BANCA MARCH-IE STUDY

The "family premium" in listed European businesses:

Is it really a consequence of the family dimension of the company?

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EXECUTIVE SUMMARY

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MARCH GESTIÓN:

March Gestión (MGF) is Banca March's asset manager. With over €4 billion and a team of 30 professionals, its investment philosophy involves creating value while protecting wealth. Its main areas of expertise are global equity and asset allocation. MGF has received numerous awards for its management over recent years.

BANCA MARCH:

Banca March is one of Spain's leading financial groups. It is totally family-owned, specialises in private banking, corporate banking and asset management, and has one of the highest solvency ratios in Europe. In 2010 and 2011, it was No. 1 in the European banking stress tests, according to the Committee of European Banking Supervisors. Banca March was named Spain's Best Asset Management and Wealth Management bank in 2013, by Global Banking & Finance International; Best Private Bank 2013 in Spain by the British magazine, World Finance, for the fourth year running, and best European Private Bank in 2013, by International Alternative Investment Review (IAIR).

IE BUSINESS SCHOOL:

IE Business School trains leaders who go on to promote innovation and change in organisations. Recognised as one of the world's leading business schools, IE Business School has an urban campus in Madrid as well as centres on all five continents. It has a faculty of more than 400 professors who teach students from 93 countries on its masters, PhD and executive education programmes. IE Business School develops online and classroom learning methods which benefit the School's network of communities, made up of 40,000 graduates holding positions of responsibility in more than 100 countries.

Dear Reader,

It is my pleasure to introduce the 2nd Banca March - IE Business School Family Business Report. As a family bank with over 100 years of history behind it, and a habitual investor in other family businesses, the findings of this study are really quite striking, because they are so positive.

Hence, the publication of this report makes us doubly proud. Firstly, because we can do justice to all those family businesses around the world whose efforts and commitment generate jobs and wealth, even in tough times like the ones we are facing today, due to the economic crisis. Then, secondly, because as investors in internationally listed family firms, The Family Businesses Fund we run has shown that these firms are a very profitable investment, with a cumulative return of over 30% in the two years since the product was launched, and we are convinced that that it will become one of our most profitable long-term funds.

I would also like to take this opportunity to acknowledge the excellent research by IE Business School professors, Cristina Cruz, and Laura Nuñez, without whose effort and dedication we would not today know a little bit more about the intriguing mystery of the greater long-term profitability of family businesses.

We hope that you will find this report both interesting and informative.

Yours faithfully,

José Luis Jiménez Guajardo-Fajardo
Chief Executive Officer, March Gestión.

The "family premium" in listed European businesses

The findings of the 1st Banca March-IE Report[1] left no room for doubt: listed European family businesses generated higher stock returns in the period 2001-2010 and achieved a much higher return on assets (ROA) in addition to providing greater value in other aspects such as job creation and greater stability in times of crisis.

In spite of the cogency of these findings, the study posed numerous questions about the factors determining the existence of this "family premium" among listed European companies. Many of these questions were raised by readers of the 1st Banca March-IE Report.

They were investors, portfolio managers, family owners and many more people who, given the clear evidence of family businesses' greater ability to create value, wondered whether this "family premium" was actually due to the positive effects of family control, or alternatively the outcome of other factors which had nothing to do with the family dimension of the company.

The 2nd Banca March-IE Report seeks to answer this question by examining the impact of these "other factors" on the profitability of listed European family businesses. Specifically, the study answers the following questions:

- Are the higher stock returns generated by European family businesses compared to non-family businesses a form of compensation for taking higher risks?
- Does the competitive environment in which family firms operate affect their profitability? Is the success of family businesses uniform across all European countries? And in all sectors?
- Do the specific features of family businesses, such as their smaller size, explain their higher profitability?
- Is the "family premium" the same for all family businesses? Are there any differences in terms of the percentage of shares held by the family? How does the presence of its founder affect the risk-return of a family business?
- And what does the market think? How does it value FBs compared to NFBs? And the different types of FBs?

