STEWARDSHIP OF FAMILY ENTERPRISES

THEIR VALUE TO SOCIETY

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1

Executive Summary & Recommendations

Across the world, family firms contribute the majority of the economic value created in their host country. **The Belgian chapter of the Family Business Network states that family firms make up 77% of companies with employed personnel – 55 % of those employing more than 200 – representing 45% of total employment in Belgium. Together they are responsible for 33% of Belgian GDP.**
The Family Business Network's numbers are no outliers: in Europe as well as in other regions, estimates typically vary from 50 to 95% or more of the companies, 35-70% of employees and a similar proportion of GNP.

All too often family businesses are equated to SME's, whereas, of course, they too come in all sizes: one-person enterprises, SME's but multinationals as well. Paying attention to this diversity in size aids in avoiding stereotypes. At the larger end of the spectrum for example, of the four firms that can boast an uninterrupted presence in the Bel-20 index can all be considered family firms: GBL, Solvay, UCB and Umicore.

The general public, policy makers and opinion makers are often unaware of the manner in which family businesses contribute to economic growth and to society, nor of the specific challenges with which they are faced. **The central idea to the family firm's defining governance model is** stewardship**: the idea that current family shareholders (merely) act as custodians of the shares they hold in order to transfer these in at least the same condition in which they received them from the previous generation.** Family shareholders have committed themselves to – theoretically – never see the "colour of their money".

Evidence is mounting that stewardship is to a large extent responsible for **the robust economic and financial outperformance of family firms with respect to their non-family peers, placing them in an "(asset) class of their own".** Family firms share risk-return characteristics that set them apart from their non-family peers. Their shares are quoted at a premium to non-family shares, similar to "growth" shares. But the type of growth they pursue appears to be more stable, less volatile and much less (stock market) cycle-dependent than a typical growth stock would show, in a sense making family firm shares more like "value" stocks.

Stewardship distinguishes family firms by the manner in which they operate the business, the manner in which they finance capital and ownership, and the manner in which the culture and values of stewardship permeate their relationship with the outside world – customers and suppliers, government, the general public.

The documented outperformance of family firms is to a great extent explained by their faster growth in revenues relative to their peers, a robust finding across all industries and regions. But **the growth path family firms follow differs from that of general firms:**

- **Family firms tend to be focused –** largely determined by the founder's initial area of expertise – with a preference for exploiting niches. Family firms grow by attempting to repeat this specialisation strategy in adjacent niches.

- **European family firms engage less in innovation – but they are more effective at it.** Family firms, in Europe at least, tend to underinvest in innovation but when they do, they earn a greater return on innovation. Perhaps family firms are endowed more than other firms with tacit, non-codifiable and socially complex knowledge, which is difficult to be learned or imitated by competitors – a finding not unlike those in the "hidden champions" literature. Innovation at family firms may be managed differently than in non-family peers: a correlation exists between the type and extent of innovative activities and the desire to safeguard the family's control.
- **Family firms support a country's export strength and competitiveness with their capacity for production efficiency and their mastery of short and relatively simple value chains.** But export strength is not the same as internationalisation: family firms tend to shy away from branching out abroad.

As a consequence, **family firms provide investors, and in particular relatively risk-averse investors, with an appropriate opportunity to diversify and at the same time invest "at home".**

Importantly, the outperformance of family firms is not due to aggressive financing or excessive risk-taking. Family firms' proverbial *patient capital* owes to a desire for sustaining the family-owned or -controlled business over multiple generations. Family firms are reluctant to look for external equity (or debt) that may erode the family's control; as a result, they are nudged towards financing their investments with internally-generated earnings. **In contrast perhaps with pervasive perceptions of how (wealthy) families earn their income, the pay-out ratio of family firms is structurally** lower **across the world than in their non-family counterparts. The reinvestment of retained earnings further enhances the anchoring of family firms in Belgium** and ought to be encouraged.

The outperformance of the stewardship model challenges the conventional wisdom that a clear separation of ownership and control trumps the family-controlled firm organisation. Through stewardship family shareholders maintain unity and manage governance issues among passive and active family shareholders, between family and outside shareholders, and between owners and managers. The preservation of the first generation's driving values through the often long shared history of its family shareholders and managers may play a large part, at the same time making such performance-enhancing values difficult to replicate in other firms.

