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and the world's foremost experts



The Family
Business Model

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Introduction

There has been considerable research into family-owned businesses to establish whether there is a positive correlation between close corporate ownership and company performance. To date, there are no definitive findings although most reports tend to find positive benefits. Studies are typically limited to single markets and relate to different time periods so that an overall, broad conclusion is hard to establish. With the CS Family 900 Universe introduced in this report, we look to further the findings from a number of previous Credit Suisse research reports into family businesses, specifically the Credit Suisse White Paper 01 “Family Businesses in Europe: Growth Trends and Challenges” February 2007, “The Life-Cycle of UK Family Businesses” July 2008, “Credit Suisse Research Institute’s Asian Family Businesses Report 2011” and “Family businesses: Sustaining Performance 2012” and focus on whether there is a business case for family-owned companies on a global basis and indeed an investment case for external shareholders.

In the Credit Suisse White Paper 01 “Family Businesses in Europe: Growth Trends and Challenges” September 2007, we highlighted a number of strengths that characterize family businesses:

- Long-term commitment of owners
- Visible and identifiable ownership, in contrast to ownership by numerous institutional investors
- Track record of standing by their companies during hard times
- Trademark names that continue to open doors in the business community
- Consistency in decision-making and business practice, thereby lowering the business risks for external providers of capital
- Better alignment of owner and management interests

To this, we would now add a number of characteristics that help to elucidate why family businesses stand apart and why the return profile is different to that of the broader corporate universe:

- Desire to maintain control leads to more cautious and more efficient management and strategies
- Focus on value-added products and brand development, the corollary of which is the negatives for family owners from public failure
- Focus on core activities means they are less acquisitive and growth is organic
- Investment intensity, be it R&D or broader capex, is lower but the more limited compression to ROE suggests that investment and R&D is more efficient.
- Lower volatility in more broadly held companies
- Value creation through superior cash flow return spreads and asset growth

Entrepreneurship is borne of opportunity and necessity. As the macroeconomic backdrop has moved towards increased deregulation and decreased involvement of the state, we have seen that family-owned businesses are not just key drivers of economic growth but are also key employers. It is therefore imperative to understand how and why these companies perform and how they will impact macroeconomic policies and stock market performance. With the lessening of the role of the state in the economy across the globe, entrepreneurs will be the innovators and drivers of future growth and development.

Stefano Natella

Global Head of Equity Research, Investment Banking

Giles Keating

Vice Chairman of IS&R and Deputy Global Chief Investment Officer, Private Banking & Wealth Management

Key highlights

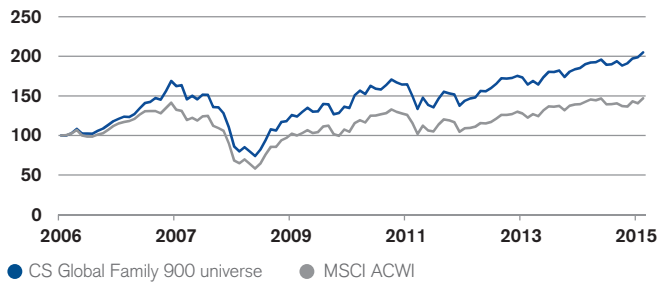
For the first time, we look to establish if and how family-owned businesses create wealth at a global level. We compare the cycle of growth and returns at family-owned companies worldwide versus the MSCI ACWI as well as the differences in business strategies to understand why family-owned businesses outperform.

Julia Dawson and Richard Kersley

- The CS Global Family 900 has shown an excess return of 4.5% CAGR versus MSCI All Countries World Index since 2006.
- Investing alongside the founder generates the best share price returns and we see the outperformance decreasing over subsequent generations.
- Family-owned companies are a lower ROE business model in the more developed markets of the USA and Europe. They demonstrate higher ROE in Asia and EMEA. Lower ROE is indicative of more conservative strategies as well as broader priorities for family ownership beyond simply financial returns.
- However, over the longer term, family companies in the CS Global Family 900 have generated twice the economic profit – earnings in excess of the opportunity cost of utilizing assets or capital – compared to benchmarks. We illustrate this with case studies of Wal-Mart, Alfa Laval and Sino Biopharmaceuticals.
- Family-owned companies trade on slightly higher EV/EBITDA and PB multiples compared to benchmarks. Share price appreciation is closely correlated to economic profit generation.
- Leverage is lower at US and European family businesses in line with previous research. We are able to show faster deleveraging post-crisis compared to benchmarks. Asian family business leverage is higher on the other hand.
- The business cycle is smoother and more stable. We show that sales growth is less volatile through the cycle with lower peaks and less pronounced troughs.
- Family companies invest less in R&D. In the USA, R&D intensity is just 25% of benchmark levels, in Europe it is 20% below benchmark. While this is indicative of the more conservative style of management, we also believe that it reflects more efficient R&D given the relatively limited difference in returns.
- Family business growth is organic. Since 1990, M&A has been just 2.1% of sales versus 5.8% at non-family businesses. We also find that family-businesses make better and cheaper acquisitions as they drive better growth and returns in the 3-year period post-acquisition.
- Corporate governance risks are overstated. We evaluate empirical measures of accounting performance as a corporate governance proxy and find that there is a closer alignment between owner and minority interests than the market understands. Accounting quality at family-owned companies is superior and reflects the owners' focus on preserving wealth over the long term.
- We find 'survivorship' and transition to be easier in sectors that are more reliant on tangible assets. We see a quicker dilution of ownership in companies founded on intellectual property. This may reflect that successor generations do not share the founder's vision or interests.
- We discuss potential risks and weaknesses that include related party risks, closed pools of managers, employment of under-qualified family members and different voting rights.

Figure 1

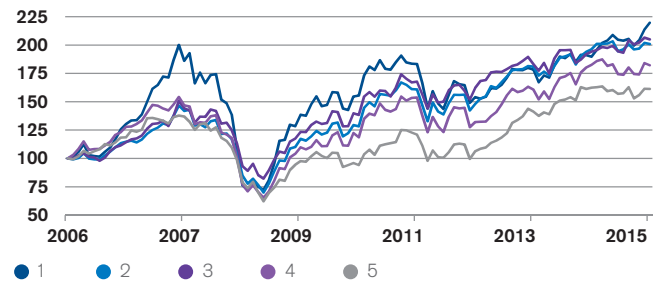
CS Global Family 900 universe versus MSCI ACWI



Source: Bloomberg, Credit Suisse Research

Figure 2

Share price returns by generation

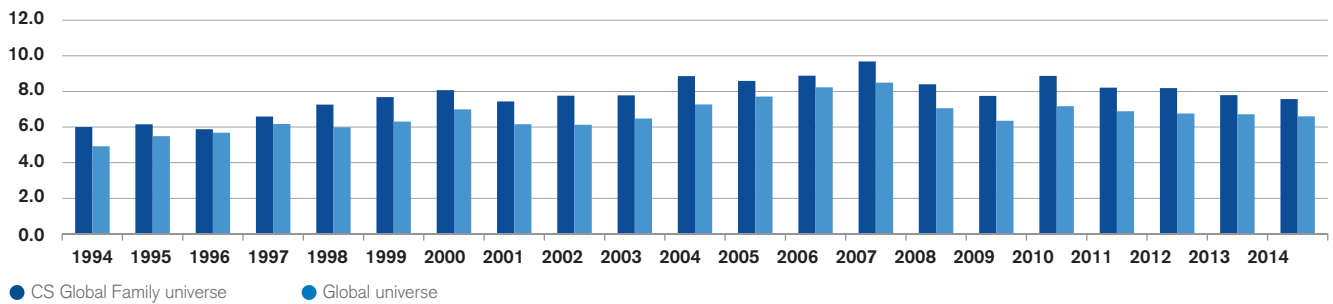


Source: Credit Suisse HOLT

Figure 3

CS Global Family 900 universe cash flow return on investment versus MSCI ACWI

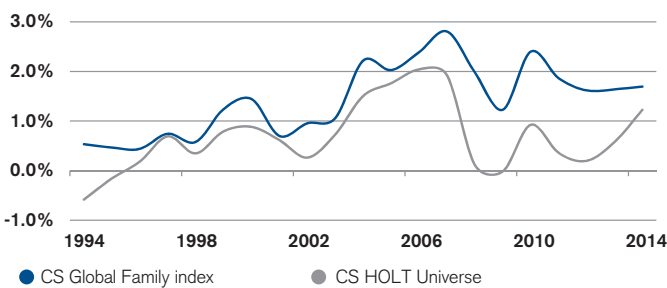
Excluding financial and regular utilities



Source: Credit Suisse HOLT

Figure 4

Economic profit as percent of EV

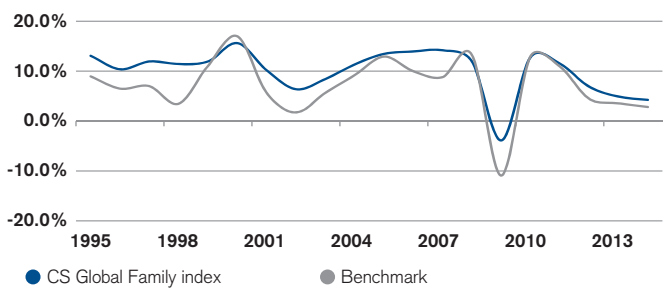


Source: Credit Suisse Research

Figure 5

Annual sales growth

Percent excluding financials



Source: Credit Suisse HOLT

Figure 6

Family-owned businesses as key economic drivers

	Family-owned businesses (%)	GDP contribution (%)	Share of employment (%)
North America	90	USA 57	USA 66
Europe	85	70	60
APAC	85	34	57 South Asia/ 32 North Asia
Latin America	85	60	70
Middle East	90	80	70

Source: EY Family Business Yearbook 2014



Are family businesses a good investment?

Do family-owned companies offer good investment opportunities for external shareholders? Using the Credit Suisse Holt valuation framework, family businesses appear to demonstrate superior cash returns and economic value creation, underpinning premium valuations and share price outperformance.

We find that family-owned companies have traded at a small premium versus MSCI ACWI of 12% on EV/EBITDA and 5% on the P/B since 2006. This reflects ROEs that have on average been 4.3% higher than the benchmark and cash flow return on investment (CFROI) over 9% higher. While we find

regional differences in returns, typically lower in more mature businesses in Europe and the USA, we believe that investors are prepared to pay this slight premium for a more stable sales and return cycle relative to benchmarks as well as the sustained longer-term value creation reflected in superior CFROI and economic profit metrics.

Figure 7

Family-owned company returns and valuations – 2014

	ROE (%)	CFROI (%)	EV/EBITDA (x)	P/B (x)	Net debt/ Equity (%)	Net debt/ EBITDA (x)
Global	11.5	6.4	10.6	2.1	52.0	1.8
USA	12.0	9.1	13.2	3.3	30.7	1.1
Europe	12.1	7.5	9.2	2.0	42.7	1.3
Asia	10.8	5.5	9.7	1.7	44.4	1.7
Latam	9.3	6.7	10.1	2.1	86.6	2.6
EMEA	17.9	8.1	18.6	1.8	82.6	1.9

Source: Company data, Credit Suisse estimates

Figure 8

Comparative returns and valuations versus MSCI ACWI – 2014

	ROE (%)	CFROI (%)	EV/EBITDA (x)	P/B (x)	Net debt/ Equity (%)	Net debt/ EBITDA (x)
Family businesses	11.5	6.4	10.6	2.1	52.0	1.8
MSCI ACWI	12.1	6.3	9.5	2.1	48.2	1.5
Premium/(discount)	-4.8	1.0	12.3	-1.2	7.9	17.1

Source: Company data, Credit Suisse estimates

Figure 9

Comparative returns and valuations versus MSCI ACWI – since 2006

	ROE ()	CFROI ()	EV/EBITDA (x)	P/B (x)	Net debt/ Equity ()	Net debt/ EBITDA (x)
Family businesses	13.2	7.5	9.2	2.1	54.7	1.7
MSCI ACWI	12.6	6.9	8.2	2.0	48.6	1.4
Premium/(discount)	5.0	9.1	11.8	5.1	12.4	19.8

Source: Company data, Credit Suisse estimates

The CS Global Family 900 universe

We have created a basket of over 900 companies globally where founders or the families of founders retain over 20% of outstanding shares. Our case studies of Wal-Mart, Alfa-Laval and Sino Pharmaceuticals illustrate how family-owned businesses drive long-term wealth creation compared to more broadly owned peers.

We have established a database of 920 publicly listed companies globally that have a market capitalization of at least USD 1bn and where there is a family-owned shareholding of at least 20% of shares outstanding. We find examples in 35 countries. The preponderance of these, in terms of numbers, is to be found in Asia which is explained by the different and more recent pattern of economic development in the region compared to Europe and the USA. In more developed markets, we see more fragmented ownership and many families selling out over time as a general theme. Frequently quoted statistics from the Family Business Institute show that only one third of family-

owned businesses last into a second generation of ownership, 12% to a third and just 3% to a fourth. In our analysis, we have controlled for the greater numbers of Asian companies in this family-owned company universe by evaluating all our data on a sector- and country-neutral basis relative to the MSCI ACWI benchmark. We have excluded joint ventures and assets, which have previously been owned by the state and sold into private hands.

For full details of the country and sector breakdown of the companies in the CS Global Family 900 universe, please see Appendix 1.

Figure 10

Top 10 family-owned companies by region

Ctry	Company	Ticker	Sector	Price Data		Price Change (%)		
				Price (lc)	Mcap (\$m)	1m	3m	12m
North America								
USA	Wal-Mart Stores, Inc.	WMT	Consumer Staples	74.8	241,397	-4%	-11%	-2%
USA	Oracle Corporation	ORCL	Information Technology	43.9	191,540	-2%	0%	4%
USA	Google, Inc.	GOOGL.OQ	Information Technology	554.2	188,819	-1%	-2%	-3%
USA	Facebook Inc.	FB	Information Technology	80.1	225,066	0%	1%	26%
USA	Berkshire Hathaway Inc.	BRKa.N	Financials	217,291.0	179,206	1%	-2%	13%
USA	Kinder Morgan, Inc.	KMI	Energy	41.6	90,239	-3%	1%	24%
USA	Nike Inc.	NKE	Consumer Discretionary	102.3	87,952	2%	5%	34%
USA	McKesson Corporation	MCK	Health Care	237.8	55,073	6%	4%	26%
USA	Phillips 66	PSX	Energy	79.6	43,148	-2%	1%	-6%
USA	Franklin Resources	BEN	Financials	51.6	31,905	-1%	-4%	-6%
Europe								
CH	Novartis	NOVN.VX	Health Care	98.5	278,918	2%	1%	22%
CH	Roche	ROG.VX	Health Care	282.5	254,426	5%	9%	6%
BE	Anheuser-Busch InBev	ABI.BR	Consumer Staples	112.3	197,476	3%	-1%	39%
FR	L'Oreal	OREP.PA	Consumer Staples	176.5	108,066	4%	9%	37%
ES	Inditex	ITX.MC	Consumer Discretionary	30.7	104,785	7%	9%	44%
FR	LVMH	LVMH.PA	Consumer Discretionary	166.6	92,534	7%	2%	28%
DE	SAP	SAPG.F	Information Technology	67.8	91,154	0%	8%	21%
DE	BMW	BMWG.DE	Consumer Discretionary	103.1	72,472	-3%	-9%	12%
SE	Hennes & Mauritz	HMb.ST	Consumer Discretionary	342.1	58,988	-1%	-6%	21%
CH	Compagnie Financiere Richemont SA	CFR.VX	Consumer Discretionary	84.2	46,488	-1%	0%	-11%
Asia								
KR	Samsung Electronics	005930.KS	Information Technology	1,307,000	173,855	-6%	-4%	-10%
IN	Tata Consultancy Services	TCS.BO	Information Technology	2,610.0	80,210	5%	-2%	23%
JP	Softbank	9984.T	Telecommunication Services	7,447.0	72,136	-4%	1%	3%
HK	Hutchisonwhampoa	0013.HK	Industrials	115.0	63,245	0%	8%	10%
HK	Sun Hung Kai Properties	0016.HK	Financials	132.6	49,154	3%	9%	27%
USA	JD.com, Inc.	JD.OQ	Consumer Discretionary	34.0	47,056	-1%	23%	34%
TW	Hon Hai Precision	2317.TW	Information Technology	99.1	48,679	8%	14%	19%
IN	Reliance Industries	RELI.BO	Energy	876.8	44,521	3%	1%	-18%
SG	Jardine Matheson	JARD.SI	Industrials	62.7	43,817	2%	-3%	2%
JP	Fast Retailing	9983.T	Consumer Discretionary	51,300.0	42,150	5%	11%	51%



Superior and more stable growth

Since 1995, the companies in our family-owned universe have shown annual sales growth of 10% compared to 7.3% for MSCI ACWI companies. Since 2006, this sales growth has averaged 8.5% for family companies versus 6.2% for the benchmark. In all but two years, sales growth has been superior at family companies as we see in Figure 11. This sales growth has been less volatile throughout the time series including during both the internet bubble and collapse (2001-02) and the 2008 financial crisis when family-owned companies had both lower peaks and troughs.

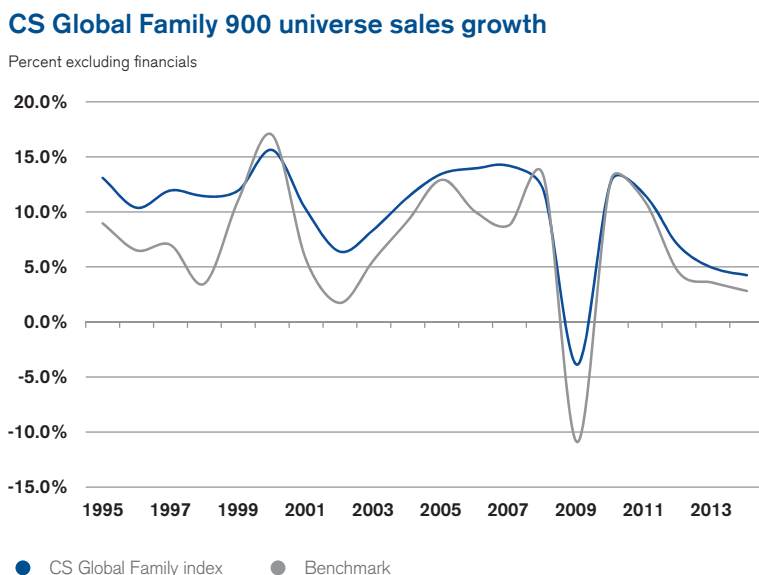
The reasons for this superior growth profile are multifold but we would view a longer-term corporate strategy as being fundamental to the structural nature of this higher and less volatile growth (Figure 11). In our CSRI report, Family Businesses: Sustaining Performance, over 40% of first and fourth generation owners said that the typical time horizon for the payback on a new investment was 5-10 years and over 50% of second and third generation owners expected new investments to pay back over 3-5 years. 60% of respondents said that their long-term management perspective was important for the ongoing success of their business.

As part of this longer-term approach, the importance of product or service quality, the development of long-term customer relationships and brand loyalty, along with the focus on core products and innovation in these core products rather than diversification are elements that help to explain this outperformance. We also see that lower dividend pay-outs by family-owned businesses (discussed below) allow them to conserve cash flows internally and help fund growth.

Return on equity fails to capture value creation

Considering profitability in terms of return on equity (ROE), our analysis shows that since YE06, the CS Global Family 900 universe has generated annual returns that are 50 basis points above the MSCI ACWI benchmark. These are principally driven by superior family company ROEs in Asia, Japan and EMEA. US family-owned companies have generated ROEs that average 250 basis points below the benchmark but as we see in Figure 13, there is a smoother profile to returns through the

Figure 11



Source: Company data, Credit Suisse estimates

cycle. In growth periods, family-owned business returns average 270 basis points below benchmark but in slower growth periods such as since the 2008 financial crisis, this underperformance narrows to 180 basis points. Despite being lower, this implies more stable returns over time and is the result of the longer-term focused strategies inherent in family business models relative to the shorter-term return focus of more diversely owned companies. We see US family-owned companies prepared to sacrifice some financial returns in order to capture other non-economic returns and to preserve the status quo and ownership.

In Europe, we also witness a lower return profile compared to the benchmark, but one that is more volatile at the same time. Pre-crisis, i.e. a period of superior macroeconomic growth, European family-owned companies saw returns 60 basis points below benchmark and post-crisis, a period marked by very limited growth in Europe, ROEs average 10 basis points lower than benchmark. So while returns in Europe are closer to benchmark than in the USA, the profile is considerably more volatile and the standard deviation of European family-owned business ROEs is 4.4% compared to 2.6% in the USA and 2.1% for the global benchmark. This could suggest a less efficient capital structure.