The study uses the same definition of family business as in the 1st Banca March-IE Report[2] and the same universe of companies[3]. In order to tackle the questions posed we have added new variables of interest and limited the sample to countries with a sufficiently representative number of companies. This gives us a final sample which provides much more accurate and detailed information.

- The sample only includes countries with at least 50 listed non-financial companies.
- We introduced new risk indicators, making a distinction between economic, solvency, market and liquidity risk.
- We compiled data on the exact percentage of ownership held by the family during each of the 10 years considered to analyse the effect of family ownership on risk and return.
- We analysed family businesses individually to draw a distinction between family firms in which the founder is present from those companies that have already weathered the generational handover.

Final sample of the 2nd Banca March-IE Report

- 6 countries: United Kingdom, France, Italy, Spain, Germany and Switzerland.
- 832 businesses: 31% (255) family and 69% (577) non-family.
- 10-year time horizon. Period 2001-2010.

[1] Cruz, C. and Nuñez, L. 2012 "Value creation in listed European family firms 2001-2010".
http://entrepreneurship.blogs.ie.edu/2012/06/19/la-creacion-de-valor-en-la-empresa-familiar-cotizada-europea/

[2] A family business is 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.

[3] 3 All "non-financial" companies listed on European stock markets with more than €50 million in market capitalisation in 2010.

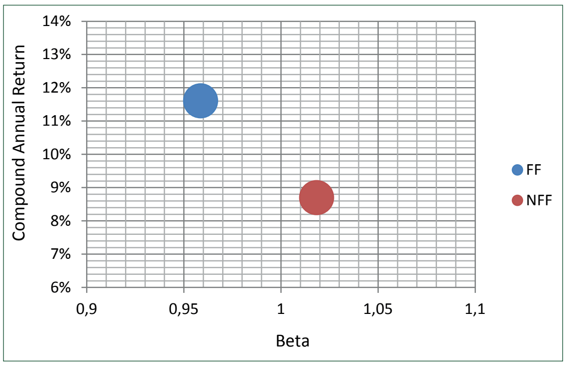
Are the higher returns generated by a family business a form of compensation for taking higher risks?

NO. The "family premium" still exists even after taking into account the various risks associated with investing in family businesses.

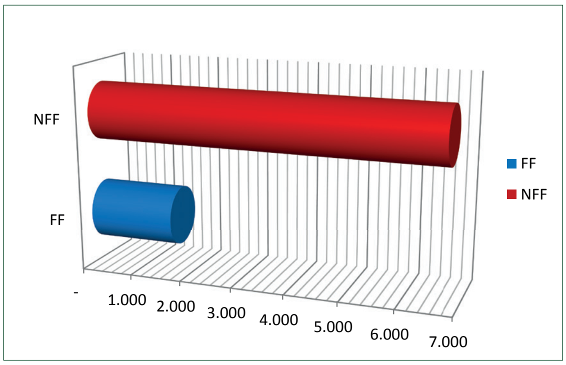
- FBs provide greater ROA than NFBs and their annual stock return was 300 basis points above NFBs on average over the period 2001-2010.
- FBs have lower insolvency (lower probability of bankruptcy), economic (less volatility in their results) and market (lower beta and price volatility) risks than NFBs.
- The only risk which is greater with FBs than NFBs is the liquidity risk (average annual volume traded in EUR million). However, our statistical analysis indicates that this greater risk is not enough to justify the existence of the "family premium".

Company	Country
Fuchs Petrolub	Germany
Faiveley Transport	France
Mulberry Group	United Kingdom
Puma	Germany
Anglo-Eastern Plantations	United Kingdom
Bijou Brigitte Accessories	Germany
Elringklinger	Germany
Compugroup Medical	Germany
Prim	Spain
Audi	Germany
Average Annual Return Top 10 FF	37,13%
Average Annual Return FF	11,61%
Average Annual Return NFF	8,70%
Average Annual Return per unit of risk Top 10 FF	1,03%
Average Annual Return per unit of risk FF	0,21%
Average Annual Return per unit of risk NFF	0,12%

