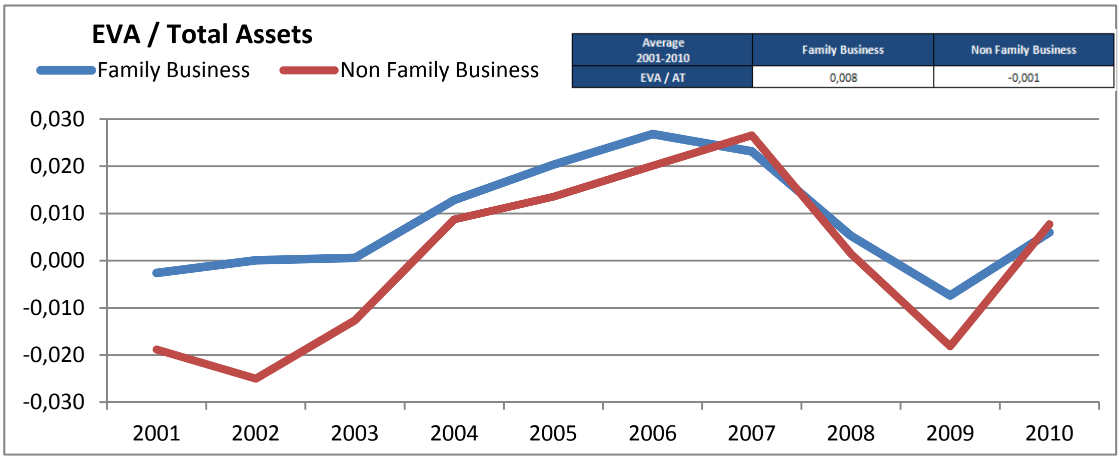
- **Family businesses outdo their local stock market indexes:** in all the countries examined family firms achieved much higher returns than local indexes did at similar or even lower risk levels. The biggest difference in return was attained by German family businesses compared to the DAX, their national benchmark index.

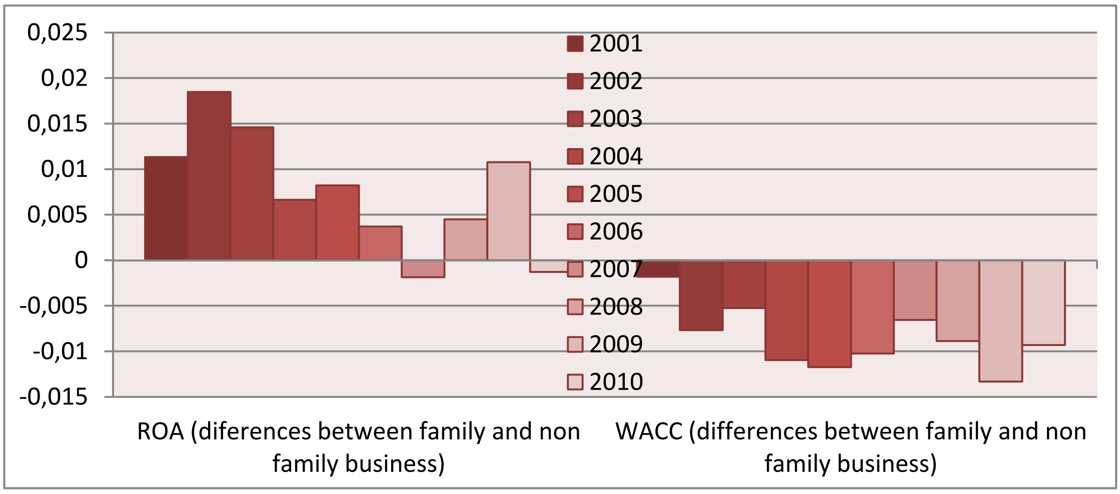
Return rates of listed European family firms by country compared to local indexes (2001-2010)



- **Family businesses create value while the rest of the market destroys it:** if we measure value creation through the EVA[3] generated by a company for each unit of assets employed in its business, the data show that over the last decade family businesses created value while non-family firms destroyed it. This was due to a combination of two factors:
    - **Family businesses can generate more profit from their assets**. Family firms achieved a much higher return on assets (ROA) than non-family businesses over the course of the decade.
    - **Family businesses can gain access to financing at a lower cost**. The weighted average cost of capital (WACC) of family businesses was lower than for non-family firms, as both the interest they pay on their debt and their cost of equity are lower.