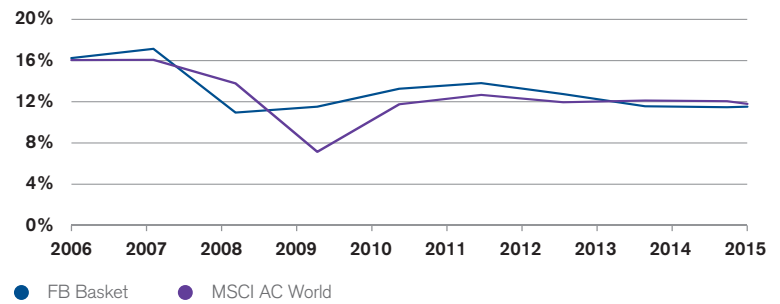
In Asia, the average return differential between family-owned companies and benchmark is just 20 basis points over the full 9-year period and again, we see a smoother profile of returns. Interestingly, the trough in ROEs in Asia ex-Japan family-owned businesses was 12% in 2008, some 340 basis points above the benchmark trough. This is a striking contrast to the US and European family companies where returns troughed 2-5% below broader benchmarks, i.e. family-owned businesses bore the brunt of the 2008 hit. So until 2013, we can see stronger performance from family-owned companies in years of superior macro growth and more limited downside during more challenging macro backdrops.

Higher cash flow returns – CFROI

However, a simple ROE analysis provides an inadequate description of the family business model. Cash is a key consideration in general. We have again used our Credit Suisse HOLT database to look at a more embracing view of profitability, HOLT’s proprietary metrics of CFROI (cash flow return on investment) and economic profit, to assess these companies’ real economic performance and to see if family companies create value by using capital effectively over time. Economic profit is essentially the cash flow return generated from a company’s assets. Figure 16 shows clearly that the family businesses in our universe have generated an average 130 basis points higher CFROI each year since 2006 compared to the MSCI ACWI constituents (excluding banks and regulated utilities) and confirm the outperformance seen in our previous reports on US and European family businesses.

Figure 12

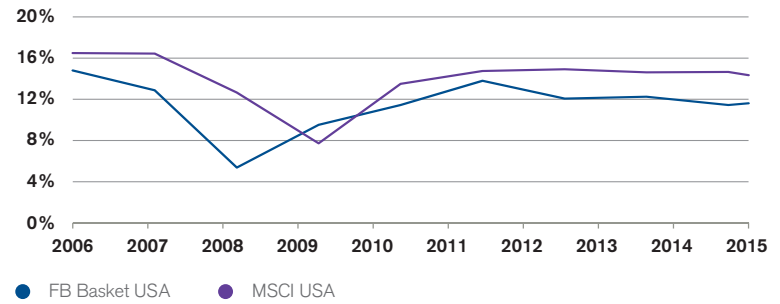
ROE (%) – CS Global Family 900 universe



Source: Bloomberg, Credit Suisse research

Figure 13

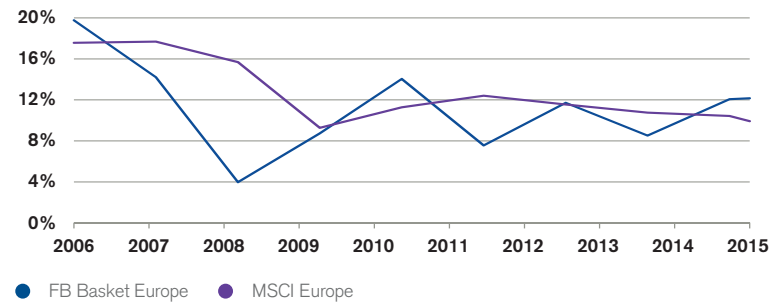
ROE (%) – US family-owned companies



Source: Bloomberg, Credit Suisse research

Figure 14

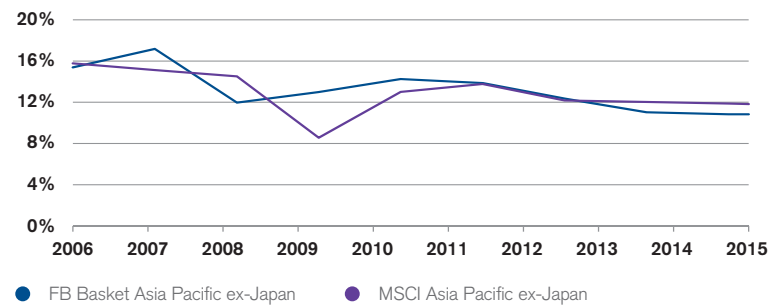
ROE (%) – European family-owned companies



Source: Bloomberg, Credit Suisse research

Figure 15

ROE (%) – Asia excluding Japan family-owned companies

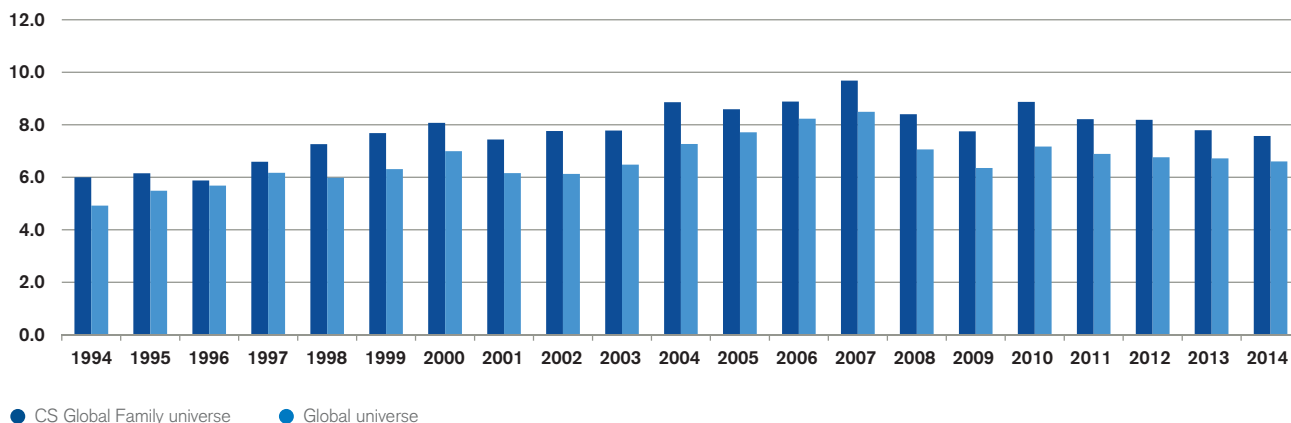


Source: Bloomberg, Credit Suisse research

Figure 16

CS Global Family 900 universe CFROI versus MSCI ACWI

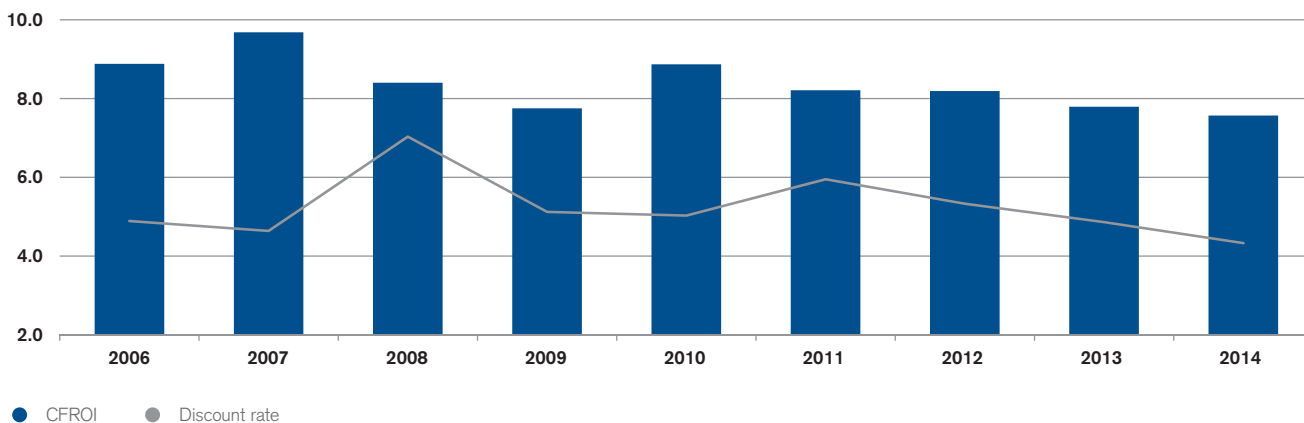
Excluding financials and regulated utilities



Source: Credit Suisse HOLT

Figure 17

CS Global Family 900 universe CFROI versus cost of capital



Source: Credit Suisse HOLT

We can also see in Figure 17 that the CFROI generation has consistently been above the discount rate over this period, by an annual average of 320 basis points. This compares to 190 basis points for companies in the MSCI ACWI universe (Figure 18). This 130 basis points differential is a clear illustration of the superior value generation of family-owned businesses when considering a deeper analysis of returns beyond a simple ROE and underlines higher valuations.

On a sector-adjusted basis, we see that the companies in our family-owned universe have generated a higher annual CFROI of an average 9.3% since 2006, with the USA having the highest returns in every year (see Figure 19). Again we see the more uneven returns of European family-owned business demonstrating that CFROIs are far more cyclical here than in other regions due to the greater exposure to sectors, such as consumer discretionary plays and the fact that they are more dependent on global rather than regional growth.

Economic profit – the real value creation

We have also analyzed family-owned companies in terms of economic profit (EP) generation, i.e. the growth in value as a function of CFROI spreads and asset growth that demonstrates the effectiveness of invested capital. Economic profit is defined as earnings in excess of the opportunity cost of using the assets or capital. Figure 20 shows that the family-owned company universe has consistently delivered greater economic profit, measured as a percentage of enterprise value, over the past 20 years. This is particularly relevant for higher growth companies and explains how businesses can generate value despite declining CFROI margins since 2007 (Figure 16).

When looking at absolute economic profit (Figure 25), we can also see the divergence in value creation since the economic crisis of 2008, with family-owned businesses' EP accelerating to close to double pre-crisis levels while companies generally have struggled to create positive EP in recent years. This, in our view, is one of the key reasons that markets pay a higher valuation for family-owned businesses relative to the multiple their lower ROE would suggest they merit.

In terms of business efficiencies, we consider asset turn ratios and see that family-owned businesses have again consistently higher ratios (Figure 22). Family-owned asset turns have held up better since 2008, falling 13% versus more than 16% for MSCI ACWI. This, combined with the higher CFROI spread illustrated in Figure 21, explains the growing difference in economic profit being generated by family-owned business relative to the index.

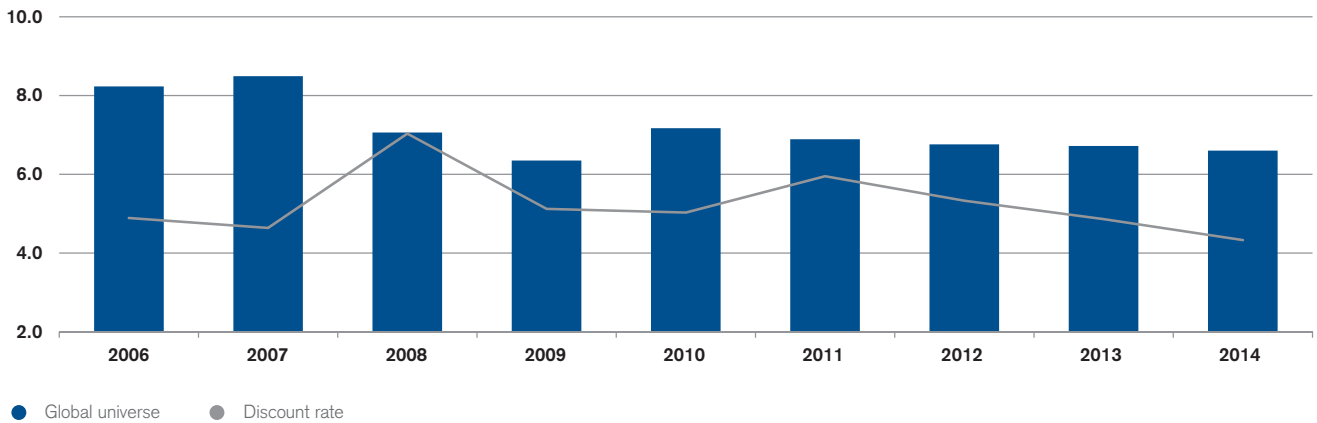


PHOTO: ISTOCKPHOTO.COM/BO1982

Figure 18

MSCI ACWI CFROI versus cost of capital

Excluding financials and regulated utilities

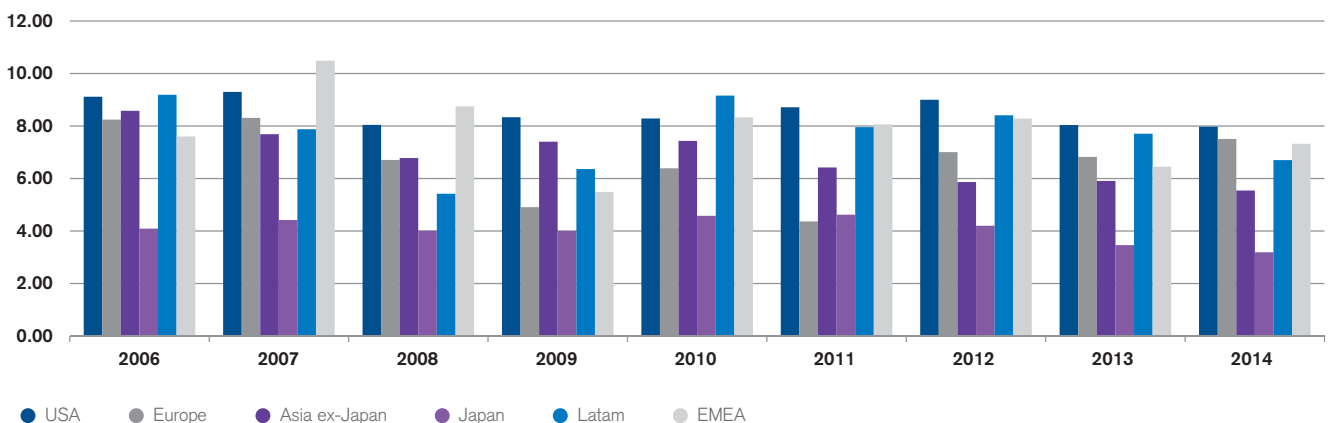


Source: Credit Suisse HOLT

Figure 19

CS Global Family 900 universe CFROI

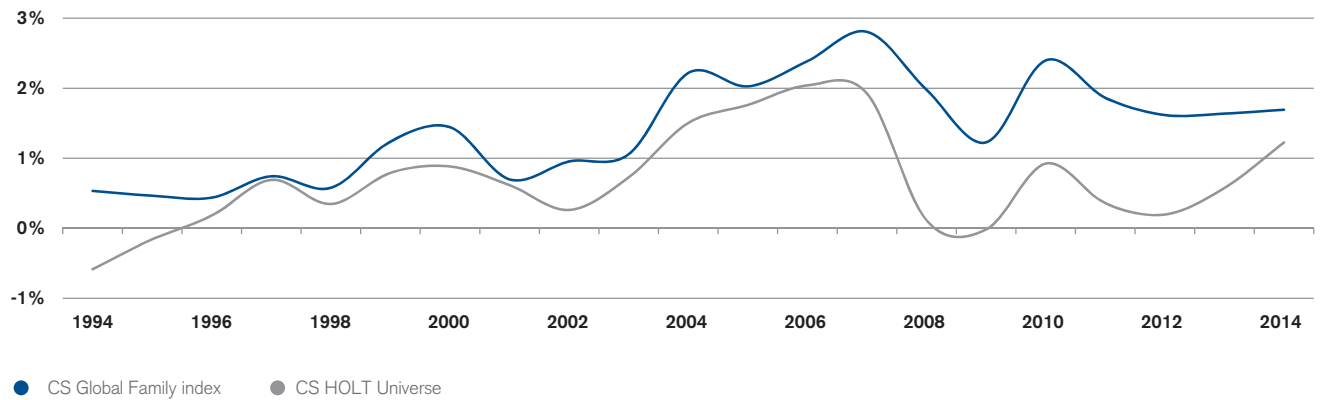
Excluding financials by region percent



Source: Credit Suisse HOLT

Figure 20

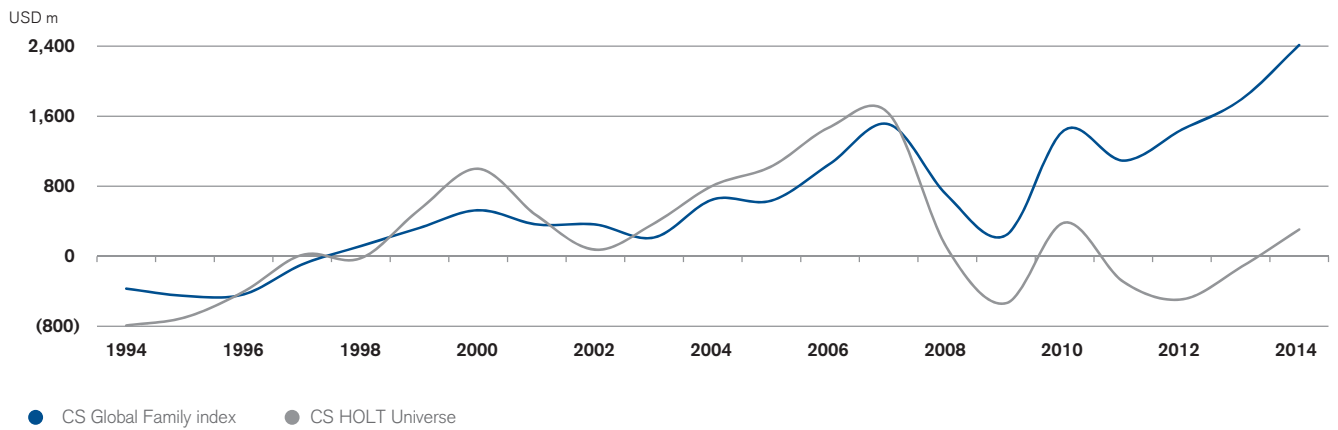
Economic profit as percent of EV



Source: Credit Suisse HOLT

Figure 21

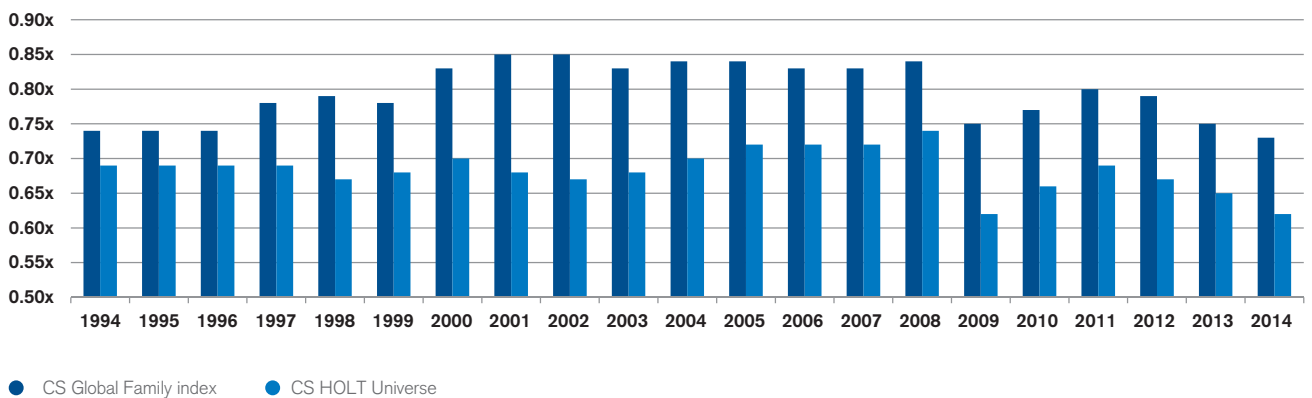
Economic profit



Source: Credit Suisse HOLT

Figure 22

Asset turn ratio – CS Global Family 900 universe versus MSCI ACWI



Source: Credit Suisse HOLT



USA CASE STUDY

Wal-Mart

Walmart

Supercentre



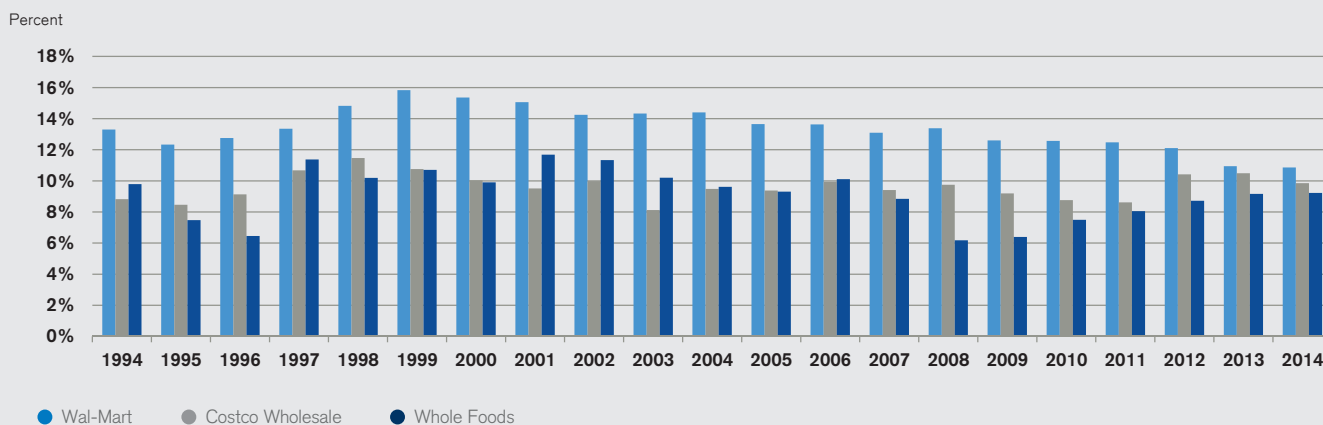
Wal-Mart is the archetypal family-owned company, a consumer staples retailer founded by Sam Walton in 1962 and still controlled by the founder's family with a stake of 50.35%. Robert Walton, the founder's eldest son, is chairman with two other family members serving as directors on the 16-person board. Although we note that the companies differ in size and target markets, if we compare Wal-Mart's economic profit generation relative to other US non-family owned retailers, namely Costco and Whole Foods, we see that Wal-Mart has consistently generated higher CFROIs and economic profit over the past 20 years though these are now converging. Even with

declining CFROIs, Wal-Mart has been able to generate superior economic profit as a percentage of enterprise value compared to the non-family owned retailers as well as a more stable profile of CFROI over the period.