Top 10 highest return family businesses 2001-2010



Average FB risk-return compared to NFBs 2001-2010



Average liquidity (average annual volume traded in EUR million) 2001-2010

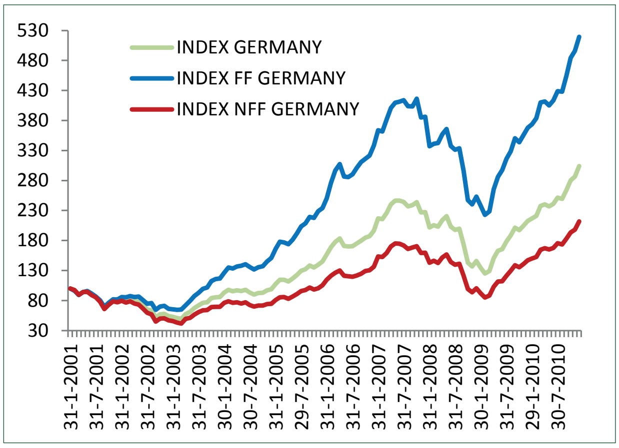
Is the success of family businesses uniform across all countries?

NO. The "family premium" exists in all the countries studied, but the difference in return between FBs and NFBs varies greatly from one country to another.

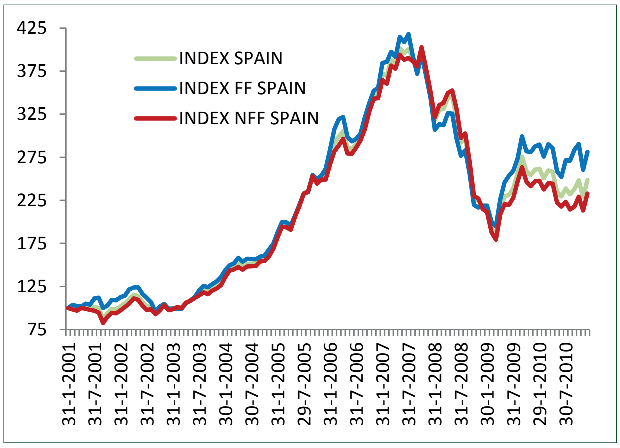
- In Germany, FBs clearly outperform NFBs in stock returns, obtaining 1,000 basis points more per year on average, followed by the United Kingdom where this difference is 600 basis points per year. At the other extreme is Switzerland where the differential is only 9 basis points, but once again in favour of FBs.
- These greater stock returns of FBs are not compensation for higher market risk. In fact, in Germany and the UK, the countries where FBs are clearly more profitable than NFBs, the market risk of FBs is lower than it is for NFBs.
- In all the countries in the sample, FBs present lower insolvency risk and higher liquidity risk than NFBs. However, our findings for market and economic risk vary by country.

Company	Country
Fuchs Petrolub	Germany
Puma	Germany
Bijou Brigitte Modische Accessories	Germany
Elringklinger	Germany
Compugroup Medical	Germany
Average Annual Return Top 5 FF Germany	33,36%
Average Annual Return Spread FF vs. NFF Germany	10,29%
Average Annual Return Spread FF vs. NFF Total Sample	2,91%

Top 5 highest return German family businesses 2001-2010



German FB, NFB and market stock indexes



Spanish FB, NFB and market stock indexes

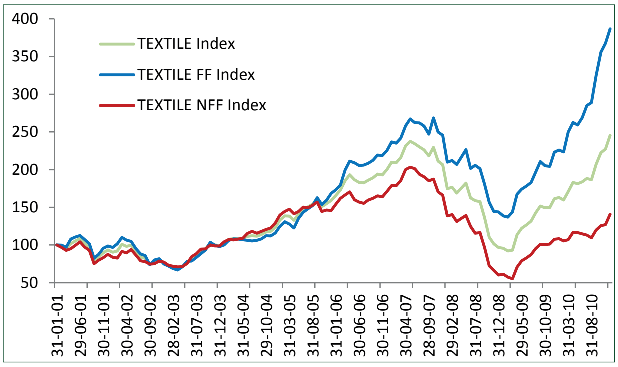
Is the success of family businesses uniform across all sectors?