Stewardship defines family firms in the way family, ownership and business interact at a certain point in time – and across multiple generations through time. By design, the idea of intergenerational transfer and continuity of vision is engrained in these firms. The impact of having one's name and reputation linked to products and services is a very strong incentive to do better. The concept of stewardship turns the concept of ownership around. It is an entirely different

matter to be the shareholder of a named institution than to hold shares in an anonymous corporation. **Family firms are particular shareholders' companies in which the duty to perpetuate the firm in optimal condition beyond the current generation defines the family's meritocracy.**

The sense of purpose, the *affectio societatis* of family shareholders is a reason for Belgium to be proud of its family firms. **Belgium must develop into an environment in which existing and future family businesses feel supported to continue operating here, an environment in which success is not equated with selling dearly to the highest bidder.**

We single out four recommendations to strengthen and anchor the favourable contribution of the family firm stewardship model to Belgium's economy: the creation of a family firm representative institution, a regulatory framework that accommodates the long-term stewardship governance model, the promotion of entrepreneurship with local family firms, and an environment that stimulates large family firms not to de-anchor out of Belgium.

Engaging with a representative institution highlighting the contribution of family firms

It is a paradox that the class of firms which add most to their host country's welfare are maybe least understood. Communicating better how and why family firms add value is a shared responsibility. Family shareholders are traditionally too discrete, the scholarly world is divided among the finance and the management science literature, and government and the general public more often than not regard family firms as ordinary firms where a family happens to be present.

Family firms must establish a representative institution that can act as spokesman for family firms, promote the recognition of family firms as a constituency and be available as intermediary with legislative or regulatory authorities. Belgian and regional governments should take account of the views of family firms and its authoritative representative in designing relevant policies, at the very least by involving them in existing consultation mechanisms.

Trust in family businesses could further be enhanced when family firms ease up on their time-honoured discretion and promote where they come from and how they go about their business. The things a family does to hold together, to sustain their commitment, to improve the firm's performance deserve to be made public. Making explicit the values and policies that regulate the firm in return makes family shareholders accountable. **Family firms in synergy with the government should promote to family shareholders, their stakeholders and the general**

public, educational and experience-sharing programmes on what it means to act as a family shareholder.

Family firms and institutions interact. Institutions such as industrial policy may well mitigate some of the negative tendencies ascribed to family firms. In return, family firms may "make up" for the lack of some beneficial institutions through e.g. their reputation for honesty, their reliance on retained earnings, their reluctance to downsize workforce or cut wages. These attributes do not make family firms more "pure" in general. But within their universe, a considerable number of families behave in such an ethically conscious, locally concerned manner that government, opinion makers and the public at large acknowledge their contribution to their community. In examining these emblematical firms, what immediately comes to the surface is their sense of belonging somewhere, their roots perpetuated through the stewardship model. **Family firms, in synergy with legislators, could examine how to increase this beneficial halo effect beyond the family firm itself, in the relationships with the other stakeholders in the community, through a family's local philanthropical activity…**

Maintaining a stable regulatory environment supporting stewardship's governance model

The "overlapping generations" model of family firms requires a stable legal and regulatory environment in which the stewardship model can work. The technical, administrative and financial support to establish corporate governance codes, family governance institutions (charters, councils…) that enable family business to establish a stewardship model are vital for a sound economy. **Family firms and their representatives are responsible for explaining why and how these codes and institutions contribute to lowering governance issues in the firm, thereby enhancing its performance and contribution to the host economy.**

Extensive research has corroborated the central hypothesis of the law and finance literature that **concentration of ownership and control can be considered an attempt to substitute for weak shareholder protection**. Legislation facilitating shareholders to sue managers for abuse of their position is systematically stronger in countries where ownership is most dispersed. At the same time, countries where a considerable proportion of firms can be deemed to be controlled by families (or states) typically have relatively stringent labour market laws.

Recent legislation across Europe decrees that (all) long-term shareholders are entitled to loyalty shares and preferential voting rights. Other incentives for anchoring "patient" or "loyal" capital could relate to preferentially treating the formation of reserves or dividends in the form of shares.

Of course, any instrument to create a wedge between economic and decision-making rights must not be allowed to perpetuate non-viable family entrenchment, to create an absolute majority where there should be none, or to allow control to exist without checks and balances. Used appropriately however, governance mechanisms strengthen each of the dimensions of family, ownership and business. **Any policy aimed at better anchoring family firms therefore must pay due attention to the optimal design of such mechanisms, whether formally or informally.** In turn, **family firms and their representatives must make clear to the general public and legislators how and why they make (legitimate) use of governance instruments** to structure relations among passive and active family shareholders, to transact shares and exchange information, to control the firm in order to hold together and safeguard the family's influence across generations.