Figure 25 demonstrates how effectively the market values economic profit generation and that the share price reflects Wal-Mart's ability to drive asset growth, which more than cushions declining CFROIs so that overall value creation actually increases.

Figure 23

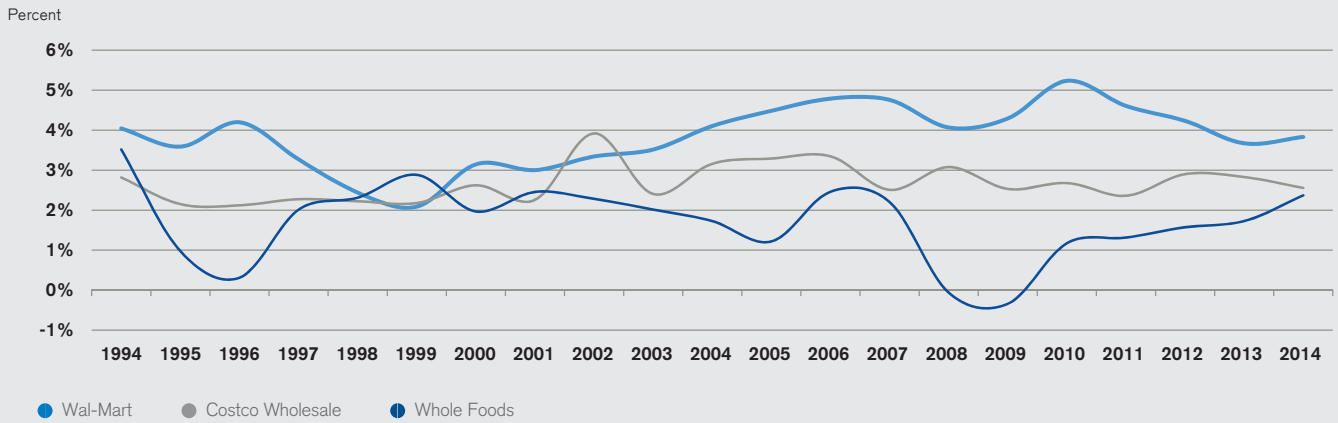
Wal-Mart CFROI versus non-family owned retailers



Source: Company data, Credit Suisse HOLT

Figure 24

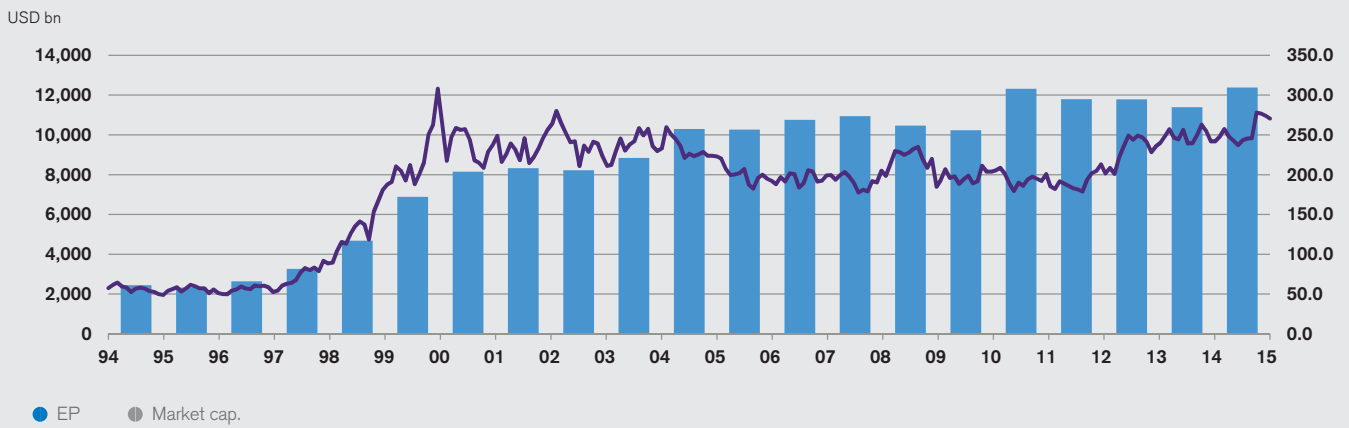
Wal-Mart economic profit as percent of EV versus non-family owned retailers



Source: Company data, Credit Suisse HOLT

Figure 25

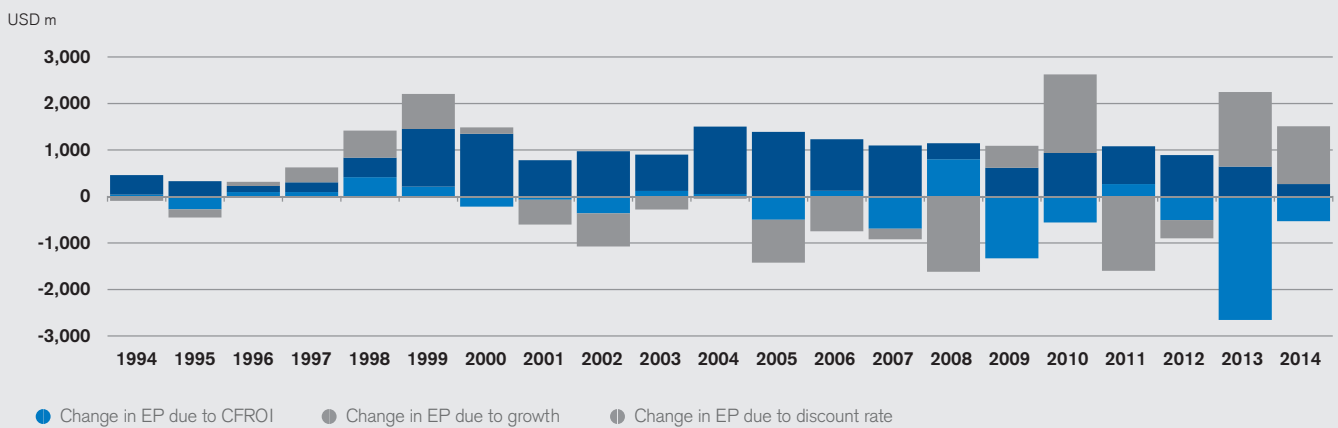
Economic profit versus market capitalization (USD bn)



Source: Bloomberg, Credit Suisse HOLT

Figure 26

Economic profit drivers



Source: Credit Suisse HOLT



EUROPEAN CASE STUDY

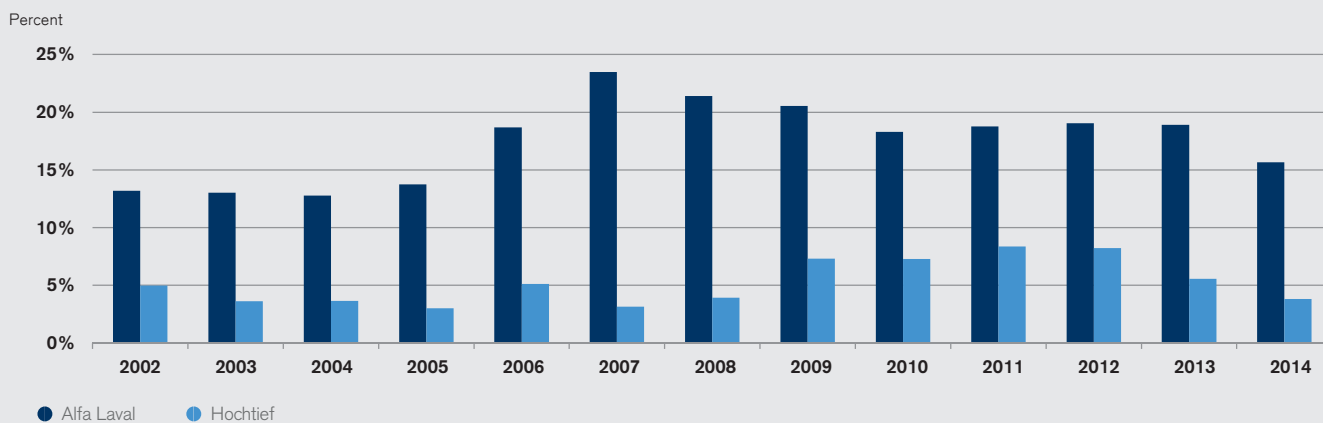
Alfa Laval versus Hochtief

Alfa Laval AB is a Swedish manufacturing and engineering company founded in 1883 and controlled by the Rausing family who indirectly own 26.1%. Finn Rausing sits on the Alfa Laval Board and on the Board of the 100% family-owned Tetra Laval group. Given that exact peers are difficult to find in its home market, we compare Alfa Laval to Hochtief, a German non-family owned engineering company and see again, as in the Wal-Mart study, that the family-owned company consistently delivers higher CFROI and economic profit.

Figure 29 demonstrates the good correlation between the Alfa Laval share price and economic profit generation, reflecting the company's ability to continuously increase economic profits, mostly driven by growth and sustainable CFROI levels. From 2002 to 2007, Alfa Laval's economic profit generation improved due to the sharp increase in CFROI and subsequently value creation has been sustained by growth despite CFROI declining.

Figure 27

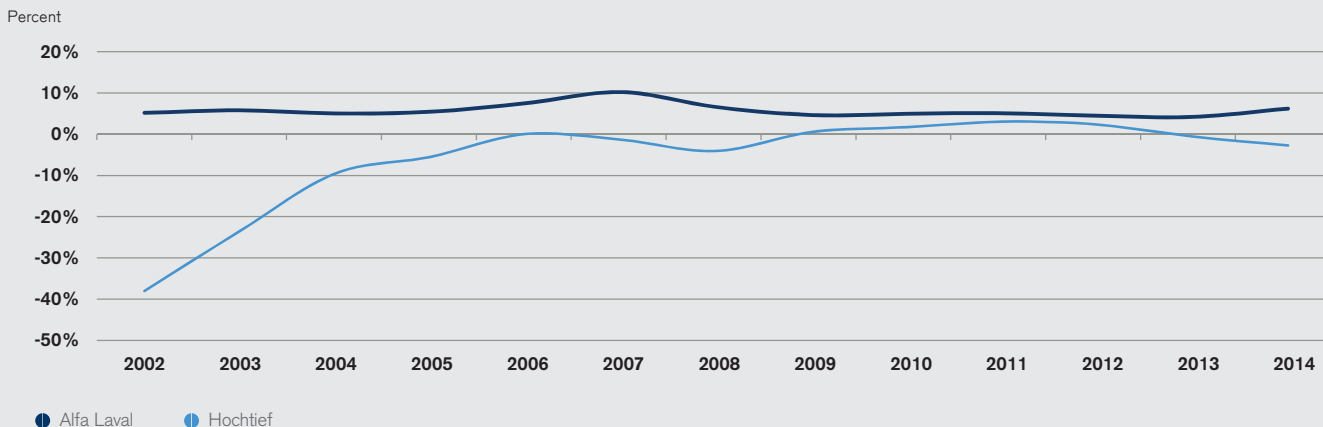
Alfa Laval CFROI versus Hochtief



Source: Company data, Credit Suisse HOLT

Figure 28

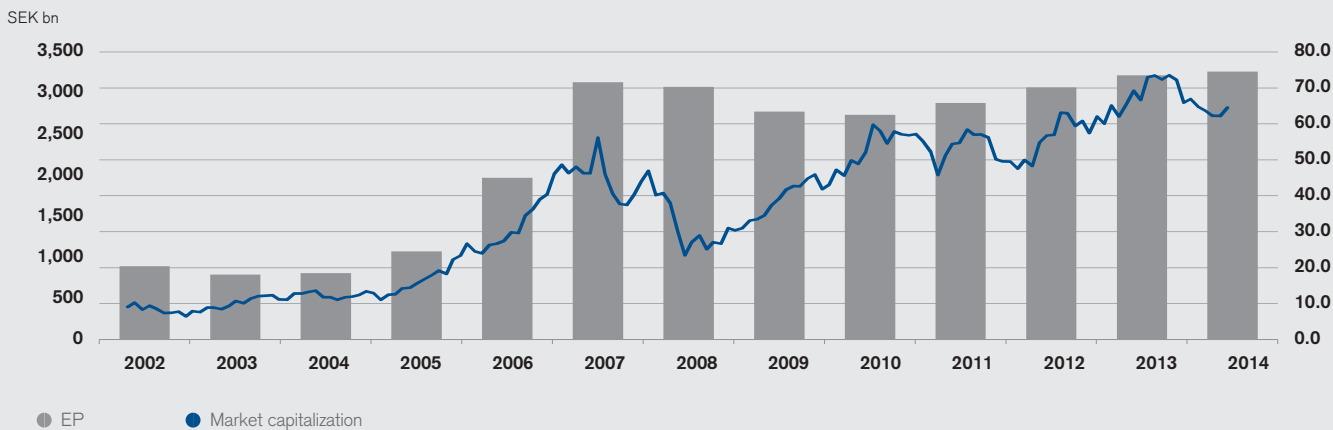
Alfa Laval economic profit as percent of EV versus Hochtief



Source: Company data, Credit Suisse HOLT

Figure 29

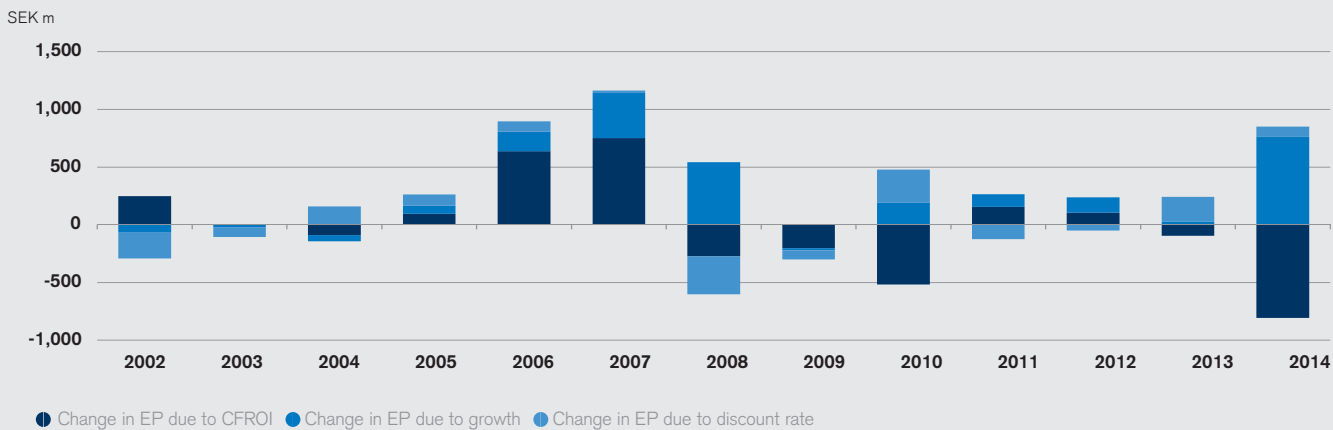
Alfa Laval economic profit versus market capitalization



Source: Bloomberg, Credit Suisse HOLT

Figure 30

Alfa Laval EP drivers



Source: Credit Suisse HOLT

ASIAN CASE STUDY

Sino Biopharmaceutical versus CR Sanjiu Pharma

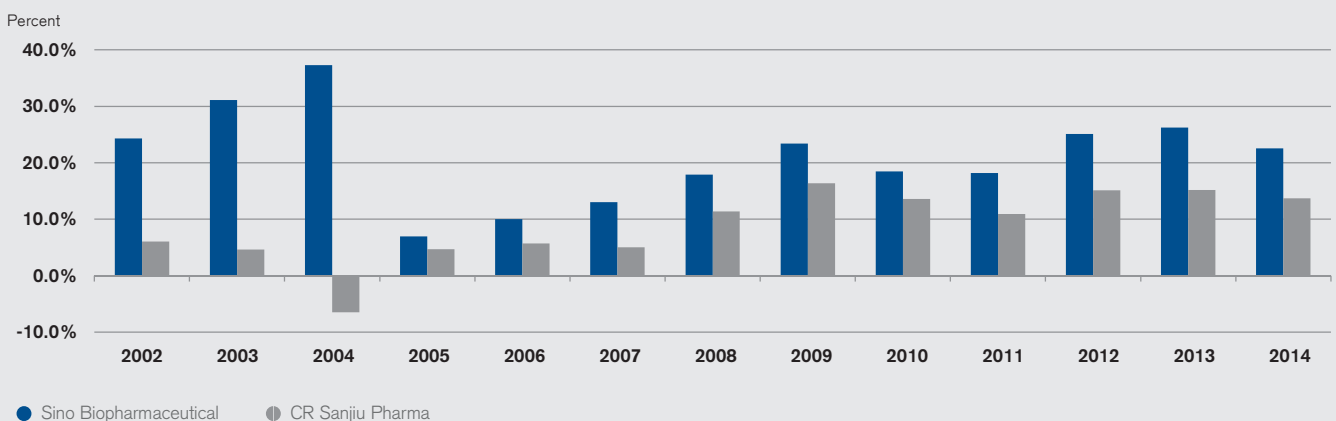
Sino Biopharmaceutical is a Chinese integrated pharmaceutical company which develops, manufactures and markets medicines for hepatitis, cardio-cerebral and other conditions, such as tumors and diabetes. The company was founded in 2000 by Tse Ping who retains a 40.7% share with his wife following the company's IPO.

For the purposes of this report, we compare Sino Biopharmaceutical to CR Sanjiu Pharma, a state-owned pharma company founded in 1999 and based in Shenzhen. As we see in Figures 35 and 36, Sino Biopharmaceutical demonstrates superior CFROI generation and economic profit as a percentage of enterprise value throughout the period from 2002 to 2014.

Again we see the close correlation between economic profit generation and the share price (Figure 33). Sino Biopharmaceutical's economic profit has increased 28-fold since 2001, mainly driven by an increase in the asset base and an improvement in CFROIs post-2005. Over the same period, the company's market capitalization rose from HKD 660m in 2001 year-end to close to HKD 45bn today.