NO. The "family premium" does not exist in all the sectors analysed. Nonetheless, in those sectors in which FBs outperform NFBs, they achieve much higher differences in return.

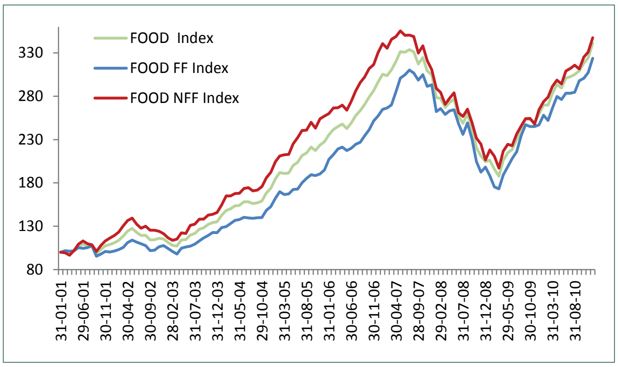
- The sector distribution of FBs and NFBs is not uniform. The sectors in which FBs predominate are ones with a medium-high ROA and lower than average risk (personal hygiene and perfumes, clothing and textiles, food, wood and paper, manufacture of machinery and transport vehicles, wholesale/retail and manufacture of computer products and electronics).
- FBs are not more profitable than NFBs in all the sectors where they predominate. However, in those sectors in which FBs outperform NFBs, they achieve much higher differences in return. The textile sector leads the way in which FBs earned 1,100 basis points of average return per year more than NFBs, despite having lower market, liquidity, and solvency risk, and similar economic risk. In the computer products, electronics and household appliances manufacturing sector, FBs also outperformed NFBs by 500 basis points per year with less risk in all respects, except for liquidity.
- The differences in all types of risk between FBs and NFBs are heavily influenced by sector distribution. There is no common pattern for all sectors.

Company	Country
Mulberry Group	United Kingdom
Gerry Weber International	Germany
Hermes International	France
Ted Baker	United Kingdom
Calida Holding	Suitzerland
Average Annual Return Top 5 FF Textile Sector	18,44%
Average Annual Return Spread FF vs. NFF Textile Sector	11,37%
Average Annual Return Spread FF vs. NFF Total Sample	2,91%

Top 5 highest return textile sector family businesses 2001-2010



Textile sector FB, NFB and market stock indexes



Food sector FB, NFB and market stock indexes

Is the smaller size of family businesses the reason for their higher return compared to non-family businesses?

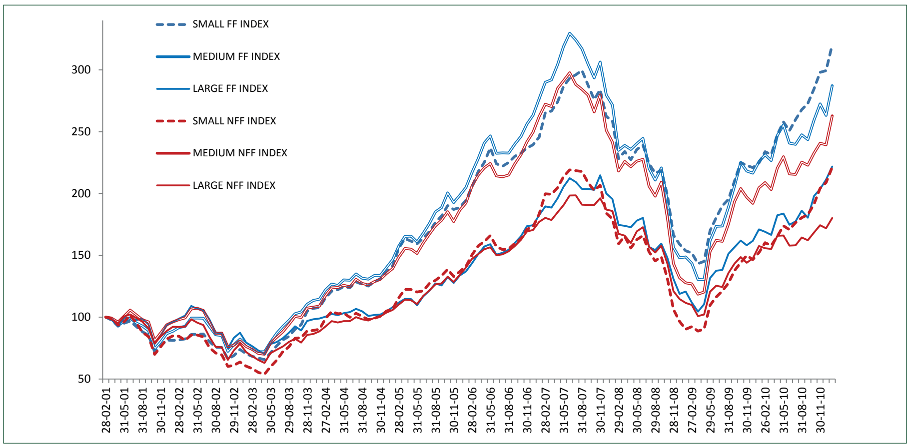
NO. The "family premium" exists irrespective of the size of the company but the differences in return between FBs and NFBs are larger the smaller the companies are.