Promoting entrepreneurship with(in) family firms

A family firm distinguishes itself in particular from its non-family peers in the public's perception around the world that "[t]he profits it makes in this country stay in this country." **An overwhelming majority of the public indicate that they expect family firms to do more for their local community than non-family firms. Crucially, family firms do not get the credit they deserve when it comes to employment.** Less than one in three see family firms as job creators, whereas we know that they employ close to half of the work force in most countries. Family businesses are trusted considerably more than their non-family peers. But individual firms are not always recognised as family firms by the public (and consumers). Employment, certainly outside of the larger cities, is often supported by family firms that act as automatic stabilisers. Family firms are more socially oriented, with more attention for those disadvantaged by life, and more loyalty towards senior employees. Here lies a considerable opportunity whereby family firms and Belgium's economy can mutually reinforce themselves.

Entrepreneurs, both long-standing family shareholders as well as pioneers, can together harness the combination of family tradition and upstart disruption to promote an entrepreneurial climate in Belgium. The recurring issue of succession and generational transfer provides an opportunity to do so, at the same time preserving "already anchored" companies: those firms need not be created anew, they already exist! In an effort to promote entrepreneurship the idea of stewardship, of safekeeping, of custody may well appeal to the Millennials and Generation Z, further anchoring family firms in the heart of the Belgian economy for the generations to come.

Steering clear of the tipping point of de-anchoring for family firms in Belgium

The constituency of family firms, through their stewardship model, contributes to the national economy where they are active. Anchoring family firms in Belgium calls for targeted measures if our country is to retain and anchor not only the local, smaller variety of family firms but offer an attractive location to large, multinational family firms as well. The non-trivial interplay among family, ownership and business implies that such measures must consider the legitimate objectives of each of the seven combinations of family, ownership and business in the Three-Circle Model, and the interdependence among one another.

The critical transition threshold is firm size where family firms have grown large enough to be able to consider whether delocalisation out of Belgium has become an option. Our country must forestall the triggering of the de-anchoring decision by providing an offer these family firms cannot ignore. The focus on the success of individual firms brings with it a lack of attention for the 360° economic, regulatory and cultural environment that adds to – or subtracts from – that success. In a follow-up paper we wish to examine whether the tipping point for families to loosen their commitment to Belgium has come nearer – and what can be done to mitigate the risk of triggering the threshold.

2

Introduction

The economic importance of family firms in Europe

In 2017, the well-known Edelman Trust Barometer included a special report on family firms. More than 15.000 respondents were surveyed in 12 countries on matters ranging from trust in family firms over employer brand to next generation preparedness.

One set of questions gauged how well family firms and their non-family peers performed on a list of attributes. The top responses in both cases included "Offers high quality products or services" (#1) and "Listens to customer needs and feedback" (#3 for family firms, #4 for business in general). Surprisingly, the #2 answer for family firms was only ranked #13 for businesses in general: "The profits it makes in this country stay in this country." Family business is very much regarded as a source of *local* value creation, whereas this consideration much less applies to other firms.

The Belgian chapter of the Family Business Network states that family firms make up 77% of companies with employed personnel (55 % of all companies employing more than 200), representing 45% of total employment in Belgium, and 33% of the Belgian GDP.

The Family Business Network's numbers are no outliers: in Europe as well as in other regions, estimates typically vary from 50 to 95% or more of the companies[1], 35-70% of employees and a similar proportion of GNP.

Of course, most small- or medium-sized companies are family firms. But family firms feature along the entire range of size. Some of the largest and most successful companies in the world are owned or controlled by families. An extreme example is Sweden, where the Wallenberg family on its own is reported to (indirectly) own and control 40% or more of the Swedish economy through controlling ownership in companies such as ABB, Saab or SEB.

Family firms in Belgium too range from the very small to the globally large. Close to half of the constituents of Belgium's leading stock exchange index, the Bel-20, are a family business. Of the four firms that can boast an uninterrupted presence in the index, three can be considered family firms: GBL, Solvay and UCB.