Figure 31

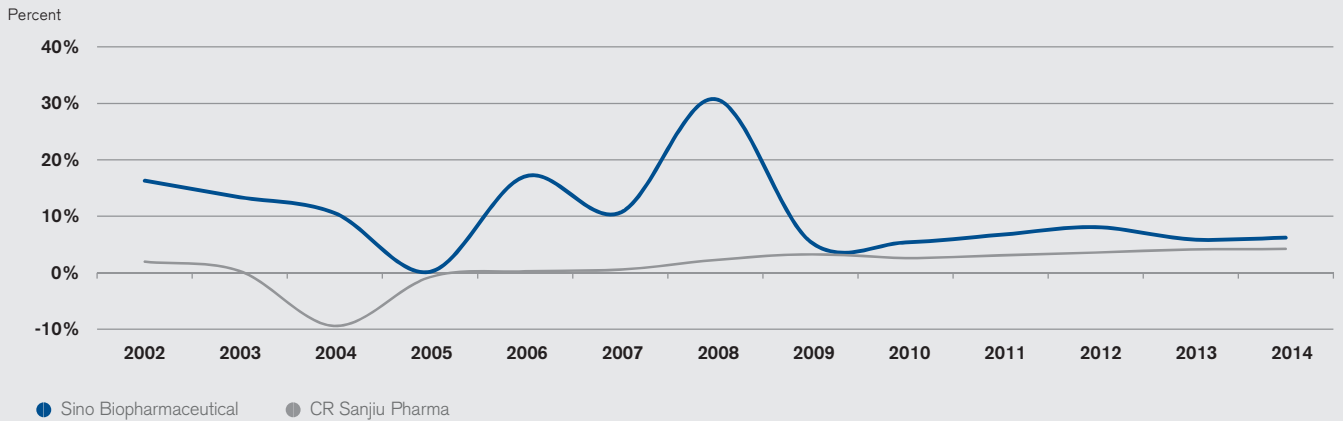
Sino Biopharmaceutical CFROI versus CR Sanjiu Pharma



Source: Company data, Credit Suisse HOLT

Figure 32

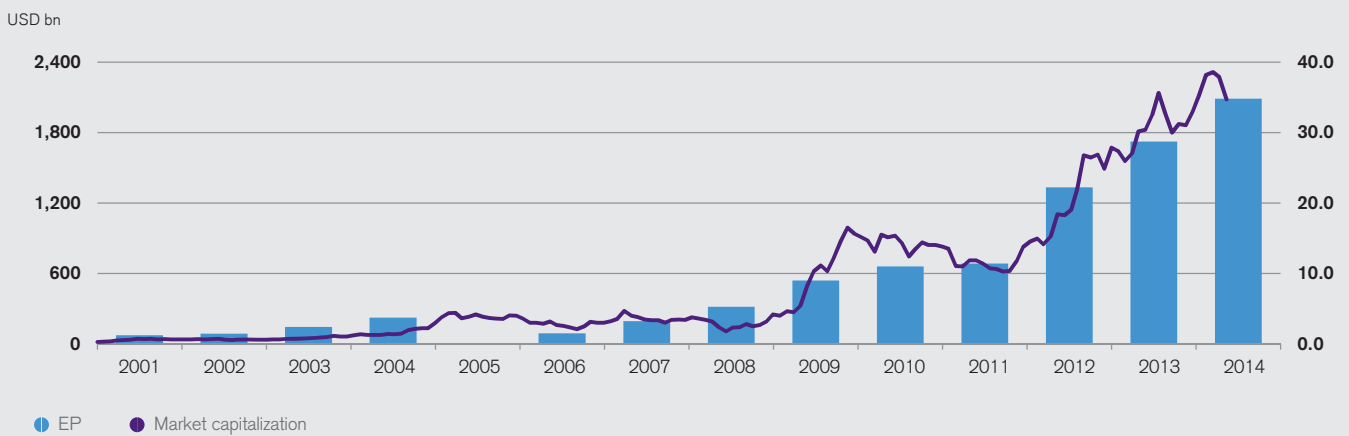
Sino Biopharmaceutical economic profit as percent of EV versus CR Sanjiu Pharma



Source: Company data, Credit Suisse HOLT

Figure 33

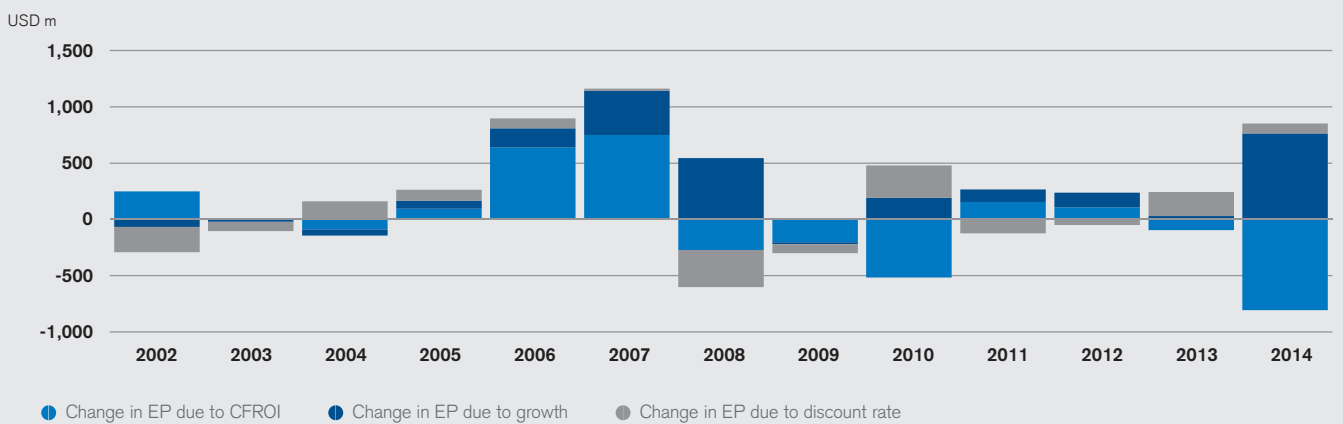
Sino Biopharmaceutical economic profit versus market capitalization



Source: Bloomberg, Credit Suisse HOLT

Figure 34

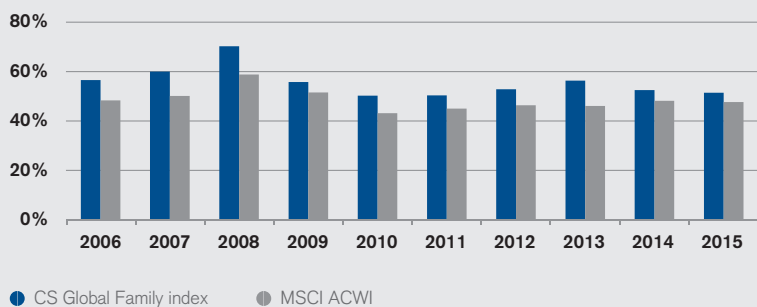
Sino Biopharmaceutical EP drivers



Source: Bloomberg, Credit Suisse HOLT

Figure 35

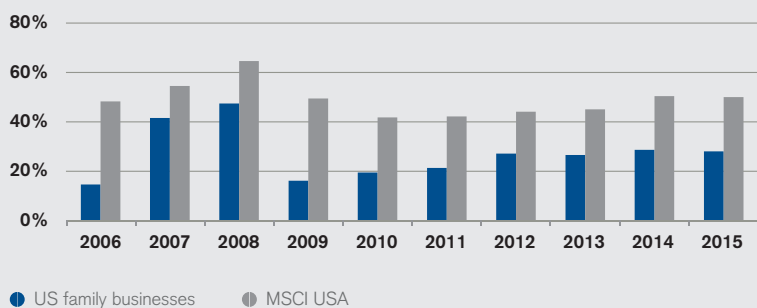
Net debt/equity – CS Global Family 900 universe



Source: Company data, Credit Suisse estimates

Figure 36

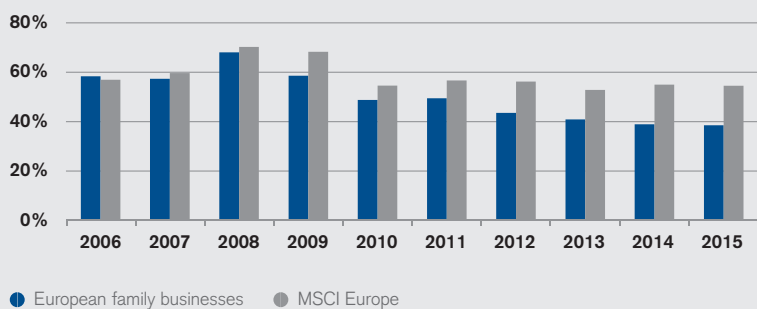
Net debt/equity – US family-owned businesses



Source: Company data, Credit Suisse estimates

Figure 37

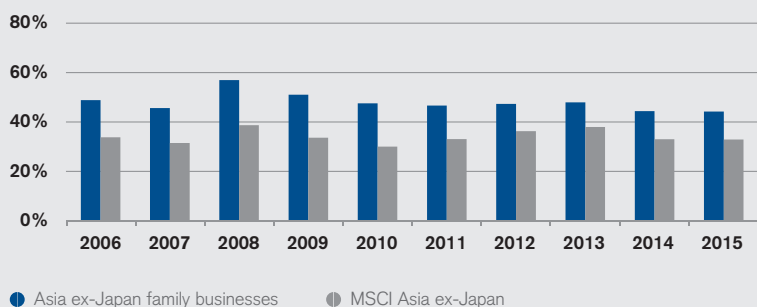
Net debt/equity – European family-owned businesses



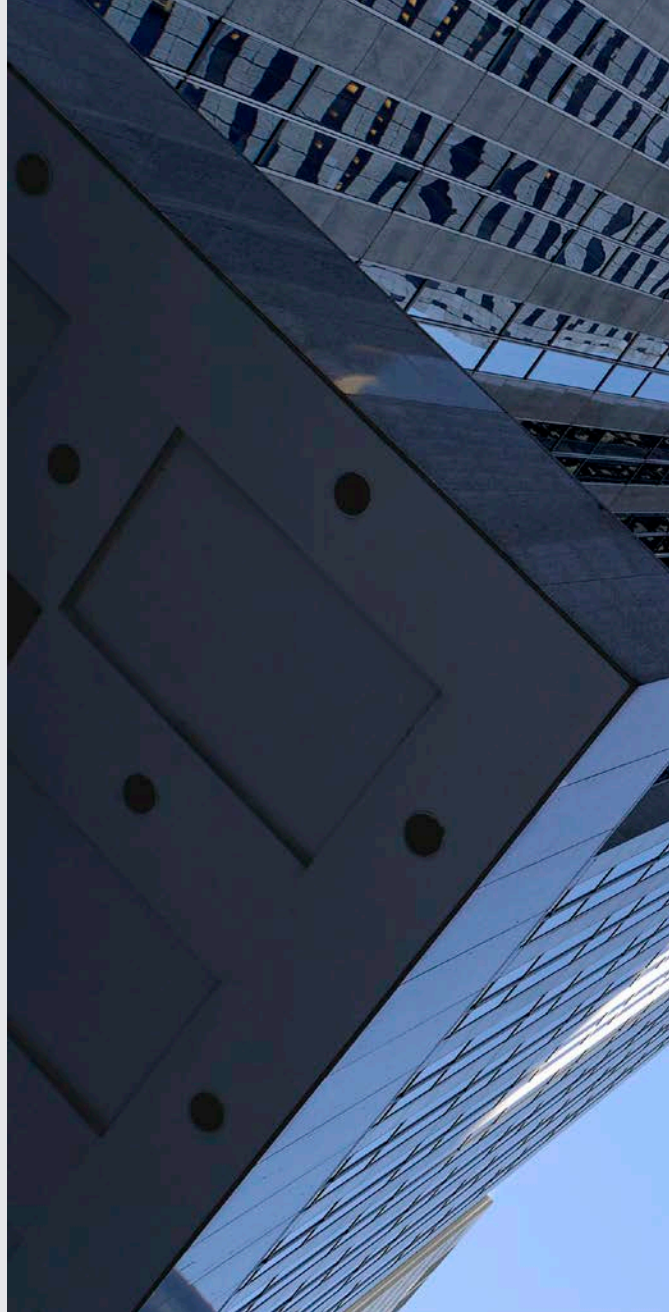
Source: Company data, Credit Suisse estimates

Figure 38

Net debt/equity – Asia ex-Japan family-owned businesses



Source: Company data, Credit Suisse estimates



Leverage – lower in the USA and Europe as expected

Much is made in academic research of family-owned businesses relying on internal funding for growth and investment in order to preserve ownership and independence. Our analysis shows this to be true for US and European family-owned companies, while Asian family-owned businesses have relied on greater external funding and leverage. The financial crisis of 2008 led to a rapid deleveraging at both US and European family-owned businesses in absolute terms and relative to non-family companies (Figure 36 and Figure 37) and this further illustrates the more conservative characteristics of management and strategy. Throughout the 9-year time history below, we see that European family-owned companies have relied on materially higher leverage compared to the USA. This is partly explained by European companies, on average, having a higher proportion of tangible assets relative to US companies, which have a higher share of IP and intangibles (due to the great tech sector weighting) on their balance sheets.



Higher leverage ratios at European companies may also be explained by the more volatile returns and cash flow generation seen earlier and thus a greater use of external financing to fund working capital requirements. But Figure 36 clearly shows how US family-owned companies have responded to and helped drive the economic recovery by raising debt to finance growth.

We see higher leverage in Asia versus benchmark (Figure 38). There are three likely reasons in our view. Firstly, the companies are relatively young in the region, so founders are still trying to maintain control and fund growth rather than risk dilution. Secondly, as we see in Figure 38, the companies are smaller in terms of market cap and may not have required as much funding for growth. And thirdly, founders may not have had access to savings, capital provided by family networks or other means. We note that many Chinese companies have resorted to more venture capital funding as a source of financing for development.

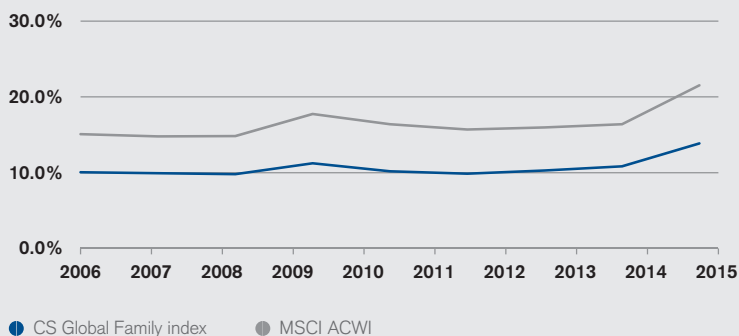
R&D intensity

Academic research findings are equivocal as to whether family businesses show greater R&D intensity, or whether they are more conservative in their spending on R&D, given more limited access to or use of external financing. The desire to protect independence and the status quo perhaps exacerbates the trade-off between R&D and investments and cashflow available for dividends.

Our findings are unequivocal. Using the CS HOLT database, we find that family-owned business investment in R&D, as measured by capitalized R&D/sales, has averaged 5-6% below the R&D intensity of the MSCI ACWI Index, i.e. it is 30% lower in absolute terms. On a sector-adjusted basis, it was 17% below in 2014. Figure 39 shows that this spread has in fact widened since the 2008 financial crisis, underpinning the argument of a more conservative style of management with a slower pick up in R&D commitment by family businesses in the aftermath of the crisis and mirroring the deleveraging discussed above.

Figure 39

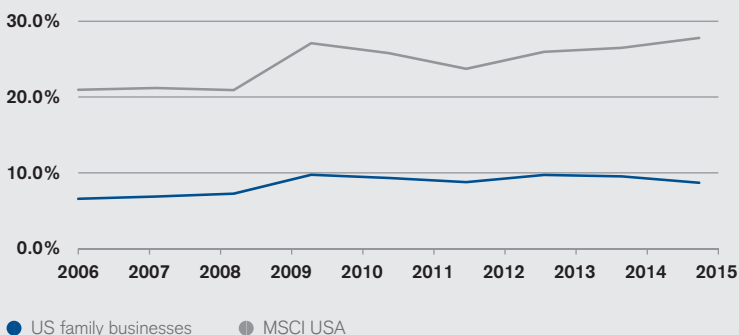
R&D/Sales – CS Global Family 900 universe



Source: Credit Suisse HOLT, Credit Suisse research

Figure 40

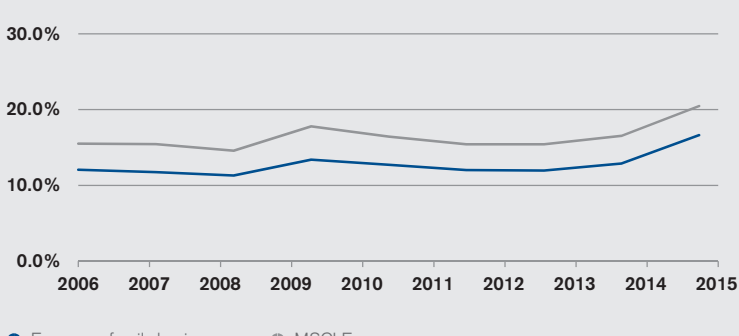
R&D/Sales – US family companies



Source: Credit Suisse HOLT, Credit Suisse research

Figure 41

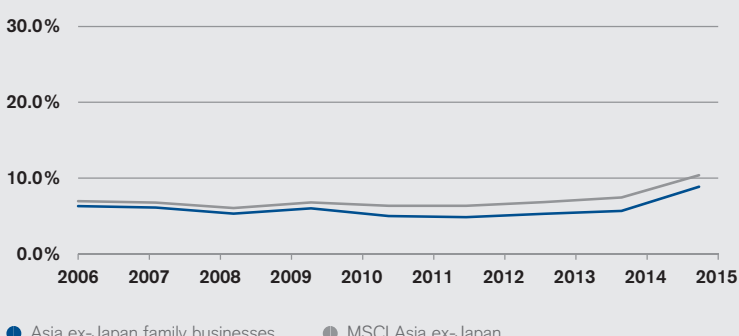
R&D/Sales – European family companies



Source: Credit Suisse HOLT, Credit Suisse research

Figure 42

R&D/Sales – Asia ex-Japan family companies



Source: Credit Suisse HOLT, Credit Suisse research

Our analysis also shows that this lower R&D intensity at family companies is characteristic of all regions. Since 2006, we see average R&D/sales running at 5-10% in both the USA and Asia-ex-Japan with Asian levels closely tracking benchmark levels, just 120 basis points differential on average since 2006, a reflection of the heavy weighting of family-owned companies in Asia generally. However, we see a far greater variation in the USA which, although R&D/sales again range between 5-10%, is a very significant 16% of sales lower than benchmark. In other words, R&D intensity at USA family companies is effectively just a quarter of benchmark levels. Figure 13 illustrates that these same companies generate return on equity that was an average of 250 basis points lower during the period 2006-2014. The discrepancy between R&D investment levels and returns would suggest that USA family businesses are far more efficient in their R&D choices and priorities, in our view, rather than this differential simply being a reflection of conservative management.

For Europe, we observe much higher levels of R&D by family companies in Figure 41, with an average of 12.8% of sales over the past nine years, although this is still close to 4% below benchmark. As a percentage of sales however, this is more than double the level of US family-owned companies. Different sector exposure is at least part of the explanation given the much higher weighting of healthcare companies amongst our European family-owned business universe compared to the USA. The healthcare sector generally shows double the capitalized R&D ratio compared to technology and three times that of consumer discretionary.

One interesting explanation for differing R&D profiles given by Kotlar, Fang, De Massis and Fratini is that managers are more likely to increase R&D spending when they are not meeting profitability goals. If a family owner's main goal is to maintain control rather than maximize profit, there is less incentive to increase R&D in order to boost returns, or at least short-term returns. This argument also serves to explain, at least in part, the differing R&D concentration.

Are family-owned companies better at M&A?

If family-owned businesses typically rely more on internal financing sources and if relative investment projects and/or acquisitions compete for more limited resources, we would expect management to make optimal investment decisions and returns from investments and acquisitions to therefore be higher or more efficient. If family-owned companies focus more on organic growth rather than acquisitions, can we demonstrate this in terms of sales? Again, using the Credit Suisse HOLT database and M&A scorecard, we see striking differences in both the level of M&A activity and the success of M&A activity when it occurs.



We have measured M&A activity in the family owned universe and compared it to non-family-owned companies in the CS HOLT database. We find that since 1990, family-owned businesses have spent an average of 2.1% of sales on M&A annually compared to 5.8% at non-family companies. This is more than 60% lower in absolute terms and goes hand-in-hand with lower R&D underpinning the interpretation of conservatism and a reliance on organic rather than acquisition-led growth.

Using the Credit Suisse HOLT scorecard, we can measure the improvement or decline in CFROI in the three years post-acquisition as well as growth. In addition, the scorecard assesses the relative price paid to measure whether the acquisition price was cheap or expensive. While other factors will also contribute to the success or otherwise of M&A, the relative outperformance by family company acquirers is very striking. The average increase in CFROI is 21% at family-owned businesses after three years versus 9% by all acquirers. Equally, growth averaged 22% after three years at family acquirer companies compared to just 7% at all companies.

Family-owned acquirers also demonstrate better pricing skill than the average company as shown in Figure 43. The superior improvement in CFROI within three years of acquisition corresponds to the generally higher CFROIs we see at family-owned companies.

So what are the negatives to family-owned businesses?

Are there any negatives? Yes, of course and these mainly relate to corporate governance shortcomings and the inability of minorities to control or exert good influence over owner-managers. While these risks may be perceived to be greater than they in fact are, we would nevertheless like to highlight a few recent examples that illustrate these concerns.



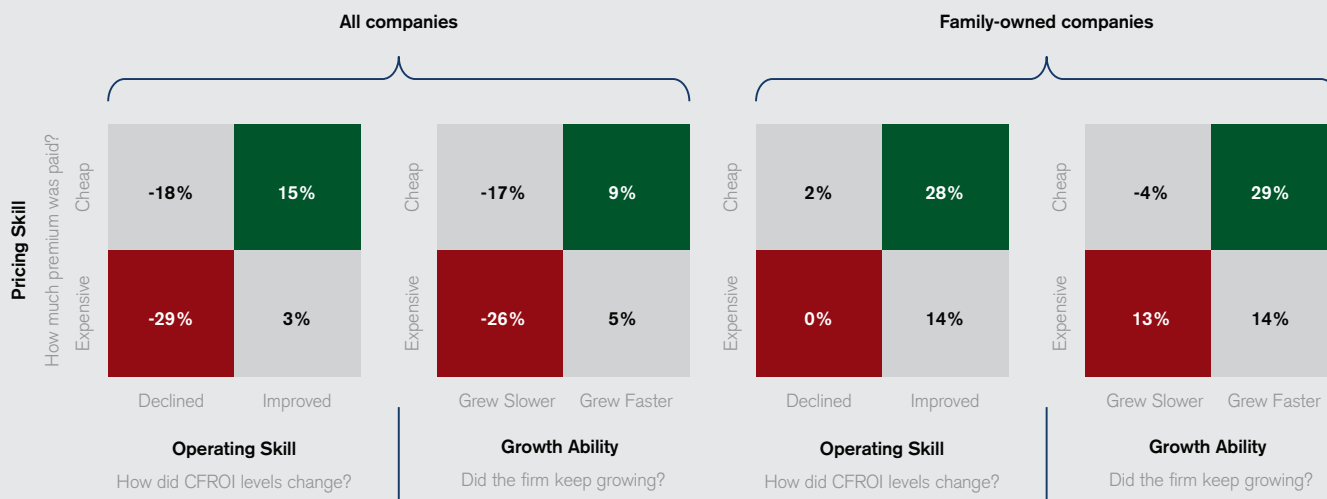
Banco Espirito (BES), Portugal's largest listed bank by assets collapsed in August 2014. The Espirito Santo family had owned 25% of BES via holding companies, one of which, Espirito Santo Financial Group, itself went into administration in late July 2014 after failing to meet short-term debt obligations amid media reports of accounting irregularities (FT, 30 May 2014). This highlights the risks of related party owners and transactions over which minorities can have no influence.