- The percentage of FBs is higher in very small companies (less than €350 million in market capitalisation) where FBs account for almost 40%. However, only 18% of large listed companies (more than €3.3 billion in market capitalisation) are family firms.
- In all size segments, FBs are more profitable than NFBs, but the difference is greatest in the smallest companies, even though they have much lower market and economic risk than NFBs.

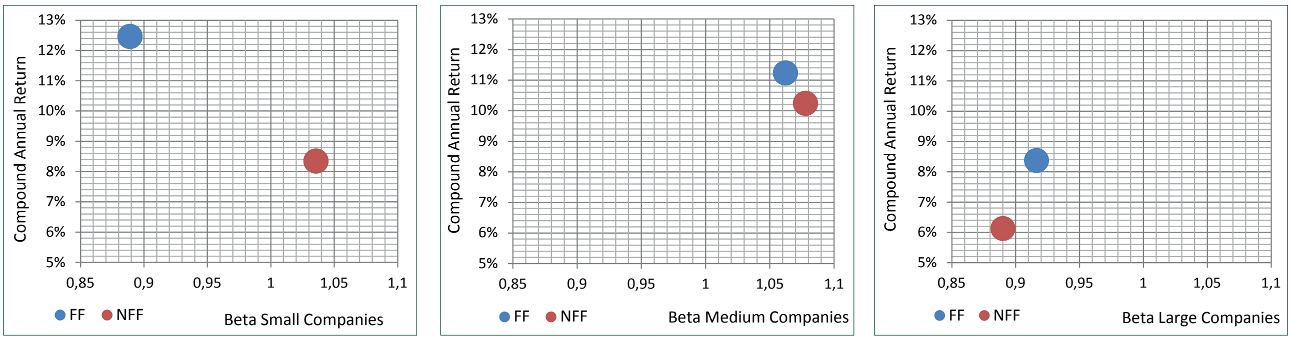
Companies < €350 mill. Market Capitalization	Country
Mulberry Group	United Kingdom
Anglo-Eastern Plantations	United Kingdom
Prim S.A.	Spain
James Halstead	United Kingdom
Hugli Holding	Germany
Average Annual Return Top 5 Small FF	29,97%
Average Annual Return Spread Small FF vs. NFF	4,20%

Companies > €3300 mill. Market Capitalization	Country
Audi AG	Germany
Kuehne & Nagel International	Germany
Schindler	Germany
Hermes International	France
The Swatch Group LT	Switzerland
Average Annual Return Top 5 Large FF	19,77%
Average Annual Return Spread Large FF vs. NFF	2,30%

Top 5 highest return family businesses by size 2001-2010



Market stock index by company size



FB versus NFB stock market risk-return by company size

Is the "family premium" the same for all family businesses irrespective of the percentage of shares held by the family?

NO. The percentage of shares held by the family has a positive impact on stock returns, but this relationship is non-linear.

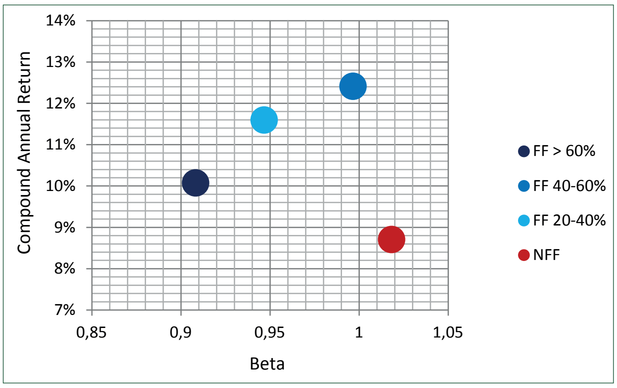
- The relationship between family ownership and stock returns has an inverted-U shape. In other words, the "family premium" is higher with increasing family ownership up to a point, beyond which the benefits of greater family control dwindle. This "optimal family control" point is around 40%.
- The risk-family ownership ratio is usually not linear either, showing an inverted-U shape for both economic and stock market risk and a U shape for solvency risk. The only risk factor that has a strongly positive linear relationship with family ownership is liquidity, as companies where family control is greater than 60% have the least liquid shares.