Together family firms form the heart of almost every country's economy, contributing enormously to the country's economic and social welfare. What has been and would be the consequence of less family firms active in Belgium? Is there a "halo effect" that transcends the boundaries of these firms and benefits broader society? If a country such as ours is to (continue to) represent a welcome home

1 KMU Forschung (2008).

for family firms, what then are the key factors to success? Where lie the tipping or trigger points for anchoring – or delocalisation? These are the question Itinera Institute wants to answer.

The first question to ask, however, is if there is, in fact, such a thing as "the" family firm and what, if any, are their secrets? Are there characteristics common to these firms – possibly irrespective of their age, size or industry – that explain their economic value added and their documented financial outperformance? Do these family traits warrant policy makers' attention, suggesting measures that can "anchor" family-owned or -controlled firms better in Belgium?

3

The Family Business system

Research has validated that family firms are characterised by longer-term trans-generational "family values" and altruism that they want to see reflected in entrepreneurship, and on the downside, by the risk of "family issues" spilling over to the business side. But the manner in which family, ownership and business aspects interact is different in each individual firm. Family firms bring together a diverging set of stakeholders, each with their own interests – a system that has become known as the Three-Circle Model. To render justice to this essentially multidimensional nature of family firms, we will base our approach on this model.

The Three-Circle Model

The common European definition of a family business, irrespective of size, includes the following criteria[2]:

- The majority of decision-making rights are in the possession of the natural person(s) who established the firm, or in the possession of the natural person(s) who has/have acquired the share capital of the firm, or in the possession of their spouses, parents, child, or children's direct heirs. The majority of decision-making rights can be indirect or direct.
- At least one representative of the family or kin is formally involved in the governance of the firm.
- Listed companies meet the definition of family enterprise if the person who established or acquired the firm (share capital) or their families or descendants possess 25 per cent of the decision-making rights mandated by their share capital.

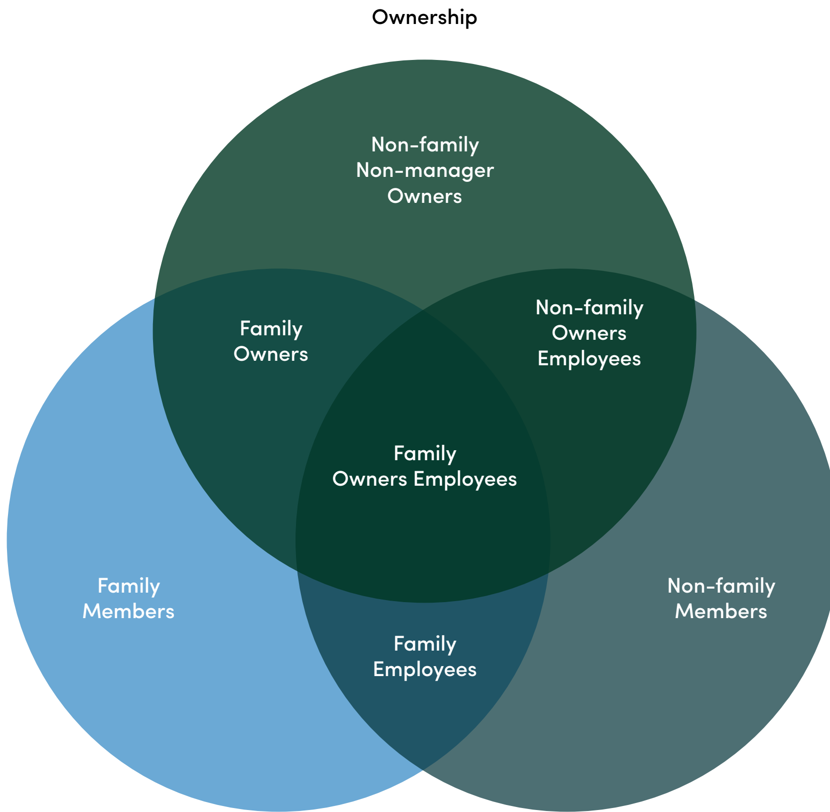
The definition highlights the central role played by the three elements of family, business, and ownership, but it tries to capture the essence of family involvement in entrepreneurship through a narrowly quantitative view rather than look for the qualitative aspects of the interplay between family, business and ownership.