Recent events in Sweden highlight the potential risks of concentrated management and the lack of real board independence. While not family-owned,

Figure 43

Comparison of M&A track record all companies versus family-owned companies

Median 3-year post acquisition excess total shareholder return



Source: Credit Suisse HOLT



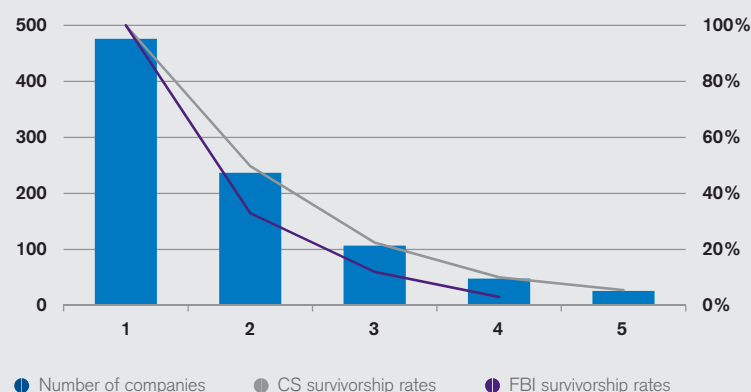
the closed nature of the ownership of Industrivarden has been criticized as a corporate governance risk, given press reports of executives using corporate jets for personal use and directors approving one another's expenses (FT, 27 April 2015). While we do not suggest that family-owned businesses will act in a similar fashion to Industrivarden's directors, a relatively closed pool of managers and directors could present similar risks to minorities.

The employment of overpaid, under-qualified family members is typically cited as a specific risk at family companies. While acknowledging this, and the particular difficulties of removing underperforming family members in the context of broader family relations, we witness an increasing level of professional education and qualifications amongst later generations taking over from the founding entrepreneur. These issues are of course more important when families retain a greater stake in the company.

A number of family-owned companies offer different classes of shares, most typically non-voting shares to external shareholders. This has been a trend in many tech companies that have IPOed in recent years enabling founders to sell down whilst securing control nonetheless. The Renault AGM highlighted the drawbacks of different voting rights proposals when the French government used the Florange Law to ensure double voting rights for its 15% stake in the company, the Law enshrines the right to double voting rights for shareholders in French companies on the register for more than two years. Given that most retail shares are held in bearer form and it is the larger shareholders and particularly key shareholders who are named on the

Figure 44

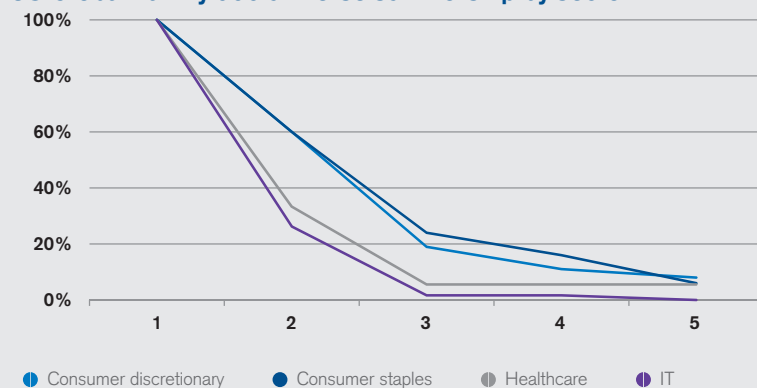
CS Global Family 900 universe and survivorship rates



Source: Credit Suisse research, Family Business Institutes

Figure 45

CS Global Family 900 universe survivorship by sector

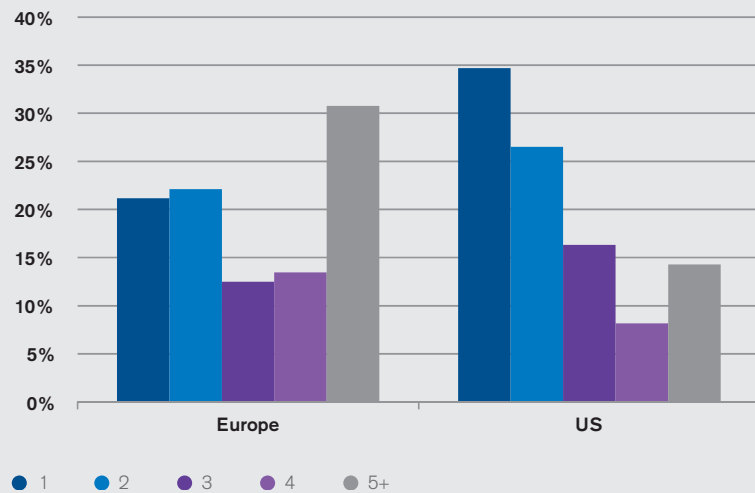


Source: Company data, Credit Suisse estimates



Figure 46

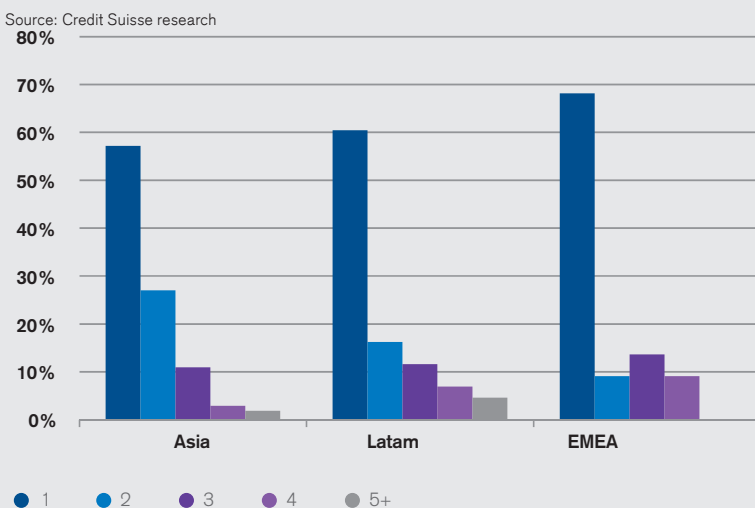
Generational ownership Europe and USA



Source: Credit Suisse research

Figure 47

Generational ownership – Asia and Emerging Markets



register, this Law has served to further entrench and concentrate family control. Most of the family-owned companies in France have double voting rights now, the most notable exception is L’Oreal, which voted in April 2015 to maintain one share one vote. The adoption of double voting rights to reward long-term investors is a clear negative in our view.

The risk of succession and survivorship

Succession and the business risks around succession within a family-owned company are cited as a key potential cost to external investors. We have looked to see if there is any evidence of the challenges for family companies as they switch from wealth creation to wealth inheritance. Of the 920 companies in our universe, 384 or 42% were listed after 2000. In fact, 3% were listed in the past five years. The vast majority of these have been Asian companies, underlining both the more recent economic development of the region and the long established role of entrepreneurship. The higher number of Asian companies versus Europe and US ones is also explained by the depressed state of capital markets in recent years and the reluctance of founders and families in the latter markets to sell at these valuations.

If we assume a generation to be 25 years – it may well be longer in the case of the original founder/entrepreneur – we can estimate the generation that is currently “owning” the family holding. We show this in Figure 44, along with the survivorship rates relative to the first generation. The generational breakdown of the companies included in our 920 universe is very similar to the statistics put forward by the Family Business Institute, which puts just 33% transitioning from family to the second generation, 12% making the third generation and a mere 3% to the fourth generation. Our basket shows 50%, 22% and 10% respectively.

As we note above, companies in sectors that have higher IP, such as healthcare and IT (dependent on the founder’s know-how) show families selling down

earlier than in other sectors with more tangible asset business models. We see evidence in our research of these succession risks reflected in lower share price returns and accounting quality, particularly in second generation ownership and we discuss these below.

Survivorship and generational transition is of course not simply a function of successful family ownership and management. We see the role of the state as key in many areas from supporting the development of family ownership in many areas. For example, Japan, France, Germany, Turkey and Switzerland have enabled family businesses to thrive despite the heavy presence of the state in the economy. Germany has very beneficial inheritance tax laws that allow families to retain full or highly concentrated ownership that is not possible in economies with more onerous inheritance tax rules.

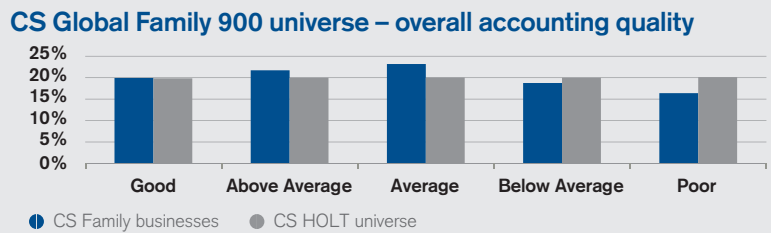
The state has also been a bar on entrepreneurship in other instances. The obvious example of communist ownership of property in China and Russia barred anything other than micro-entrepreneurship and the state retains a heavy presence in countries through asset ownership and regulation. As a result, any comparison of generational ownership or survivorship between Asia, EMEA and other markets is largely distorted.

Accounting quality is in fact superior

We are able to look at proprietary indicators using CS HOLT as an alternative proxy for corporate governance and assess the real risks of family owners’ interests versus outside shareholders. Using CS HOLT’s accounting analysis as a means to measure potential agency costs or actual discrepancies in accounting practice that are to the detriment of minorities, we find no evidence of this. In fact, accounting quality (Figure 48) at family-owned businesses is generally superior to the overall CS HOLT universe with 67% of the companies ranking Average or above compared to the 60% within CS HOLT (the companies being ranked into quintiles).

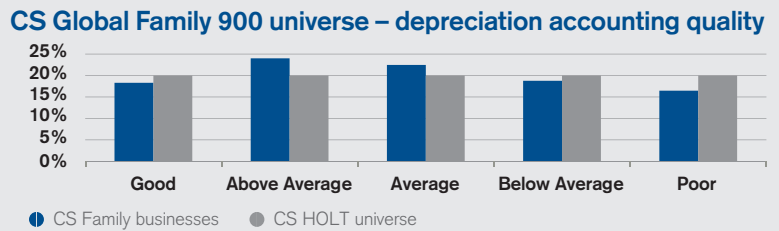
When we consider more detailed accounting metrics, we also see this superior practice at family-owned companies. Accounts receivable also show 67% of these companies rank Average or above along with 64% on accounts payable. This might also suggest better working capital management. Similarly, we see 65% of family-owned companies ranked as average or above on revenue recognition and 62% for expense recognition implying good transparency and reliability of financial statements. From this accounting point of view, we believe that some of the perceived corporate governance risks may be overstated and that there is a better alignment of interests by family and minority owners than may be understood.

Figure 48



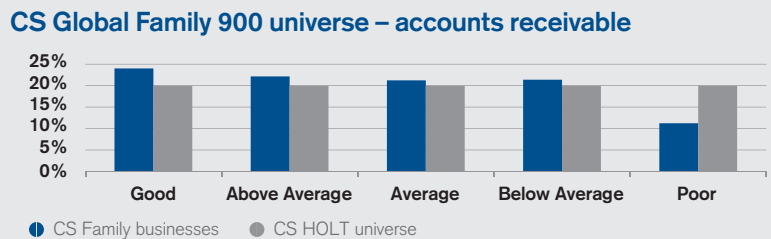
Source: Credit Suisse HOLT

Figure 49



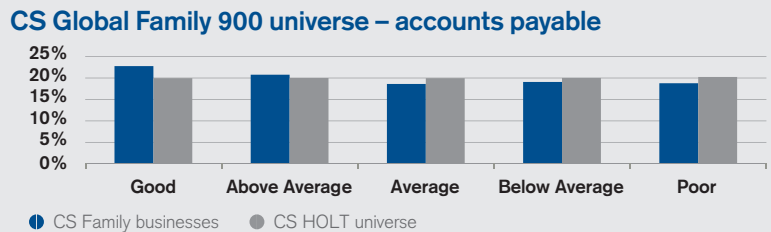
Source: Credit Suisse HOLT

Figure 50



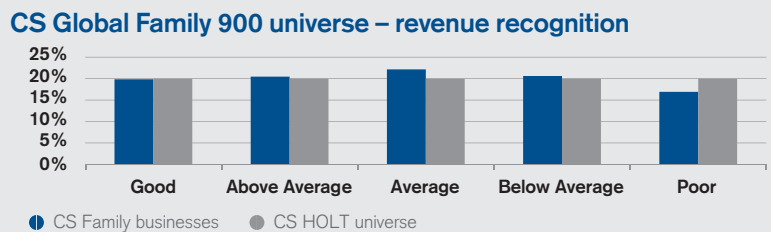
Source: Credit Suisse HOLT

Figure 51



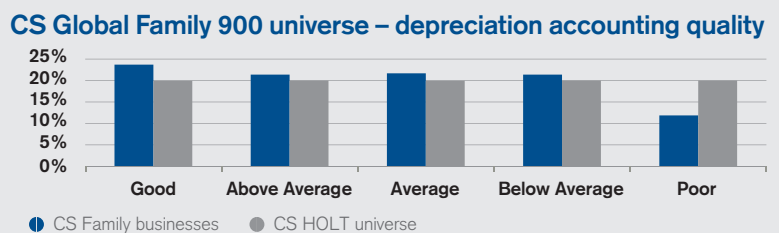
Source: Credit Suisse HOLT

Figure 52



Source: Credit Suisse HOLT

Figure 53



Source: Credit Suisse HOLT

Diversity

Further to our CS Gender 3000 report of September 2014, we look to see whether family-owned companies have higher levels of diversity as academic research suggests. We find very interesting results that demonstrate clearly higher levels of female representation on boards of directors and in senior management at family-owned companies in the USA and Asia. By contrast, we see fewer female board directors in Europe, which shows both the slower response of family companies to the mandated quotas and targets in place and perhaps the

lack of female family members available to fill these positions. In Latin America, diversity is worse in family companies in both the boardroom and management and highlights the cultural drivers of diversity that we discussed in [CS Gender 3000](#).

Figure 54

Diversity at family-owned companies

	Boards				Senior mgmt
	2010	2011	2012	2013	2013
North America	15.4%	16.0%	16.8%	18.2%	16.2%
Europe	12.1%	14.0%	16.6%	19.4%	15.0%
Developed Asia	7.4%	7.9%	8.6%	9.0%	13.2%
Emerging Asia	7.6%	8.0%	8.0%	8.8%	15.4%
Latin America	6.0%	6.0%	5.6%	5.0%	5.9%
EMEA	13.1%	12.6%	11.8%	12.6%	10.9%
Total	9.0%	9.7%	10.2%	11.2%	13.8%

Source: Company data, Credit Suisse research

Figure 55

Difference versus CS Gender 3000

	Boards				Senior mgmt
	2010	2011	2012	2013	2013
North America	2.7%	3.1%	3.3%	4.2%	1.2%
Europe	-1.4%	-0.9%	-1.1%	-1.2%	0.3%
Developed Asia	1.9%	1.5%	1.6%	1.2%	0.6%
Emerging Asia	1.4%	1.5%	1.1%	0.8%	5.0%
Latin America	0.2%	-0.3%	-0.2%	-1.2%	-3.2%
EMEA	5.8%	5.3%	4.2%	4.4%	-0.5%
Total	-0.6%	-0.6%	-1.1%	-1.5%	0.9%

Source: Company data, Credit Suisse research



The investment case for family-owned companies

Does the wealth creation of family businesses offer an investment opportunity for outside shareholders? The focus on cash preservation leads to superior cash returns and superior share price performance. Our analysis shows that the highest share price returns come from investing alongside the founder with share price returns subsequently diminishing with generational transition.

The question for investors of course is whether family-business success creates a good investment opportunity for minority investors or whether rent is simply extracted for the benefit of internal shareholders. As discussed above, looking on a sector-adjusted and market-weighted basis, the 920 companies in our family business universe today demonstrated a 47% outperformance compared to the MSCI ACWI over the nine years to the end of April 2015 (Figure 59). This equates to an annual excess return of 4.5% over the same period.

On a simple equal weighted basis illustrated in Figure 60, our basket of stocks has beaten the MSCI ACWI index by 351% over the same period. This is a CAGR of 21.6% for these family-owned stocks compared to 3.6% for the index. Clearly, investing alongside family owners has been a significant positive for outsiders too.

We have previously launched the CS Family Business Index (Bloomberg ticker CSFAM Index), an index comprising 40 listed US and European family companies (but not Asian)

which exhibit HOLT's Best in Class characteristics. Since its launch in 2007, the index has outperformed the MSCI ACWI by a CAGR of 140 basis points annually. This index is not sector or market adjusted.

We see that family-owned companies trade at slight premiums both for 2014 and on average since 2006. This reflects the higher returns, both in terms of ROEs and CFROI that the companies show in aggregate. However, we see considerable regional differences with European and US companies within our CS Global Family 900 universe showing lower returns on average. This corroborates previous research and we believe that external investors are prepared to pay a slight premium for the more stable performance through the cycle that we have seen above. In terms of EV/EBITDA, there is some consistency across regions in the premium at 9-10% over the past nine years.

Figure 56

Returns and valuations for family-owned companies – 2014

	ROE (%)	CFROI (%)	EV/ EBITDA (x)	P/B (x)	Net debt/ Equity (%)	Net debt/ EBITDA (x)
Global	11.5	6.4	10.6	2.1	52.0	1.8
USA	12.0	9.1	13.2	3.3	30.7	1.1
Europe	12.1	7.5	9.2	2.0	42.7	1.3
Asia	10.8	5.5	9.7	1.7	44.4	1.7
Latam	9.3	6.7	10.1	2.1	86.6	2.6
EMEA	17.9	8.1	18.6	1.8	82.6	1.9

Source: Company data, Credit Suisse estimates

Figure 57

Returns and valuations relative to MSCI ACWI – 2014

	ROE (%)	CFROI (%)	EV/ EBITDA (x)	P/B (x)	Net debt/ Equity (%)	Net debt/ EBITDA (x)
Global	-4.8	1.0	12.3	-1.2	7.9	17.1
USA	-18.2	-2.0	22.9	17.2	-39.0	-14.8
Europe	15.8	25.0	2.8	14.4	-22.3	-24.3
Asia	-8.7	-0.4	17.0	5.3	34.5	49.2
Latam	3.0	53.9	-8.7	33.3	41.8	8.5
EMEA	62.9	31.4	218.4	31.8	222.4	92.0

Source: Company data, Credit Suisse estimates

Figure 58

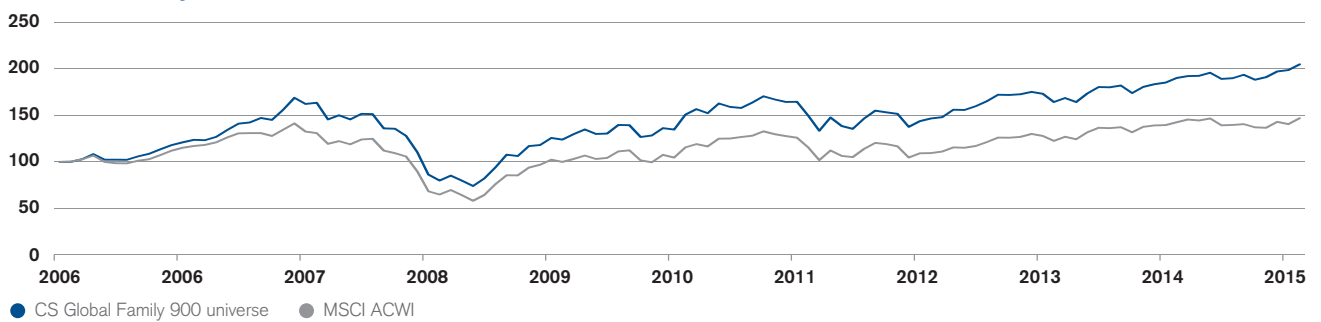
Returns and valuations relative to MSCI ACWI – since 2006

	ROE (%)	CFROI (%)	EV/ EBITDA (x)	P/B (x)	Net debt/ Equity (%)	Net debt/ EBITDA (x)
Global	5.0	9.1	11.8	5.1	12.4	19.8
USA	-13.8	2.7	8.1	5.9	-41.0	16.7
Europe	-13.7	-5.3	10.3	10.8	-2.6	9.9
Asia	2.6	0.5	8.4	-6.9	41.7	47.1
Latam	-5.5	24.8	12.0	13.8	94.8	57.7
EMEA	32.9	33.1	51.8	17.3	392.2	133.0

Source: Company data, Credit Suisse estimates

Figure 59

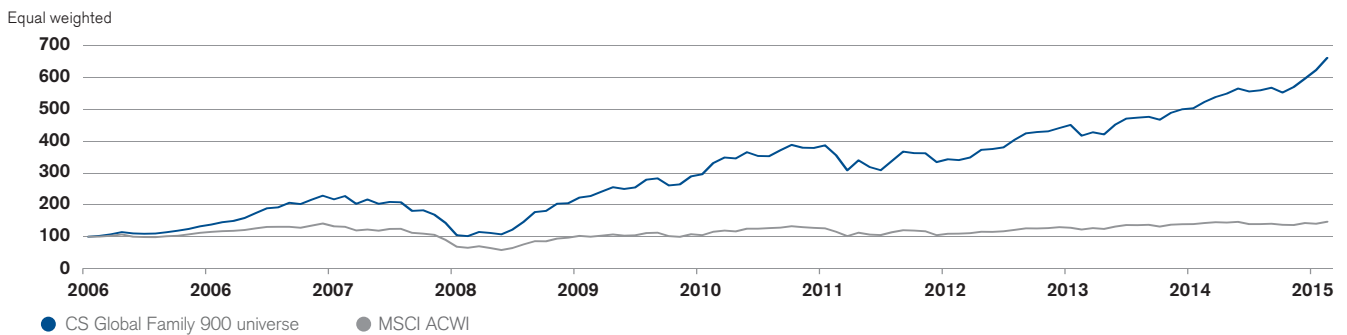
CS Global Family 900 universe versus MSCI ACWI



Source: Bloomberg, Credit Suisse Research

Figure 60

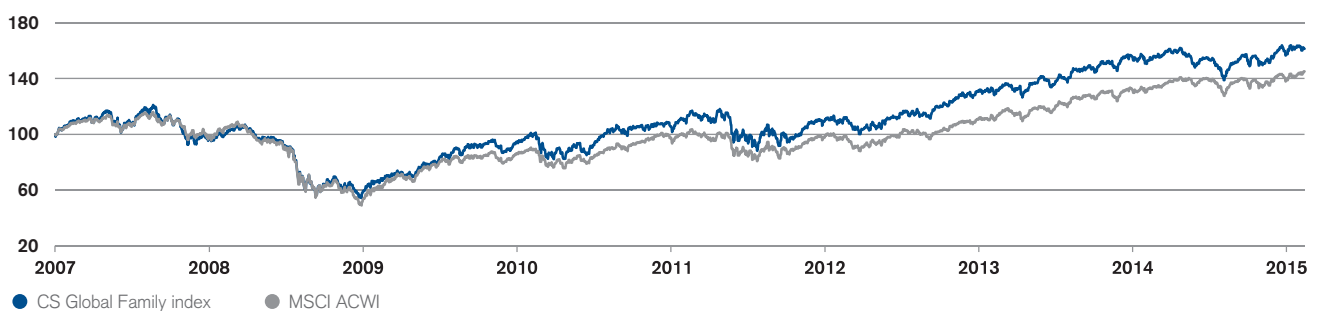
CS Global Family 900 universe versus MSCI ACWI



Source: Bloomberg, Credit Suisse research

Figure 61

CS Family index performance versus MSCI ACWI



Note: past performance is no guarantee of future returns

Source: Credit Suisse HOLT, Bloomberg



When should you invest?