Family-owned companies 20%-40%	Country
Fuchs Petrolub AG	Germany
Puma SE	Germany
Prim S.A.	Spain
Average Annual Return Top 3	34,67%
Average Annual Return Spread FF 20-40% vs. NFF	2,89%

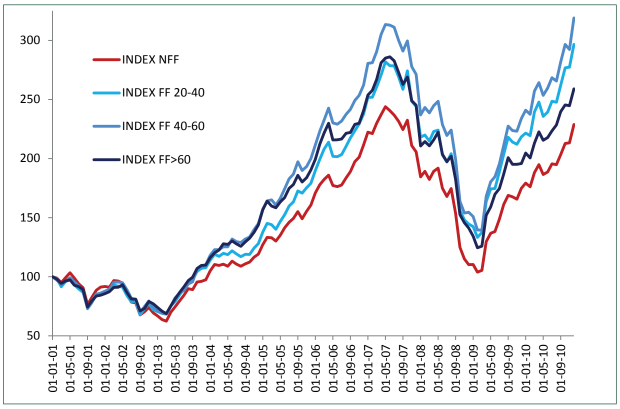
Family-owned companies 40%-60%	Country
Mulberry Group	United Kingdom
Anglo-Eastern Plantations	United Kingdom
Bijou Brigitte Modische Accessories	Germany
Average Annual Return Top 3	32,93%
Average Annual Return Spread FF 40-60% vs. NFF	3,71%

Family-owned companies >60%	Country
Faiveley Transport	France
Einhell Germany AG	Germany
Schindler	Germany
Average Annual Return Top 3	26,90%
Average Annual Return Spread FF >60% vs. NNF	1,37%

Top 3 highest return family businesses by family ownership 2001-2010



Market stock risk-return by ownership



Market stock index by ownership percentage

Does the presence of the founder affect the "family premium"?

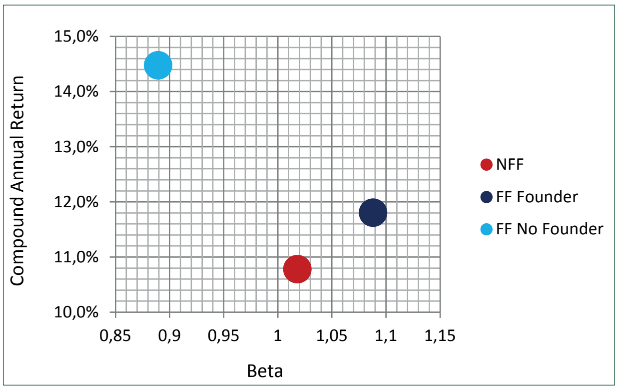
YES. The "family premium" exists for businesses where the founder is present and also for those which have already weathered the generational handover. However, there are differences in risk and return between the two types of family businesses.

- Family firms in which the founder was still present obtained significantly lower stock returns than businesses which had already overcome the generational handover (descendant firms).
- This is the case even though their economic, market and liquidity risk is greater. By contrast, their solvency risk is lower than for descendant companies.

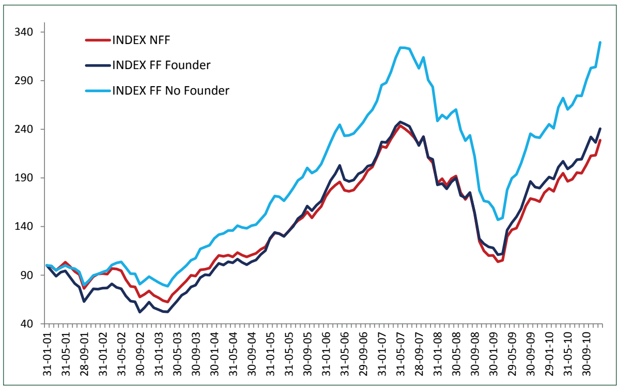
Companies with presence of the founder	Country
Compugroup Medical	Germany
Stratec Biomedical	Germany
United Internet	Germany
Gerry Weber International	Germany
Einhell Germany	Germany
Average Annual Return Top 5 FF with Founder present	24,90%