These three elements already featured in a classic approach to family business developed since the late seventies by Renato Tagiuri and his student John Davis[3], termed the "Three-Circle Model". Because these three dimensions of family, business and ownership overlap, seven interest groups vie for attention:

2 European Commission (2009), *Overview of Family Business Relevant Issues: Research, Networks, Policy Measures and Existing Studies.*

3 Tagiuri, Renato & John Davis (1996), *Bivalent Attributes of the Family Firm*, Family Business Review 9.2, 199-208.

Figure 1: The Three-Circle Model [Tagiuri & Davis 1996]



Difficult decisions can be put in a wider perspective by clearly identifying where in the diagram the issue resides: how to fire a family employee; which decisions require whose consensus; whether a discussion pertains to a misunderstanding of role in the family sphere, between owners or on the operational side; which of the parts in the system succession or transition have an impact on.

Accordingly, any quest for the secret of family firms and consequently any policy perspective aiming to attract and "anchor" family firms will need to consider which of these seven positions it embodies and consider the legitimate objectives of the stakeholders in each position, and the interdependence among one another.

In the heart of the three-circle model reside family members that own a stake in the firm's share capital and that are at the same time actively involved in the business, whether as a director, manager of employee. More than two-thirds of the publicly-traded family-controlled firms in Western Europe were managed or

governed by the family as well, through holding the position of CEO, (Honorary) Chairman or Vice-Chairman[4]. In fact, a firm is only to be termed a family firm if this subset of stakeholders is non-empty, according to the European definition.

Around this central position, family firms feature other stakeholders as well such as family members not (or not yet) actively involved in the business. A governance issue particular to family firms has to do with the proper relationship between the active family members in the previous category and the passive shareholders here. Active shareholders want impact on strategy and the implementation of owner vision; passive shareholders are concerned with the opportunity cost versus other forms of investment. But in the background is "doing something together", sharing a common project and history that reinforces personal ties – a not to be neglected immaterial advantage of family shareholdership.

Non-family employees and owners have a place in the three-circle model as well: conflicts may arise over alleged nepotism, so-called family entrenchment, the role of an "outside" CEO…

"How much" is a family firm?

A universally accepted comprehensive definition of "family firm" is an elusive concept. Researchers have examined many criteria and suggested diverse definitions, only to see a fellow researcher come up with a new approach. In our opinion, family firms can best be functionally characterised by the fact that the interplay between family, ownership and business is not trivial. The Three-Circle model therefore applies particularly well to the type of firms we consider here.

Be that as it may, when it comes to statistical research on quantitative databases, an operational definition is required. Research findings are often less than perfectly comparable because of heterogenous samples – and populations.

A case in point is the inclusion of companies such as Alphabet (Google) or Alibaba. Whereas they feature in the Credit Suisse Family 1000, they do not in the Global Family Business Index of the Center for Family Business at the University of Sankt Gallen, in cooperation with EY's Global Family Business Center of Excellence. The impact on findings of these high-growth high-tech companies is not to be ignored, of course.

4 Faccio & al. (2002).

Typically, inclusion is set conditional on a minimum threshold for shareholdings and/or voting rights held by the family. Credit Suisse upholds a 20% percentage for "founders or descendants" on either direct shareholdings or voting rights. Sankt Gallen sets the cut-off at 32% of voting rights "motivated by the observation that in OECD countries on average 30% of the votes are sufficient to dominate the general assembly of a publicly listed company."[5] In the academic literature, such percentages vary from 20% to 50% or more.

We steer clear here of imposing a specific percentage as we stress the family influence on a firm's mission, governance or strategy – whether such influence is mediated through ownership, voting rights, various control mechanisms or other means to impact decision-making. Still, we are well aware that legislators and regulators typically prefer to have an analytical definition rather than a synthetic approach. The "letter of the law" therefore merits our attention, as does the "spirit".

A final important caveat is that the term itself of "family" typically remains undefined. A particular consequence is that self-employed may or may not be deemed family firms; similarly, companies with a sole proprietor (but which may employ more people) are not always considered family firms across countries or researchers.