We have looked at share price returns by age of company and find that it pays to invest alongside the company founder, i.e. in the early years of a company's existence when period of high growth is likely. The CAGR of first-generation companies has been 9.0% over the past nine years. This does not necessarily mean that investors should automatically buy in to IPOs and Figure 62 suggests that first-generation companies would also offer the best trading opportunities, i.e. volatility, to maximize share price returns. This more volatile early return profile underlines the less mature nature of the company and less familiarity by investors who might over- and under-estimate early stage company performance and hence exaggerated share price reactions.

Interestingly from this generational breakdown, we find that third-generation ownership marginally outperforms the second generation. Interpretations of this might reflect first generation to second generation success and wealth inheritance issues before a move to broader and external management by the third generation or family wealth creation engendering a sense of stewardship rather than ownership by the third generation. In any case, our analysis of returns by generation of ownership clearly shows diminishing returns as family-owned companies mature.

Dividends

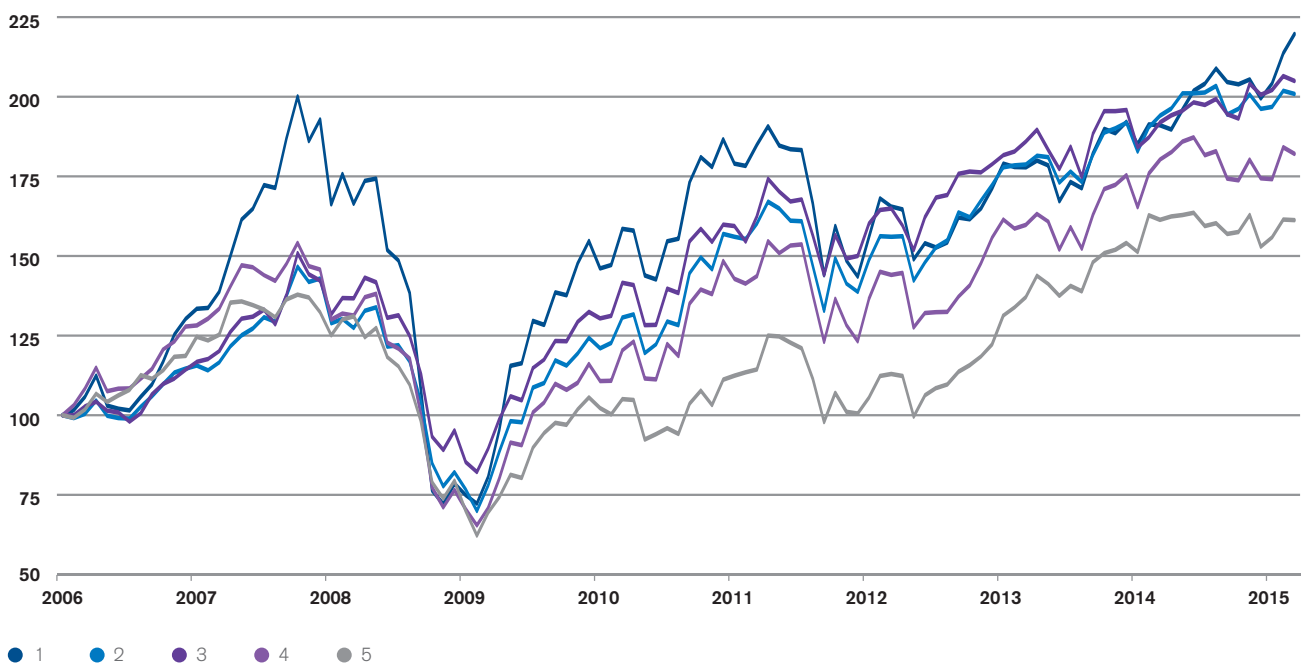
It cannot be a surprise that family-owned companies have a lower pay-out ratio. Academic research argues that one of the key differences between family-owned businesses and more broadly owned companies is that families want to maintain control or ownership and to be able to pass on the company as a legacy to future generations. That companies tend not to transition successfully down generations in most instances (see Figure 45) does not necessarily impact the intentions and decisions of founders or first-generation owners. As such, family-owned companies conserve internally generated sources of cash, hence the lower R&D and M&A intensity we see above and similarly the lower pay-out of dividends.

In addition to this, in founder and early generation ownership, we would expect to see more family members derive wealth from the company as salaried employees and in later generations, when there is more fragmented family ownership and potentially a greater number of family members participating in the family holding, leading to a greater alignment with minorities' interests and calls for a higher pay-out.



Figure 62

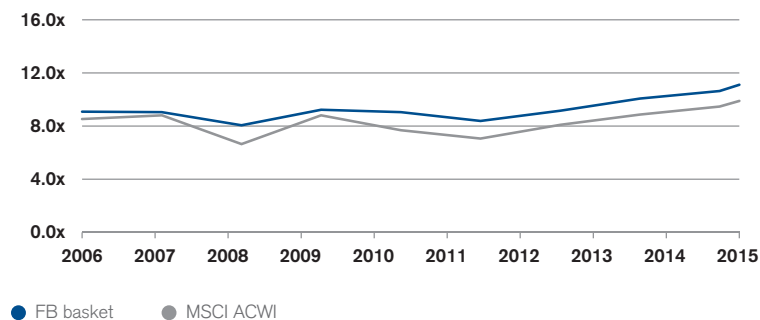
Share price performance by generation of ownership



Source: Credit Suisse research

Figure 63

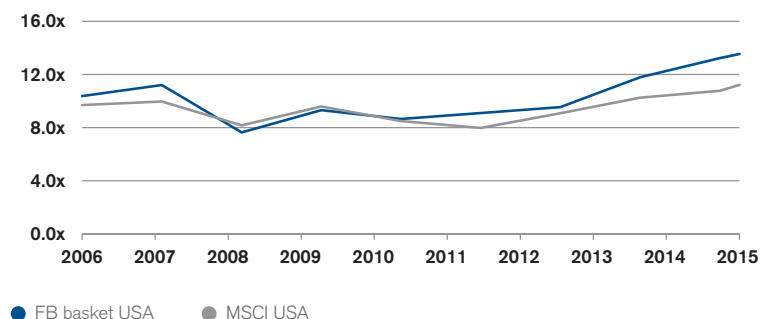
CS Global Family 900 universe – EV/EBITDA



Source: Company data, Credit Suisse estimates

Figure 64

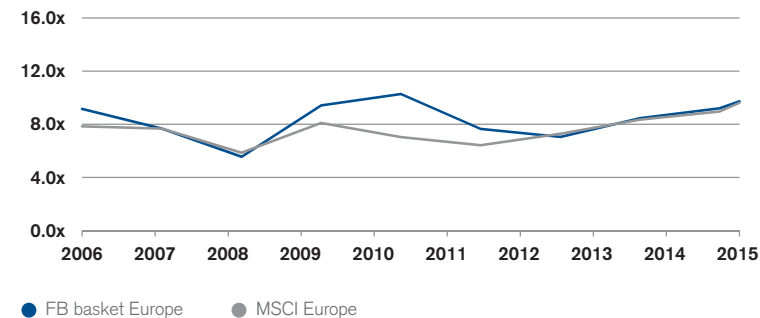
US family businesses – EV/EBITDA



Source: Company data, Credit Suisse estimates

Figure 65

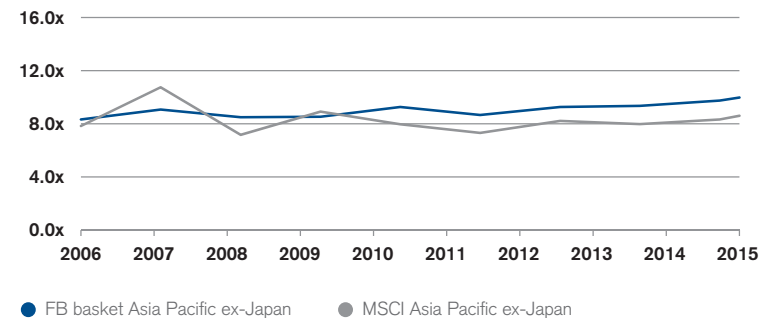
European family businesses – EV/EBITDA



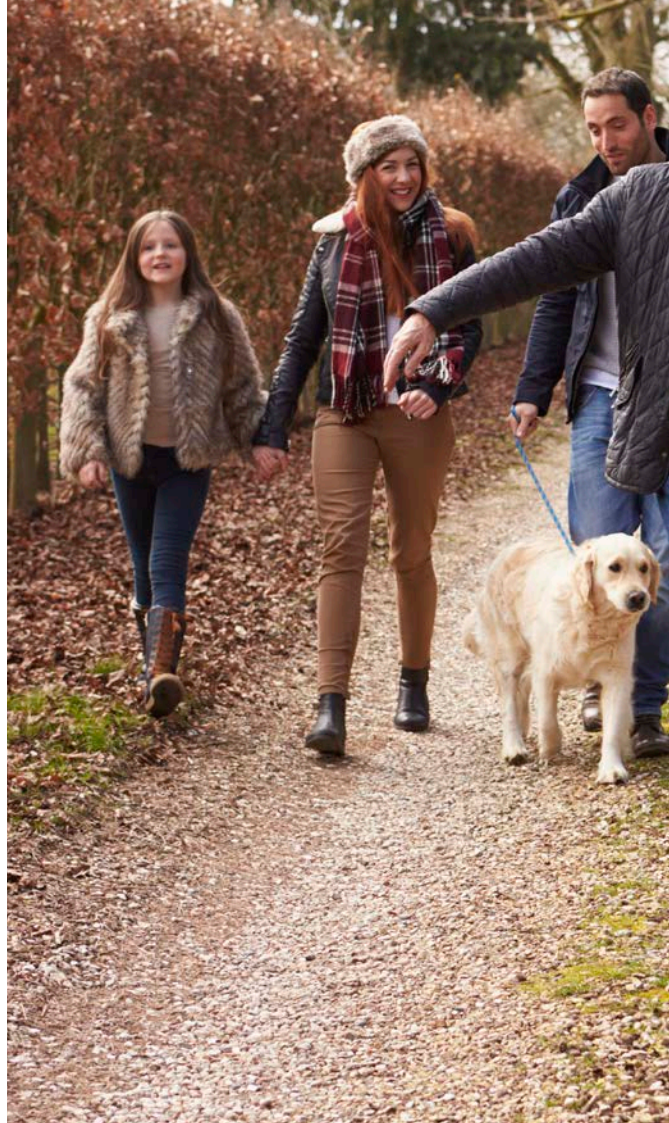
Source: Company data, Credit Suisse estimates

Figure 66

Asia ex-Japan family business – EV/EBITDA



Source: Company data, Credit Suisse estimates



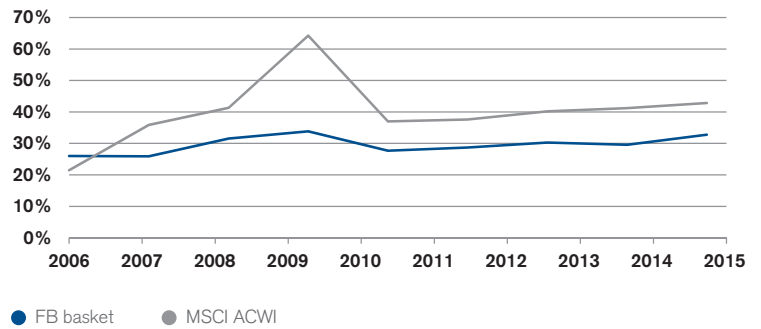
In Figure 67, we see a clear spike in the pay-out ratio for the MSCI ACWI for 2009. This is due to the fall in profits that year rather than an increase in dividends paid. A similar pattern is seen across all regions. However, while we see dividend pay-outs generally trending up in the USA and Europe in recent years (versus downwards in Asia), it is notable that family-owned businesses have a much smoother profile to pay-out ratios over the past eight years particularly in 2008-09. It appears that they were more willing to tailor dividend pay-outs to available cashflows rather than maintain absolute pay-out levels, which we can see was a priority at the broader benchmark. Yet again this would underpin the argument of these companies having a much longer-term view and running the business accordingly rather than answering the short-term demands of the market and the share price.

We have seen that family businesses in Europe and the USA trade at a slight premium relative to ROE and from a Gordon Growth Model point of view, if not from a CFROI standpoint, and the consistently wider cash flow spread relative to the cost of capital we illustrate in Figure 17. But if we evaluate the market price paid for economic profit, we see in Figure 71 that there has been a consistent discount over time, although that has generally nar-



Figure 67

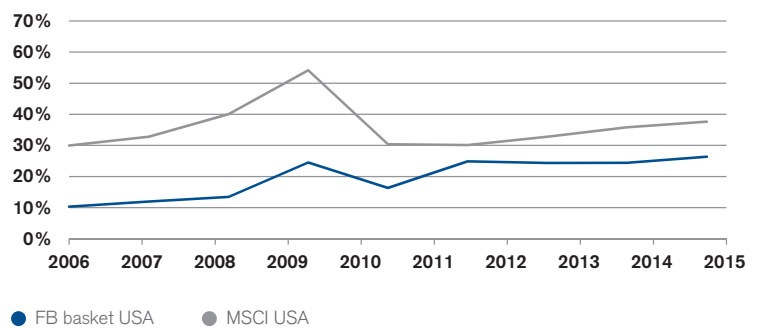
CS Global Family 900 universe pay-out ratio



Source: Bloomberg, Credit Suisse research

Figure 68

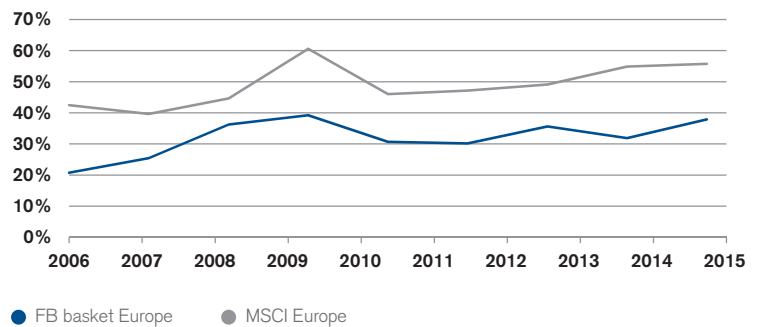
US family businesses – pay-out ratio



Source: Bloomberg, Credit Suisse research

Figure 69

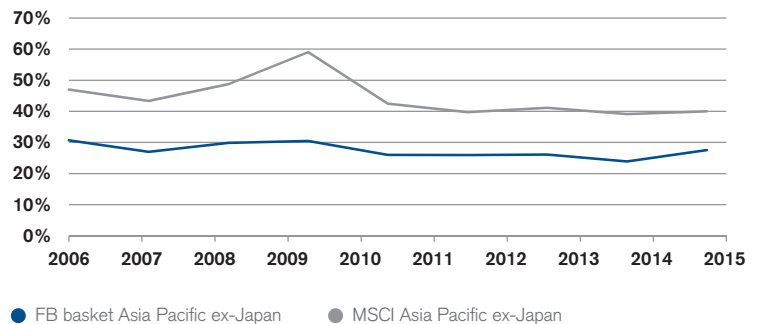
European family businesses – pay-out ratio



Source: Bloomberg, Credit Suisse research

Figure 70

Asia ex-Japan family businesses – pay-out ratio



Source: Bloomberg, Credit Suisse research

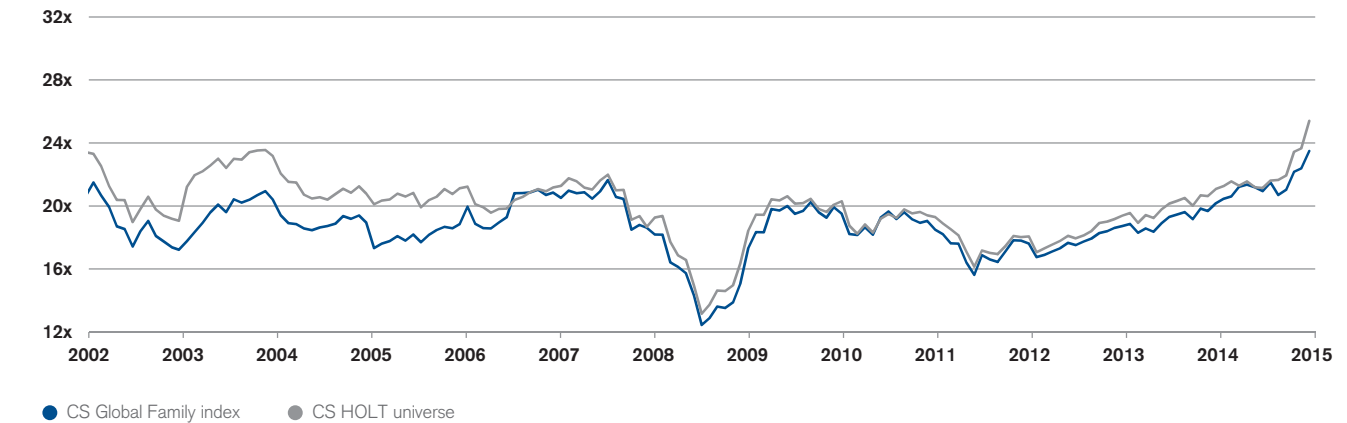
rowed over the past eight years. Notwithstanding this, in Figure 72 we see a clear widening of the discount for family-owned businesses over the course of 1Q15 suggesting good investment opportunities now exist.

While we find that large cap family-owned companies have more leveraged balance sheets contrary to other research, the fact that these businesses are the main source of wealth for family owners may make investors perceive that they are at lower risk of bankruptcy. This may explain the implicit acceptance of the lower ROE by outside investors. As Figure 63 illustrates, the price to book premium appears to be structural, particularly in Europe.