Companies in which the founder is not present	Country
Fuchs Petrolub AG	Germany
Faiveley Transport	France
Mulberry Group PLC	United Kingdom
Bijou Brigitte Modische Accessories AG	Germany
Elringklinger AG	Germany
Average Annual Return Top 5 FF without Founder present	34,80%
Average Annual Return Spread FF Founder present vs not present	-2,68%

Top 5 highest return founder and descendant family businesses



Market stock risk-return by presence of the founder

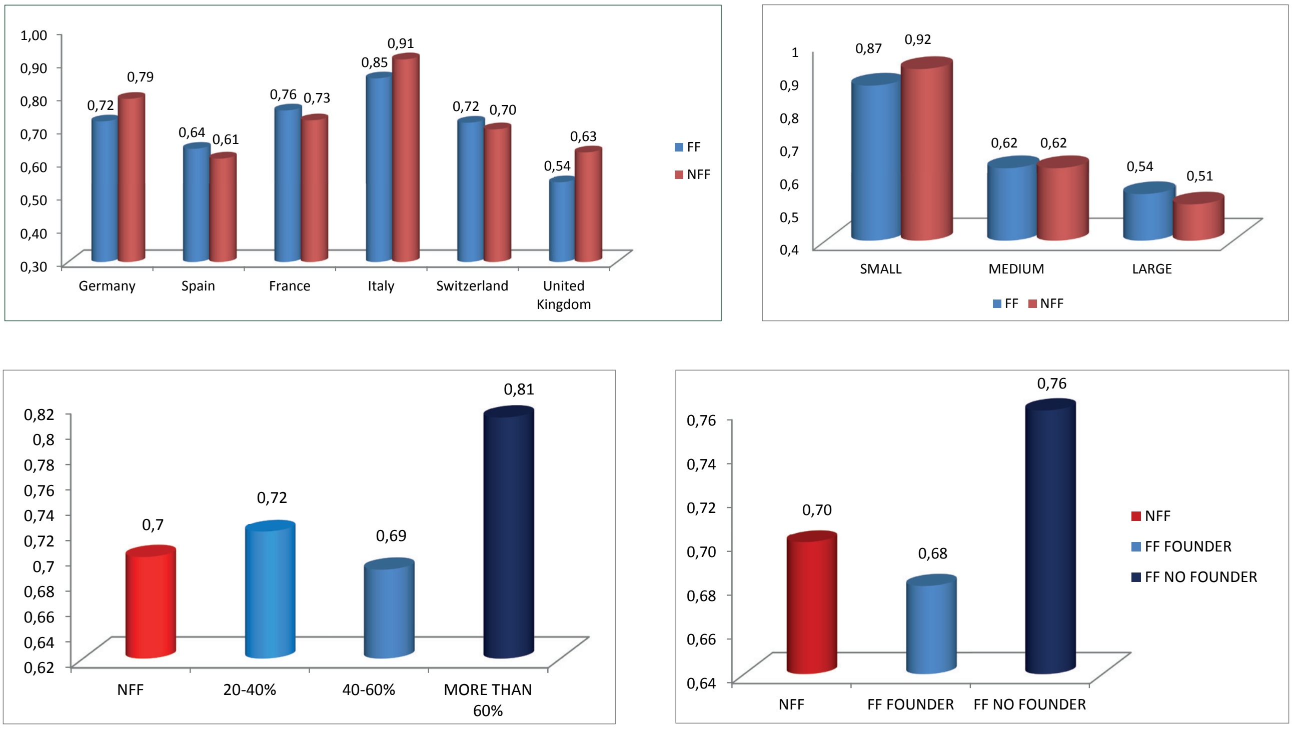


Market stock index by presence of the founder

And what does the market think?

FBs are valued lower in European markets than NFBs. However, these valuation differences are not independent of the context in which the companies operate, or their features.