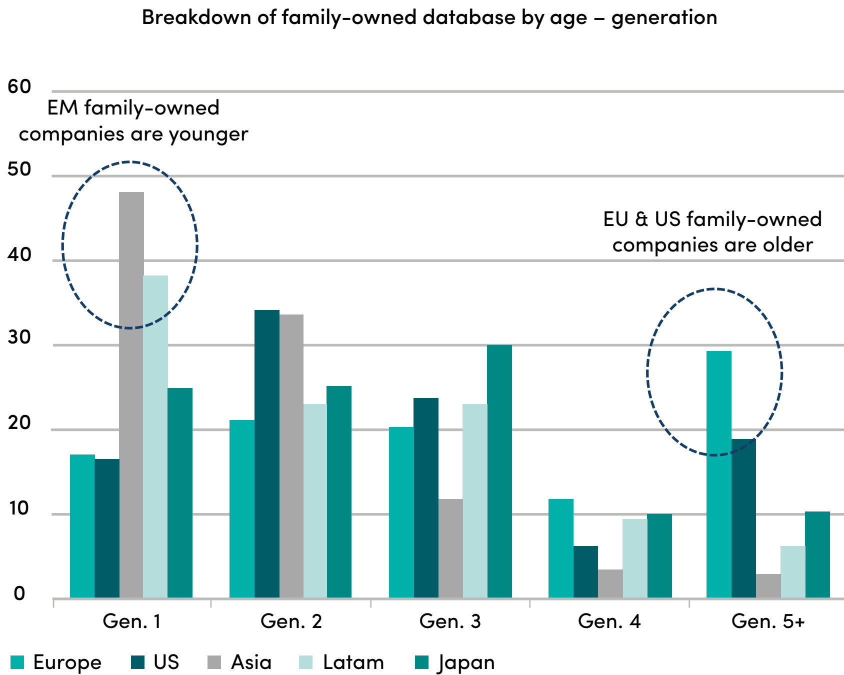
5 familybusinessindex.com.

Life stages and generational transfer

The interrelationships exhibited in the Three-Circle Model are not only limited to the current stakeholders. Families extend over multiple generations. How the current generation of owners (and/or managers) relates to the past and to the future is a matter of overriding importance in family firms.

European family firms are, on average, much older, than those in the rest of the world.

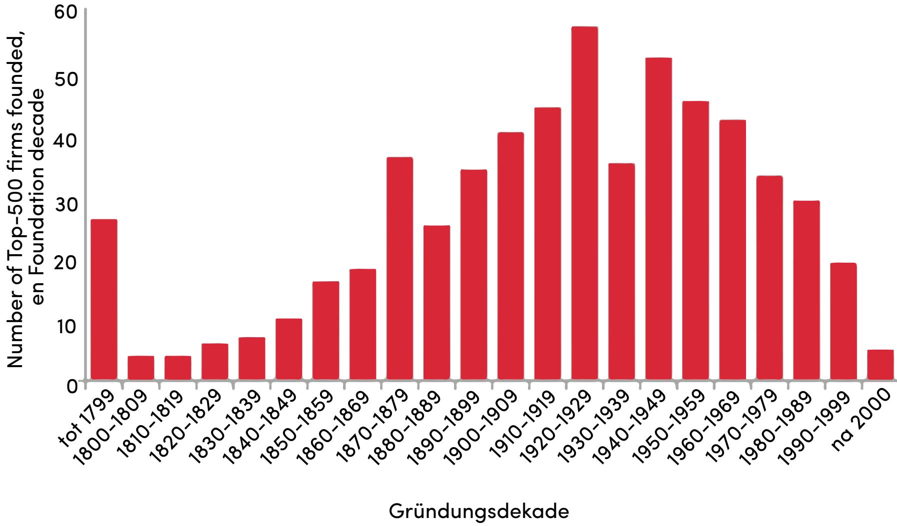
Figure 2: Generational ownership in family firms [Credit Suisse 2018]



Source: Company data, Credit Suisse estimates

Switzerland's family firms in particular have an average age of more than eighty years, more than double the average in other regions. Germany as well boasts some exceptionally long-lived family firms.

Figure 3: Vintage of Germany's Top-500 family firms [Institut für Mittelstand-forschung]



Source: Institut für Mittlelstandsforschung Mannheim

Family firms spanning multiple generations go through a set of life stages[6]. The family business' *Controlling Owner* stage lasts as long as ownership remains concentrated in a single household, with the pater familias (or mater) solely focused on the business. Either he (or she) is the founder, and consequently the first generation. Or he (or she) is the sole "ruler" in a successive generation with only a single heir.

Only after ownership passes to multiple descendants, typically as a consequence of inheritance laws, the family behind the firm transforms into a *Sibling Partnership*. Although these brothers and sisters have at some time sat together around the same proverbial kitchen table, setting up their own separate households creates issues of who holds control or how less active siblings trade off executive power for dividend income.