Figure 71

Economic profit PE – CS Global Family 900 universe versus MSCI ACWI

Excluding financials and regulated utilities

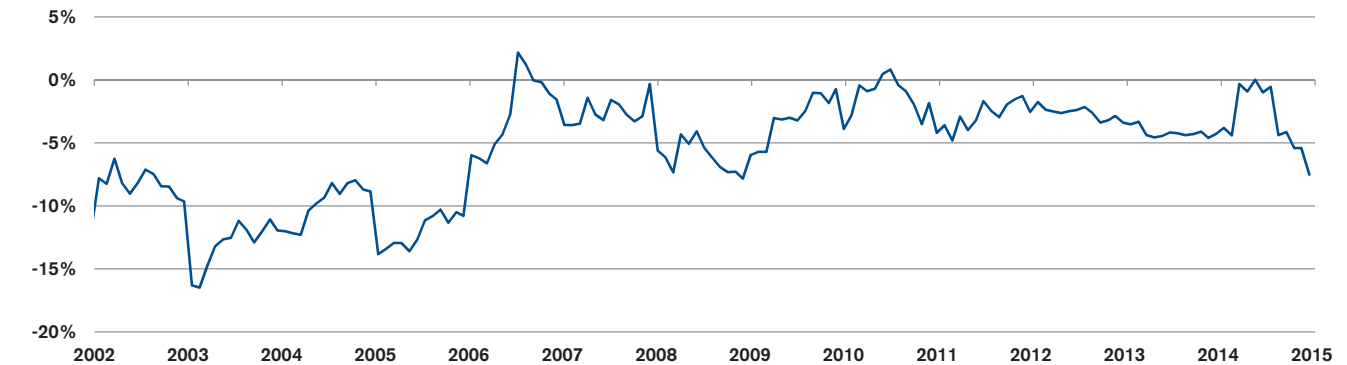


Source: Credit Suisse HOLT

Figure 72

Economic profit PE – CS Global Family 900 universe versus MSCI ACWI

Excluding financials and regulated utilities



Source: Credit Suisse HOLT

Are there supergroups within the family-owned universe?

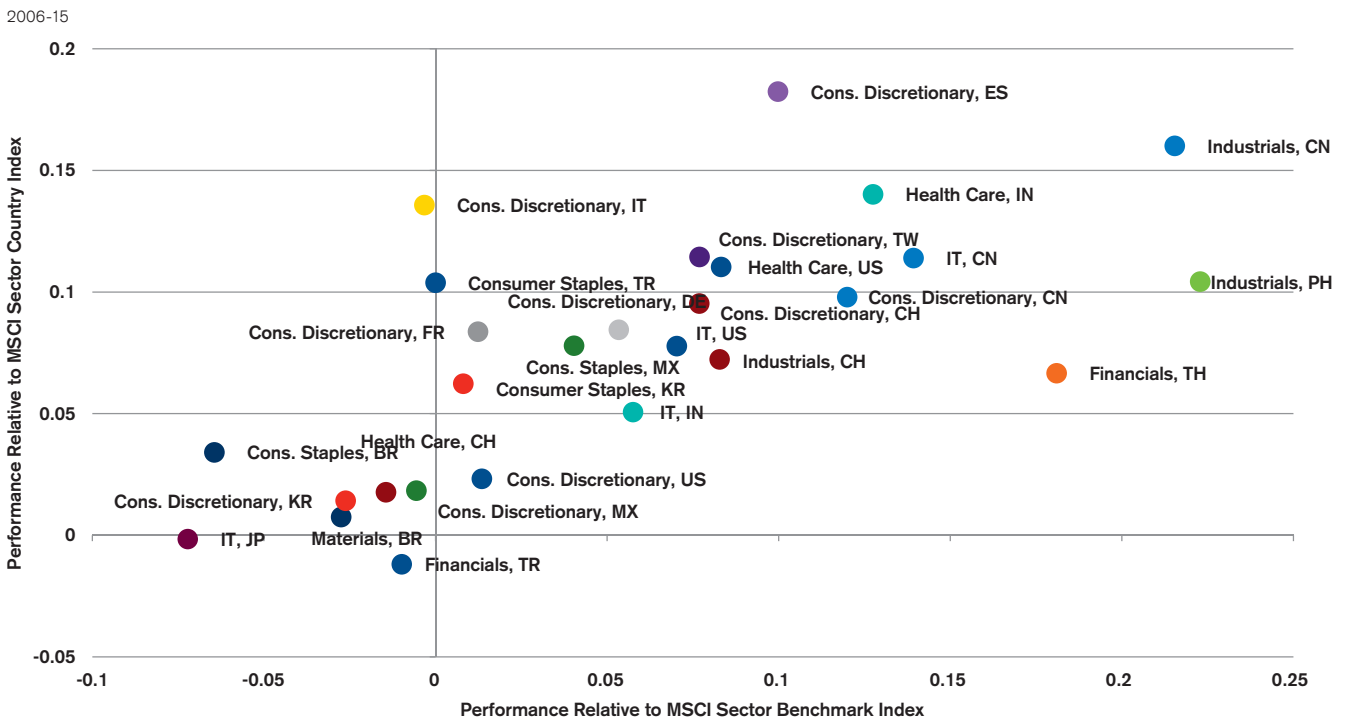
We have looked to see if there are clusters of founders and countries where there is a marked outperformance since 2006 of family-owned businesses in specific sectors against both the sector and respective country benchmarks. Figure 73 shows returns to investors that are beyond being simply sector or country plays.

On the chart to the right, we show the clusters of companies that have consistently outperformed versus both their relevant sector and country indices since 2006. For example, if we look at the cluster of Italian family-owned consumer discretionary companies, we see share price returns in line with the MSCI consumer discretionary benchmark but well above MSCI Italy. Similarly, we see Chinese and Philippine family-owned industrials deliver well above the benchmark.



Figure 73

Supergroups – companies that outperform both MSCI sector and country benchmarks



Source: Bloomberg, Credit Suisse research

Do families make good management?

Agency risks at family-owned companies are overstated in our view. We establish that public reputation and longstanding philanthropy is reflected in higher accounting quality, despite dual share classes that enable families to concentrate control. With broad progress in the corporate responsibility debate, family-owned companies no longer play a leading role.

We have looked at the MSCI intangible value assessment rankings for the companies in our universe to assess whether we can find any qualitative evidence of the more altruistic management and strategic priorities that we find discussed in academic research broadly and use these MSCI assessment of potential ESG risks. Lower returns are generally explained as a family-owned company's priorities being broader than just economic performance and indeed, particularly in Europe and the USA, we see a number of family-owned charities and foundations that have a philanthropic agenda and highlight family priorities. Our previous report, "Family businesses: Sustaining performance" (September 2012) found that the majority of family-owned companies had ESG-related strategies in place and that family businesses in Europe and the USA had a defined sustainability strategy, particularly relating to environmental issues.

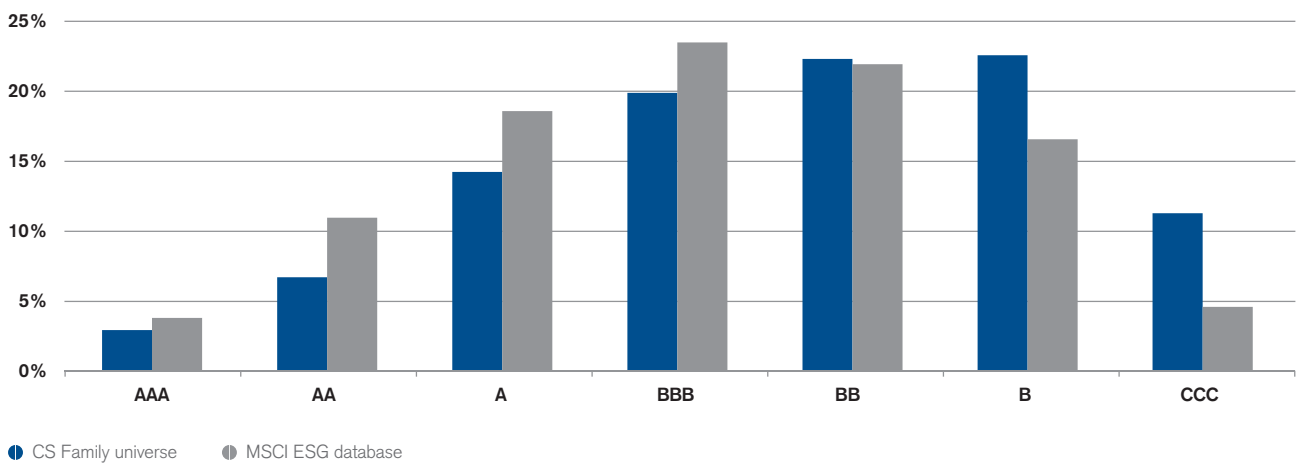
However, we do not find this to be the case in our global family-business universe in 2015 if we try to measure this using MSCI IVA rankings as a proxy for an empirical measure. As illustrated in Figure 74, we see a clear distribution difference between the companies in our universe and the >4000 companies with IVA rankings in the MSCI ESG database with the latter holding higher scorings, i.e. fewer ESG risks. If we look at the data on a regional basis in Figure 75, we see that the European

companies have a far better score than those in the USA and Asia where the majority of companies have a BB or B ranking. Almost 60% of the family-owned companies in our universe have an AAA-A score, whereas there is no AAA-ranked company in the USA and 70% have a score of BBB and below. We would interpret this change in relative good corporate citizenship, compared to our 2012 report, as an illustration as to how the ESG agenda has been adopted more globally and that the family-owned businesses' position as an early adopter of the environmental agenda has been eroded in the past few years.



Figure 74

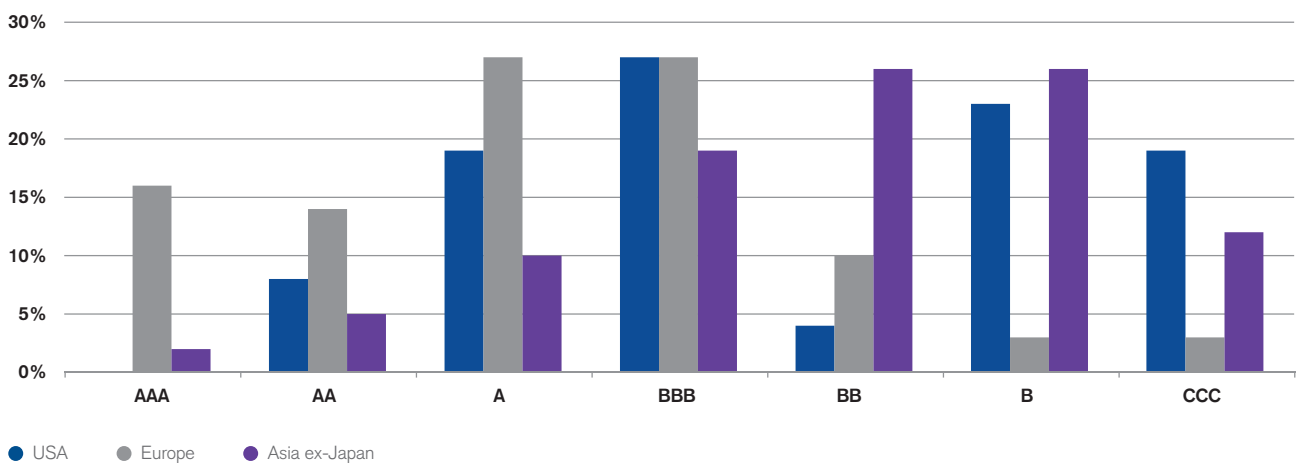
CS Global Family 900 universe – MSCI IVA rankings



Source: MSCI ESG database, Credit Suisse research

Figure 75

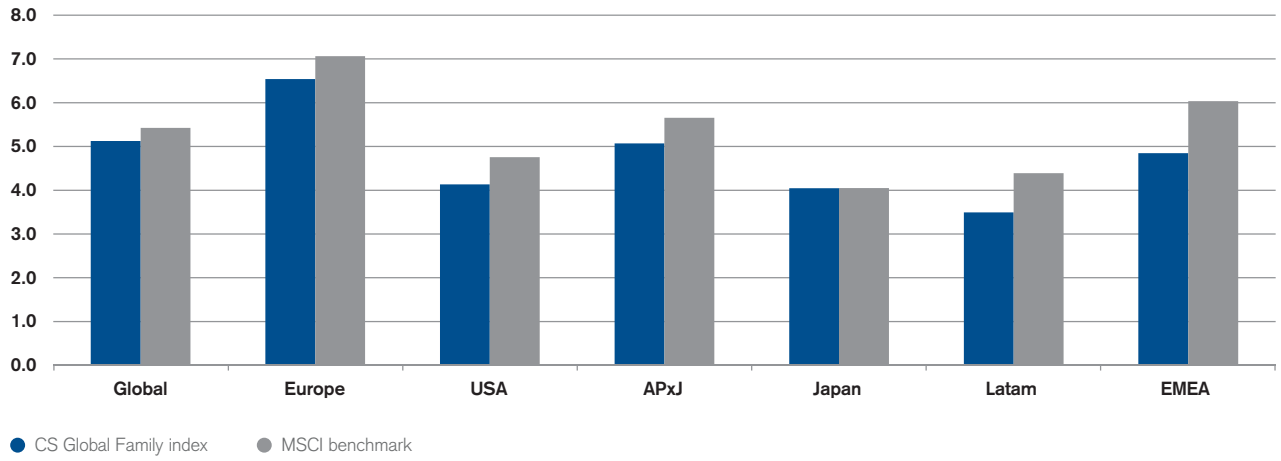
CS Global Family 900 universe – MSCI IVA rankings by region



Source: MSCI ESG database, Credit Suisse research

Figure 76

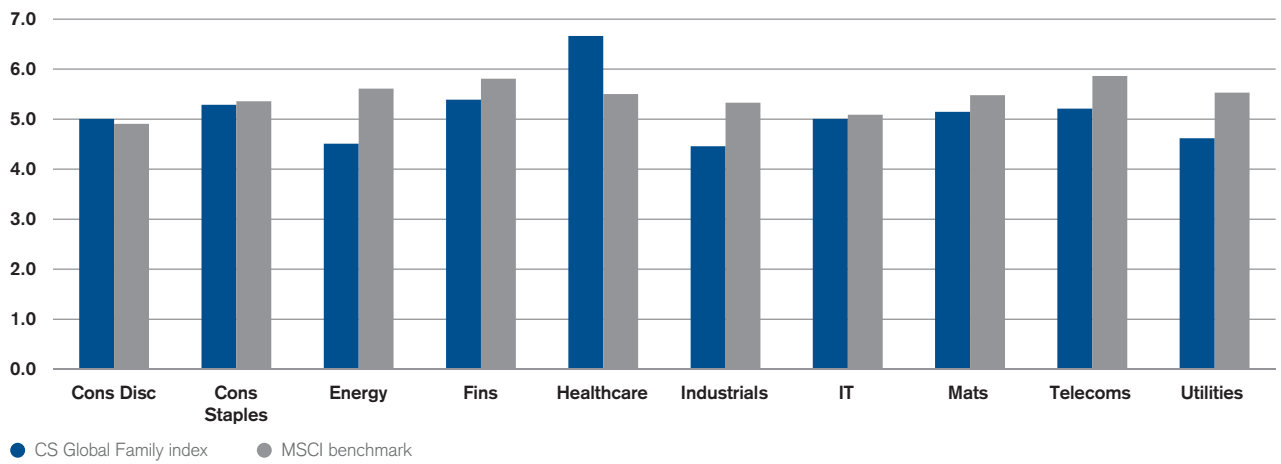
CS Global Family 900 universe – MSCI ESG corporate governance rankings by region



Source: MSCI ESG database, Credit Suisse research

Figure 77

CS Global Family 900 universe – MSCI ESG CG rankings by sector



Source: MSCI ESG database, Credit Suisse research



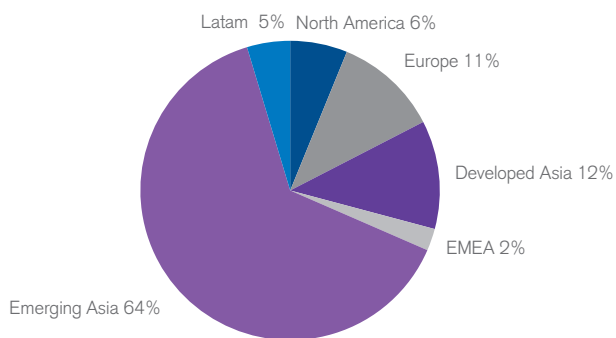
Appendix 1

The CS Global Family 900 universe

Family enterprise is concentrated in consumer-related companies and technology. Intellectual property is the fundament of many family-owned companies, whilst replication provides opportunity in more emerging markets. Capital requirements, regulation and state asset ownership also limits family ownership in the materials, utilities and telecoms sectors.

Figure 78

Number of family-owned businesses by region

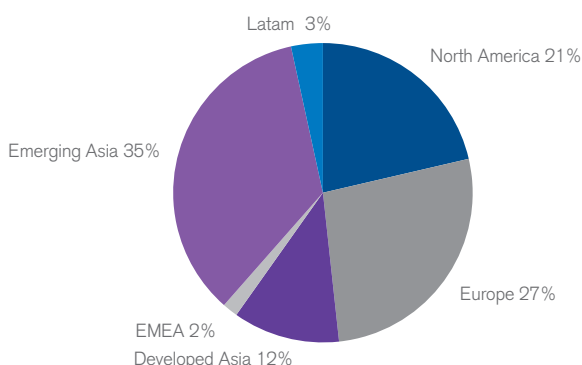


Source: Bloomberg, Credit Suisse research

Figure 79

Market capitalization of family-owned businesses

USD bn



Source: Bloomberg, Credit Suisse research

We have established a database of 920 publicly listed companies globally that have a market capitalization of at least USD 1bn and where there is a family-owned shareholding of at least 20% of shares outstanding. We find examples in 35 countries. The preponderance of these, in terms of numbers, is to be found in Asia which is explained by the different and more recent pattern of economic development in the region compared to Europe and the USA. In more developed markets, we see more fragmented ownership and many families selling out over time as a general theme. Frequently quoted statistics from the Family Business Institute show that only one third of family-owned businesses last into a second generation of ownership, 12% to a third and just 3% to a fourth. In our analysis, we have accounted for the greater numbers of Asian companies in this family-owned company universe by evaluating all our data on a sector- and country-neutral basis relative to the MSCI ACWI benchmark. We have excluded joint ventures and assets previously owned by the state and sold into private hands.

Our database represents 25% of MSCI World market capitalization and is comparable in terms of sector weightings, although our family-owned business universe shows a greater weighting of companies in the technology, consumer discretionary and staples sectors, with few financials, specifically banking stocks. We see a higher representation of financials, especially real estate businesses within our Asian universe relative to the USA and Europe. The concentration in consumer-related sectors and technology implies lower barriers to entry in these

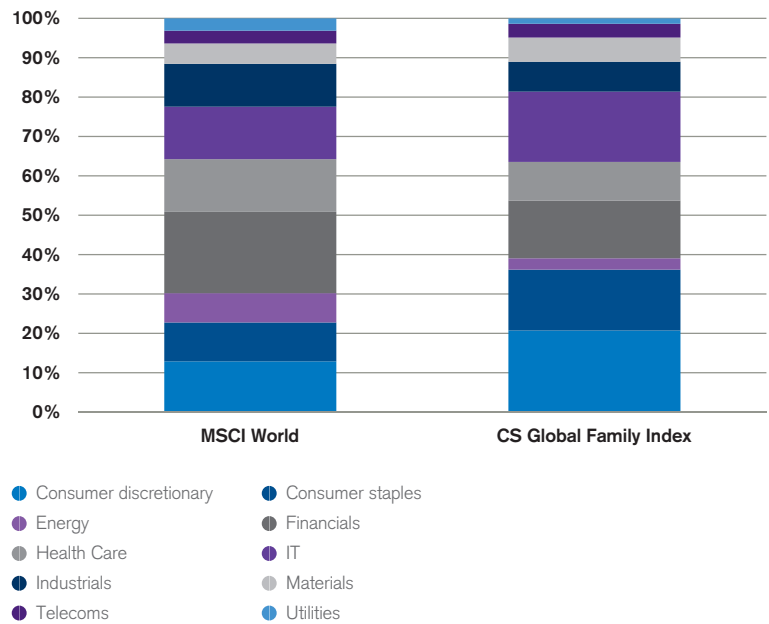
sectors from an initial capital investment point of view and in the case of technology, less competition, i.e. proprietary intellectual property. As outlined above, we have adjusted for different sectoral weightings when analyzing our data.

Less than 25% of the companies in our Family Business universe are defensives, which cannot be a surprise as entrepreneurs seek growth opportunities. Villalonga and Amit¹ highlight how a number of sectors are in fact dominated by family-owned companies: the global beer sector, for example, along with newspapers and six of the seven largest USA cable operators are still owned and actively managed by founding families. We find clusters of companies in specific countries, the obvious and well known examples being manufacturing-related consumer discretionary in Germany and apparel-related companies in Italy. Both countries also have considerable numbers of non-listed companies with a similar profile.