Trend in EVA and differences in ROA and WACC



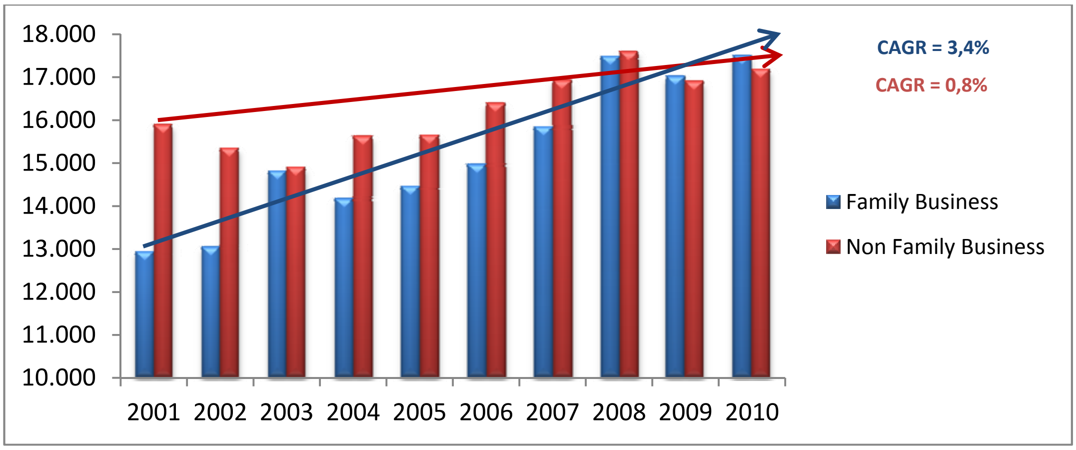


3 Economic Value Added or EVA shows the value created by companies in their operating profit in excess of the required return of the company's investors, i.e. shareholders and debt holders.

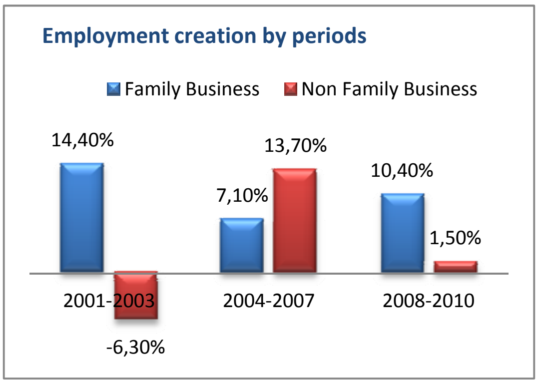
Did listed European family firms generate more value for other stakeholders in the period 2001-2010?

- **Family businesses created more jobs than non-family firms during the period 2001-2010.** The annual compound average growth rate (CAGR) of the average number of employees over the period was 3.4% for family firms and 0.8% for non-family enterprises.

Trend in the average number of employees: family versus non-family firms



- **Family businesses created more jobs in the downturns in the business cycle**. Over the last decade, job creation by family businesses was higher in downturns than in upswings. By contrast, non-family firms only created jobs during upswings while they cut them or these remained virtually stable in downturns.



- **Family businesses had much higher average labour productivity than non-family firms in the period reviewed** (€1.58 million compared to €0.16 million for non-family firms) and significantly lower wage costs throughout the period.

- Family businesses are less capital intensive but **their compound average growth rate for PP&E was significantly higher over the decade than for non-family firms** (8.7% CAGR in family businesses versus 3.03% in non-family firms).

What sets apart the 100 family businesses that created most value for their shareholders (top 100) in the period 2001-2010?

- **Germany has the most top 100 companies (24%) followed by France (16%) and Switzerland (10%).** 6% of these companies are Spanish.