- Company valuations are heavily conditioned by the market in which they are traded, as FBs are valued lower than NFBs in France, Spain and Switzerland, and valued higher in Germany, Italy and the UK.
- In terms of sectors in which FBs predominate, FBs are only valued higher in the textile sector where their book-to-market premium over NFBs is more than 0.50 (0.53 for FBs and 1.09 for NFBs).
- Differences between the valuations of FBs versus NFBs by size are minimal, although family firms are better valued when they are very small, and less valued than NFBs when they are large.
- The differences between family firms affect their valuation. Businesses in which the family owns more than 60% of shares are clearly undervalued compared to other family firms. Likewise, those in which the founder is no longer present are clearly penalised compared to the rest.



Valuation (book-to-market) of FBs and NFBs by country, size, family control and presence of the founder.

Conclusions

The findings of the 2nd Banca March-IE Report have significant implications when it comes to considering whether to invest in listed family firms:

I. There is a "family premium" on European stock markets: the "premium" of the long-term return of family businesses compared to non-family firms continues to exist, even when taking into account differences between the two kinds of companies that might affect their return (differences in terms of risk, the institutional and competitive environment, and company size). These results point to the presence of certain features associated with the control of a company by a family that determine the greater return of family versus non-family businesses. Thus, there is a "family premium".

II. The higher stock return of family business is not compensation for taking risks, as family businesses have lower risk. Family firms have lower levels of economic (ROA volatility), market (beta, and share price volatility), and insolvency (Altman Z-Score) risk than non-family businesses. The only area where FBs have higher risk levels than NFBs is liquidity risk, as the volume traded annually in these businesses is significantly lower. However, this greater risk does not justify the existence of the "family premium". Thus, the features associated with family control not only entail higher returns but also lower risk exposure for these companies.

III. The "family premium" is not independent of the sector, or of the country in which the firm is listed. This suggests that there are certain factors related to the competitive and institutional environment in which businesses are located, which would accentuate the advantages associated with family control:

i. In the case of sector analysis, listed family companies predominate in manufacturing sectors with low economic risk. This means that shares are more likely to remain in the hands of a family in less volatile environments, since, in them, the advantages of the greater stability in the management of human and financial resources traditionally associated with family control are more evident. This is reinforced by the fact that in these sectors, where family firms predominate, the three in which FBs clearly outperform NFBs in stock returns (clothing and textiles, manufacture of machinery and vehicles, and manufacture of computer, electronic and household appliance products) are more labour-intensive sectors, and call for longer-term capital investment. Hence, our findings suggest that management of the family business's "patient capital" is a competitive advantage in more stable sectors, where the human factor and longer investment horizons are more important.

ii. In the case of our country analysis, the fact that the "family premium" is much higher in countries such as Germany and the United Kingdom than in others, such as Spain and Italy, might indicate, as previously suggested in the 1st Banca March-IE Report, that the benefits of family control in listed companies are greater, the higher the transparency and efficiency of corporate governance systems in the financial markets of each country.

IV. The difference in return between FBs and NFBs is much greater in smaller listed companies. In other words, the benefits of family control are more obvious in smaller listed companies (those with less than €350 million in market capitalisation). These are family businesses which are usually unknown to the general public, yet are leaders in their sectors, focusing on a niche strategy, with an extensive presence in international markets. These companies seem to combine the best of two worlds. Their (relatively) smaller size affords them greater independence and flexibility to adapt to changes in the environment, and also entails a greater influence of family values and culture in the management of the company. At the same time, their presence in capital markets provides them with access to resources and more professional management.

V. There is an optimum point in family ownership at which the benefits associated with family control begin to disappear. This optimum point is when a company is around 40% family-owned. This suggests that there should be a "balance" between family and market ownership, in order to avoid the risks associated with the possible expropriation of other minority shareholders' income that may occur when family control is high.

VI. The "family premium" is not due to the higher return of family firms in which the founder is present. Indeed, the return of these companies is lower than that of those which have gone through at least one generational handover and which also have lower associated risk. Thus, the benefits of family control become more apparent as the generations pass.

VII. The market does not adequately value this "family premium". Family businesses are clearly penalised and those which have already completed at least one generational handover even more so. **In terms of valuation, there is, thus, actually a "family discount"**.

Cristina Cruz

Professor of Entrepreneurial Management and Family Business, IE Business School

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

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