Existing research attributes the relative outperformance of family-owned businesses, as measured by ROE or Tobin's Q, to a longer-term development strategy. This in turn is driven by the importance of maintaining independence so that

Figure 80

Sector breakdown – CS Global Family 900 universe versus MSCI ACWI

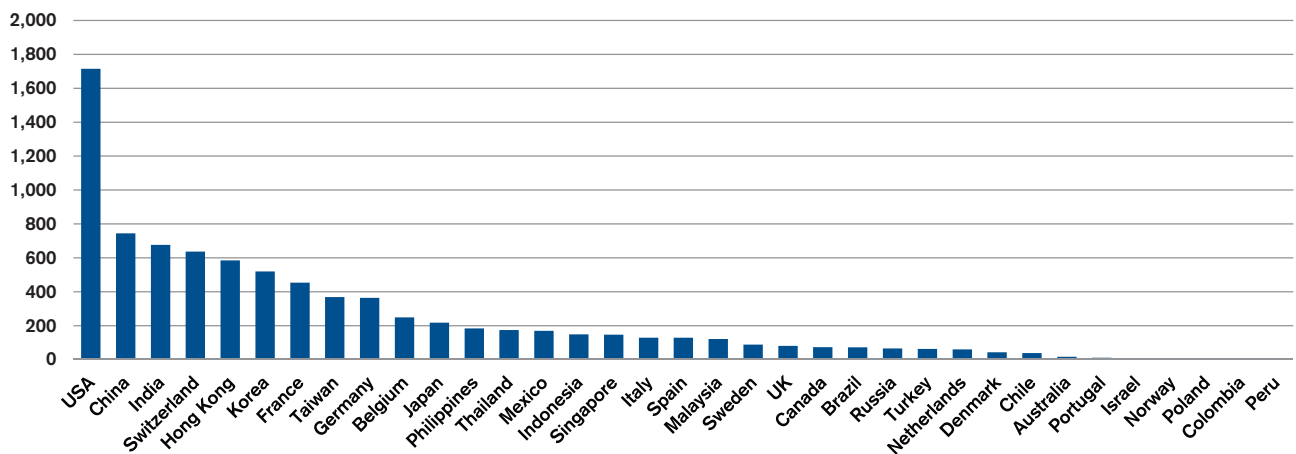


Source: Bloomberg, Credit Suisse research

Figure 81

CS Global Family 900 universe – market capitalization by country

USD bn



Source: Bloomberg, Credit Suisse research

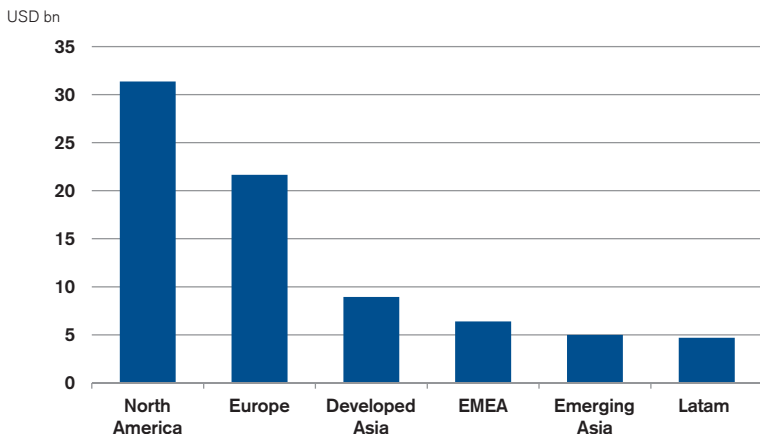
companies can be passed on to the next generation and hence the reliance on internally generated cash flows and a lower level of external debt to finance investment. This should imply less aggressive growth, according to academic research. However, our findings contradict this thesis as the 920 companies in our universe exhibit stronger and less volatile growth as well as higher leverage (as discussed above).

Other factors that are cited in academic studies to explain the difference between companies with a sizeable family holding and those with broader public ownership are a focus on organic growth rather than acquisitions, internal competition for resources meaning that only the very best investment projects are adopted and a smoother cycle to investment at family-owned companies, i.e. less investment during boom times and continued investment during downturns. Agency costs (the internal costs arising from conflicts of interest between family and external shareholders) work both to the benefit and detriment of minorities in that more conservative management can

¹ Villalonga and Amit: Family control of Firms and Industries, Financial Management, Autumn 2010

Figure 82

CS Global Family 900 universe – market capitalization by region



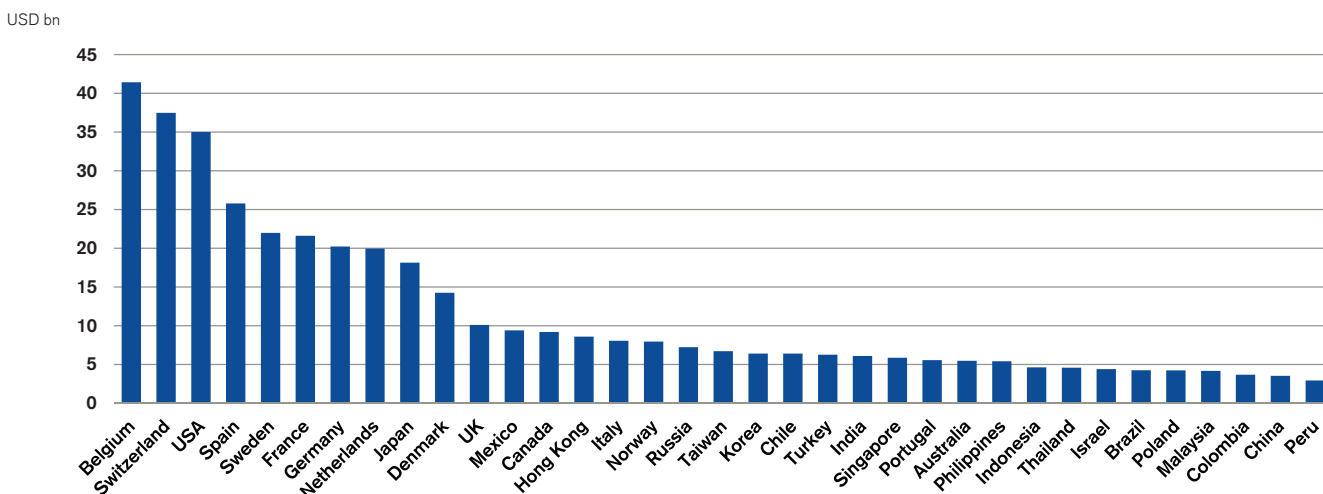
Source: Bloomberg, Credit Suisse research

reduce the risk of bankruptcy, the incentive to monitor managers can reduce costs whereas family ownership can entail the (expensive) employment of under-qualified family members, the extraction of profits to the family at the expense of minorities, as well as costly related party transactions and limited accountability, amongst many other factors.

There can be little surprise that in terms of market capitalization the USA has the greatest representation in our family-owned business universe. This reflects the capitalist, entrepreneurial development of the economy and the lack of state ownership of assets. China, interestingly, has the second highest representation, which underscores the very dynamic and entrepreneurial development of the economy over the past 35 years. Emerging markets make up 40% of our companies by market capitalization and illustrate the importance of family-owned companies in the expansion and

Figure 83

CS Global Family 900 universe – average market capitalization by country



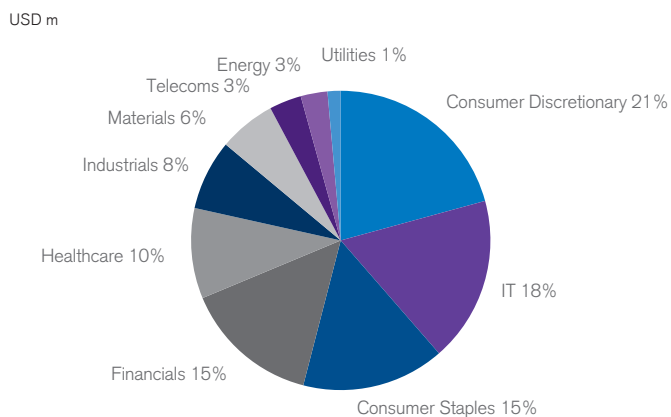
Source: Bloomberg, Credit Suisse research

advancement of these economies in the past 50 years and in some instances, post-independence.

The average size of the companies in our universe is USD 9.1bn and as we see from Figure 82, American and European family-owned businesses tend to be larger with market capitalization averaging over USD 30bn in the USA and over USD 20bn in Europe. Asian and emerging market companies are generally smaller with the average market cap below USD 10bn across all regions. This largely reflects the age and position of American and European companies in terms of their development cycle compared to the less mature businesses of Asia and emerging markets. But as expected, we generally see large cap family-owned businesses in developed markets versus small and medium cap elsewhere.

Figure 84

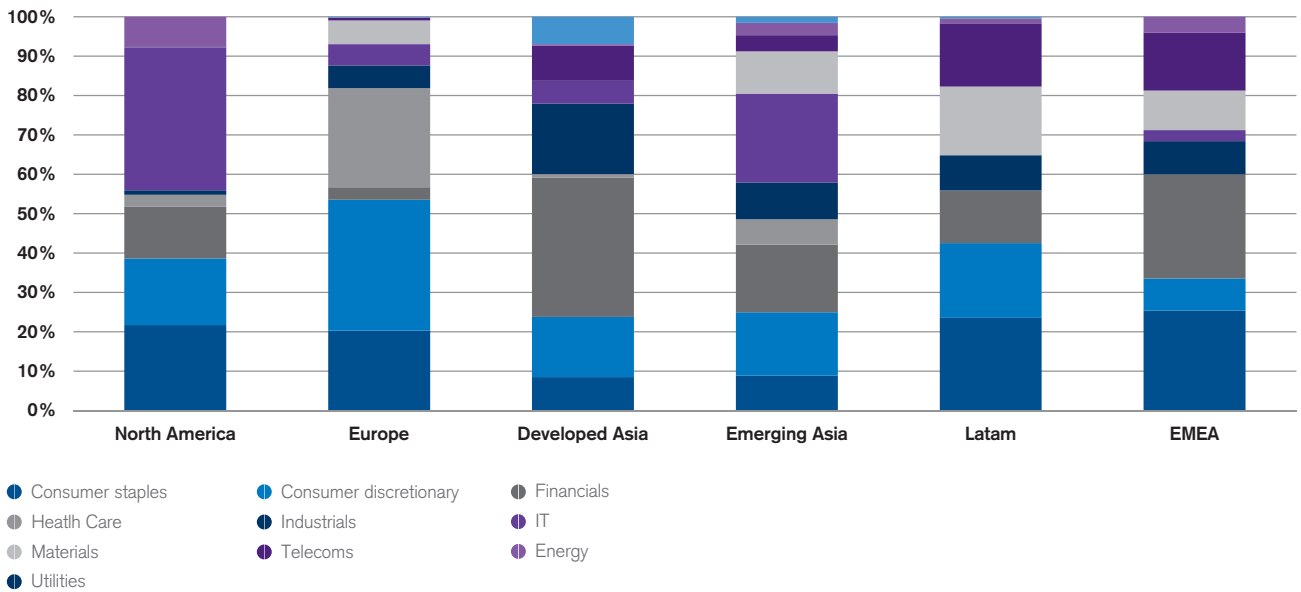
CS Global Family 900 universe – market capitalization by sector



Source: Bloomberg, Credit Suisse research

Figure 85

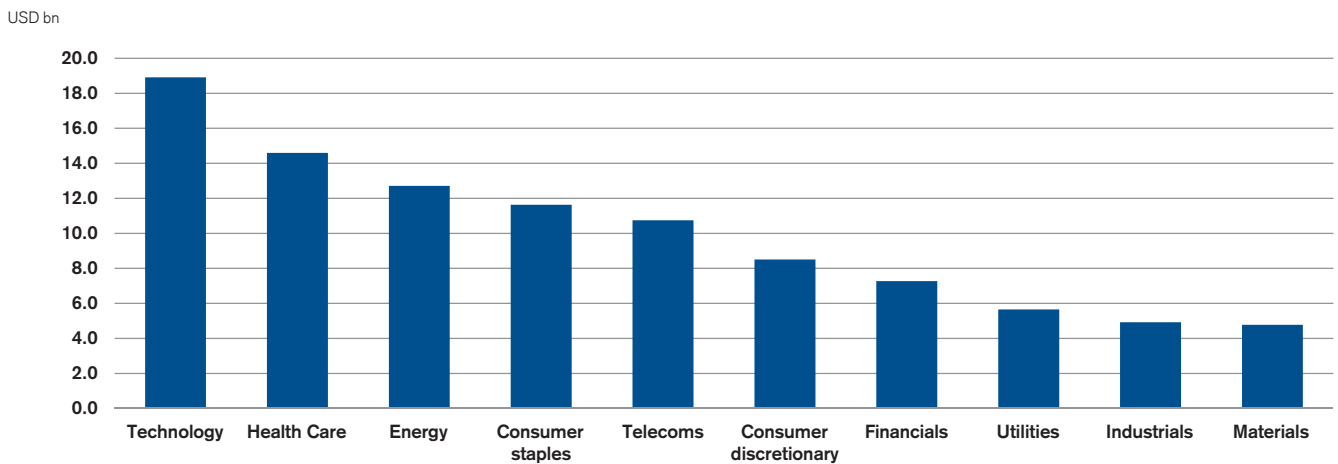
CS Global Family 900 universe – sector breakdown by region



Source: Bloomberg, Credit Suisse research

Figure 86

CS Global Family 900 universe – average market capitalization by sector



Source: Bloomberg, Credit Suisse research

Some markets are dominated by a single large cap family-owned name or a handful of large cap companies. For example, Belgium (see Figure 83) is skewed by AB InBev while other Belgian family-owned businesses have an average market capitalization of USD 9.7bn compared to the USD 9.1bn global average. Switzerland is home to Novartis and Roche and excluding these two pharma names, Swiss family-owned businesses average USD 10.7bn. Similarly, Spain excluding Inditex, has an average market capitalization of USD 6.5bn for family-owned businesses, some way below European averages and as we see in Figure 83, southern European family businesses tend to be smaller than their northern European counterparts.

Looking at family companies by sector as illustrated in Figure 84, we see a concentration in technology and consumer-related businesses and a low level of activity in materials, energy, telecoms and utilities, these latter sectors being cyclical, capital intensive or public service network industries that see greater state regulation and asset ownership. Founder-owned or family-owned technology businesses are dominated by four companies with a market cap of more than USD 170bn each: Facebook, Google, Oracle and Samsung Electronics. Well documented histories of technology start-ups recount low cost start-ups based on proprietary intellectual property evolving into high growth business models that develop a broad platform and market presence with venture capital fund-

Top 50 family-owned businesses in the CS Global Family 900 universe by market capitalization

Ctry	Company	Ticker	Sector	Price Data		Price Change (%)		
				Price (lc)	Mcap (\$m)	1m	3m	12m
CH	Novartis	NOVN.VX	Health Care	98.5	278,918	2%	1%	22%
CH	Roche	ROG.VX	Health Care	282.5	254,426	5%	9%	6%
USA	Wal-Mart Stores, Inc.	WMT.N	Consumer Staples	74.8	241,397	-4%	-11%	-2%
USA	Facebook Inc.	FB.OQ	Information Technology	80.1	225,066	0%	1%	26%
BE	Anheuser-Busch InBev	ABI.BR	Consumer Staples	112.3	197,476	3%	-1%	39%
USA	Oracle Corporation	ORCL.N	Information Technology	43.9	191,540	-2%	0%	4%
KR	Samsung Electronics	005930.KS	Information Technology	1,307,000.0	173,855	-6%	-4%	-10%
DE	Volkswagen	VOWG_p.DE	Consumer Discretionary	226.9	119,936	-2%	1%	16%
USA	Kinder Morgan, Inc.	KMI.N	Energy	41.6	90,239	-3%	1%	24%
USA	Nike Inc.	NKE.N	Consumer Discretionary	102.3	87,952	2%	5%	34%
IN	Tata Consultancy Services	TCS.BO	Information Technology	2,610.0	80,210	5%	-2%	23%
JP	Softbank	9984.T	Telecommunication Services	7,447.0	72,136	-4%	1%	3%
USA	McKesson Corporation	MCK.N	Health Care	237.8	55,073	6%	4%	26%
HK	Sun Hung Kai Properties	0016.HK	Financials	131.4	48,709	2%	8%	26%
TW	Hon Hai Precision	2317.TW	Information Technology	99.1	48,679	8%	14%	19%
CH	Compagnie Financiere Richemont SA	CFR.VX	Consumer Discretionary	84.2	46,488	-1%	0%	-11%
IN	Reliance Industries	RELI.BO	Energy	876.8	44,521	3%	1%	-18%
USA	Phillips 66	PSX.N	Energy	79.6	43,148	-2%	1%	-6%
USA	Carnival	CCL.N	Consumer Discretionary	47.2	37,037	6%	7%	19%
HK	CKH Holdings	0001.HK	Financials	121	36,152	0%	10%	24%
IN	Sun Pharmaceuticals Industries Limited	SUN.BO	Health Care	955.8	36,086	2%	5%	63%
GB	Associated British Foods	ABF.L	Consumer Staples	29.5	35,774	6%	-6%	-2%
MX	Fomento Economico Mexicano SAB de CV	FMSAUBD.MX	Consumer Staples	139.2	32,712	-1%	-2%	12%
SG	United Overseas Bank	UOBH.SI	Financials	23.1	28,296	-5%	1%	3%
USA	L Brands, Inc.	LB.N	Consumer Discretionary	87.4	25,567	-2%	-5%	57%
USA	LinkedIn	LNKD.N	Information Technology	196.2	24,718	-24%	-27%	20%
HK	Henderson Land Dev	0012.HK	Financials	62.6	24,209	2%	18%	37%
ID	Astra International	ASII.JK	Consumer Discretionary	7,375.0	22,590	4%	-6%	-1%
IN	Tata Motors Ltd.	TAMO.BO	Consumer Discretionary	483.6	21,906	-7%	-18%	15%
USA	Marriott International	MAR.OQ	Consumer Discretionary	79.0	21,729	-6%	-5%	30%
IN	HCL Technologies	HCLT.BO	Information Technology	980.0	21,615	10%	-3%	41%
IN	Wipro Ltd.	WIPR.BO	Information Technology	554.0	21,318	2%	-16%	11%
HK	Cheung Kong Infrastructure	1038.HK	Utilities	64.0	20,801	-2%	-3%	23%
FI	Kone Corporation	KNEBV.HE	Industrials	39.1	20,741	1%	-5%	28%
KR	Samsung Life Insurance	032830.KS	Financials	112,000.0	20,228	7%	12%	11%
SG	Hongkong Land Holdings	HKLD.SI	Financials	8.6	20,116	8%	13%	23%
FR	Dassault Systemes	DAST.PA	Information Technology	71.9	20,080	6%	15%	53%
KR	Hyundai Mobis	012330.KS	Consumer Discretionary	223,500.0	19,647	-7%	-10%	-23%
TH	Siam Cement	SCC.BK	Materials	534.0	18,998	0%	2%	28%
TW	Nan Ya Plastics	1303.TW	Materials	72.6	18,781	-6%	6%	7%
USA	Royal Caribbean Cruises	RCL.N	Consumer Discretionary	76.3	16,784	11%	0%	39%
FR	Sodexo	EXHO.PA	Consumer Discretionary	95.1	16,346	6%	6%	19%
CN	Jiangsu Yanghe Brewery Joint-stock Co., Ltd	002304.SZ	Consumer Staples	93.6	16,251	1%	16%	67%
SG	Wilmar International Ltd	WLIL.SI	Consumer Staples	3.4	15,957	3%	4%	4%
TW	Formosa Plastics	1301.TW	Materials	75.3	15,636	-6%	-3%	-4%
MX	G.F. Inbursa	GFINBURO.MX	Financials	35.7	15,529	-5%	-15%	-1%
DK	Coloplast B	COLOb.CO	Health Care	514.5	15,244	-6%	-3%	9%
CN	Jiangsu Hengrui Medicine Co. Ltd	600276.SS	Health Care	62.8	15,231	11%	55%	94%
KR	LG Chem Ltd.	051910.KS	Materials	249,500.0	14,932	-10%	8%	-5%
MY	Maxis Berhad	MXSC.KL	Telecommunication Services	6.9	14,161	-2%	-2%	3%

Source: Bloomberg, Credit Suisse estimates



ing before being IPO-ed. Silicon Valley names characterize this and ownership remains concentrated even after IPOs, often due to different classes of shares, e.g. non-voting shares. By contrast, we see far greater dilution of ownership pre-IPO amongst Chinese tech names, which implies far more limited access to savings and bank funding. Alibaba, for instance, did not meet our 20% ownership threshold.

Consumer discretionary names can also exhibit similar characteristics to technology companies in that they involve an element of proprietary IP. In Europe, we see this particularly in the automotive and component industries that are heavily represented in Germany, proprietary production and design IP for the Italian and French apparel-related companies. Such companies create non-financial niches that can be defended and it is interesting in our analysis of survivorship that we see a quicker tailing off of ownership in consumer discretions compared to consumer staples, as the succession may be a more complex issue where a company is based on the founder's IP.

Consumer staples tend to be scale and efficiency plays where growth can come more easily through new markets and acquisitions, management skills and strategies that are easier to acquire than IP. Consumer staples tend to be lower value-added sectors, sometimes simply copies of successful business models and products in other markets, but as we can see in Asia, the weighting of family-

business exposure is shifting away from consumer staples towards such sectors as healthcare and technology where there is a greater element of value added.

Four sectors account for over almost 70% of our family-owned business universe; the consumer and technology companies discussed above along with financials. Within financials, real estate trusts and development companies make up 35% of market cap of the sector in our universe compared to less than 16% within MSCI World. This again reflects family entrepreneurs steering away from regulated and high start-up cost businesses and displaying a preference for sectors that require more limited initial financial resources and that are scalable over time.

Across Asia and Emerging Markets, we can see a more even spread of sectors represented in our 920 companies. We see a greater concentration in developed markets, particularly in Europe, as families build their companies and proprietary IP into sector and global leaders. Within Europe, there is a predominance of consumer-related manufacturing and healthcare family-owned companies, such as FIAT, VW, BMW, Novartis and Roche. In the USA, we again witness the prevalence of family ownership in consumer sectors and IP-intensive sectors, this time technology rather than healthcare.



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