Ranking of family firms with greatest return 2001-2010

Ranking	Company	Average annual return	Average annual volatility
1	ALCHEMIA S.A.	48.758%	1.356
2	FUCHS PETROLUB AG	38.533%	0.309
3	FAIVELEY TRANSPORT	37.555%	0.451
4	MULBERRY GROUP PLC	35.302%	0.548
5	PUMA SE	34.613%	0.377
6	KABE HUSVAGNAR-B	33.215%	0.376
7	PINAR SUT MAMULLERI SANAYII A.S.	32.388%	0.653
8	ANGLO-EASTERN PLANTATIONS PLC	31.936%	0.350
9	BIJOU BRIGITTE MODISCHE ACCESSORIES AG	31.633%	0.335
10	KOPEX S.A.	31.598%	0.680
RANKING OF SPANISH FAMILY BUSINESSES IN THE TOP 100			
13	**PRIM S.A.**	**30.916%**	**0.629**
16	**DURO FELGUERA SA**	**28.138%**	**0.329**
61	**OBRASCON HUARTE LAIN S.A.**	**18.247%**	**0.396**
64	**VIDRALA SA**	**17.785%**	**0.239**
77	**PROSEGUR COMPANIA DE SEGURIDAD S.A.**	**15.994%**	**0.239**
94	**CIA ESPAÑOLA VIVIENDAS EN ALQUILER SA**	**14.056%**	**0.155**

- **The family businesses that created most value for their shareholders were smaller than the rest of family firms.** On average, the market capitalisation of these top 100 companies was €1.2 billion compared to €2.1 billion for the rest of family firms.
- **The family businesses that created most value for their shareholders were older companies.** 60% of the companies were over 50 years old and only 10% were under 25. The average for the top 100 companies is 81 years compared to 60 for all family firms.
- **The family businesses that created most value for their shareholders were companies that had already weathered the generational handover.** However, there is again the paradox that companies where the founder still served were traded at a premium in the markets compared to other family concerns.
- **The family businesses that created most value for their shareholders were companies in which the Chairman of the Board was a member of the family and the CEO was hired.**

CONCLUSIONS

The study findings leave no room for doubt: **listed European family businesses created more value for their shareholders during the period 2001-2010.** When controlled for other factors that might affect value creation in all its aspects, such as size, debt level, risk and sectoral distribution, these results clearly point to the existence of a "family effect" which has a positive impact on creating long-term value for shareholders in the case of listed European companies.

- This "family effect" would indicate that the positive effects of family ownership (reflected for example in the existence of lower agency costs, a greater commitment by shareholders and employees to the business project and a longer term vision) easily outweigh the negative effects of a possible conflict of interest between the goals of the family and those of other minority shareholders. The fact that it is a sample of listed companies undoubtedly reinforces this effect, since these firms are subject to strict reporting, monitoring and control requirements and there is the possibility of liquidity being provided to minority shareholders.

- Furthermore, our findings suggest that the long-term vision of family owners means they can undertake investments which have long maturity periods and isolate family firms to some extent from employment and investment adjustments over the business cycle. In fact, not only did these firms create more jobs in the period under review but they were also a kind of insurance policy since despite falling sales they maintained and even created jobs during economic slowdowns. The existence of this "implicit insurance" might explain the higher labour productivity and lower wage costs of family businesses.

- In view of our findings, it is very surprising that family businesses were traded at a discount compared to non-family firms throughout the period and were still undervalued in 2010. This lower valuation would indicate that the market is discounting the possible expropriation of minority shareholder income by the family. It is true that in most cases families want to control the companies they have founded and also want to maintain this family control over the generations, designing governance mechanisms that limit the influence of other shareholders to that end. What is not true in view of the findings of this report is that in doing so they are destroying value. On the contrary, at least in the period studied minority shareholders achieved much more value as shareholders in a family business. Furthermore, not only shareholders but also other stakeholders such as employees, suppliers and customers benefited from the long-term management of these companies. Is this therefore an instance of market failure?

- This negative market bias against family firms is also evident when analysing the effect of the presence of the founder on value creation. Again, the findings show that in spite of creating more value in the long term in all the aspects examined, companies in which there has been at least one generational handover are traded at a discount compared to other family-controlled firms. Perhaps too much importance is attached to succession conflicts in well-known family businesses that are often aired in the media or the oft-repeated statistic that only about 4% of family businesses survive beyond the third generation. At any event, this is not the case of listed European family businesses, 20% of which are over one hundred years old and are also often the most profitable.

- Finally, the findings also show that family involvement in the management of a company influenced value creation, although this involvement should be qualified. If the Chairman of the Board of Directors was a family member this enhanced the positive impact of the "family effect" on value creation by strengthening the company's image and the family's commitment to the business project. However, these benefits were not as obvious when it comes to the Chief Executive Officer since family firms that hired a CEO created more value for their shareholders.