When ownership continues to diffuse through the extended family, the *Cousin Consortium* requires formal governance to keep the family interests aligned and the mission or vision shared.

6 Gersick, Kelin E., John A. Davis, Marion McCollom Hampton & Ivan Lansberg (1997), *Generation to generation. Life cycles of the family business*, Harvard Business School Press.

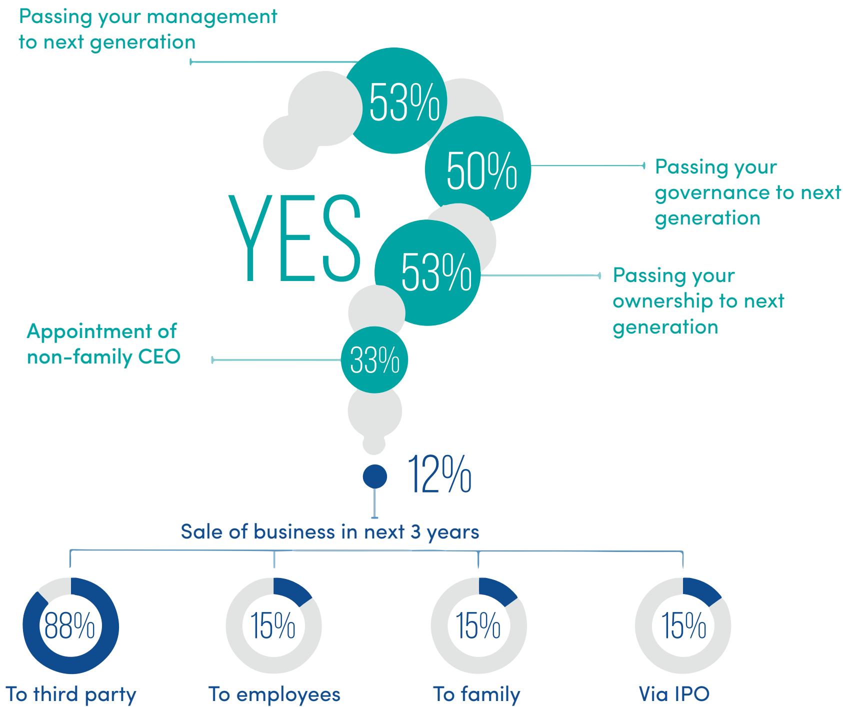
Each of these stages, from the owner-founder, over the sibling partnership and then onwards in future generations where increasingly different types of education and backgrounds enter, requires a different model for coordination and decision-making. Whereas the founder integrates the role of shareholder, CEO and representative of the shareholders, those roles start to diverge in the following generations. Delegation rules must be conceived, up to and including the management of subgroups of shareholders in the family council. The problem is how to organise the family to allocate and continue to play the role those founders or pioneers played – and whether their cousins or even their own children are capable to do so. Not unlike a country, it helps to distinguish what is in the "constitutional" family charter, what are laws, who holds executive powers, and how is continuity preserved from the top down through history.

Whereas corporate discussions largely involve the risks in a changing world, the shareholders typically consider principled decisions. Even if the concept of generation is largely artificial in view of continuous evolution, from a governance point of view it has its merit: the interval between changes of power is longer and sometimes discrete in time when a tipping point is reached. Sometimes principled discussions highlight a difference of view between the generations: on sustainability, on local initiatives and impact on the society around the company, on reporting.

The life-stages model of family business from the perspective of the family in the Three-Circle Model is paralleled by the view from the business side, in terms of economic contribution. The overwhelming majority of family businesses continue to linger – and often prosper – in the segment of smaller to medium-sized firms, with revenues at most in the tens of millions. The one-hundred-million threshold appears to be insurmountable to most of Belgium's family firms, even if we restrict our attention to those companies that have the ambition to make the transition. Governance looms large, exacerbated by the complications of generational transfer.

The Family Business Institute estimates that 33% of family firms transitions to the second generation, 12% to third and 3% to the fourth generation. Members of Credit Suisse's large-cap Family index correspondingly have 50% transfer into the second generation, 22% and 10% to the third respectively fourth generation. Especially, in Europe such transfers are more often than not designed to maintain control and influence in the family's hands.

Figure 4: Transfer expectations [KPMG 2017]

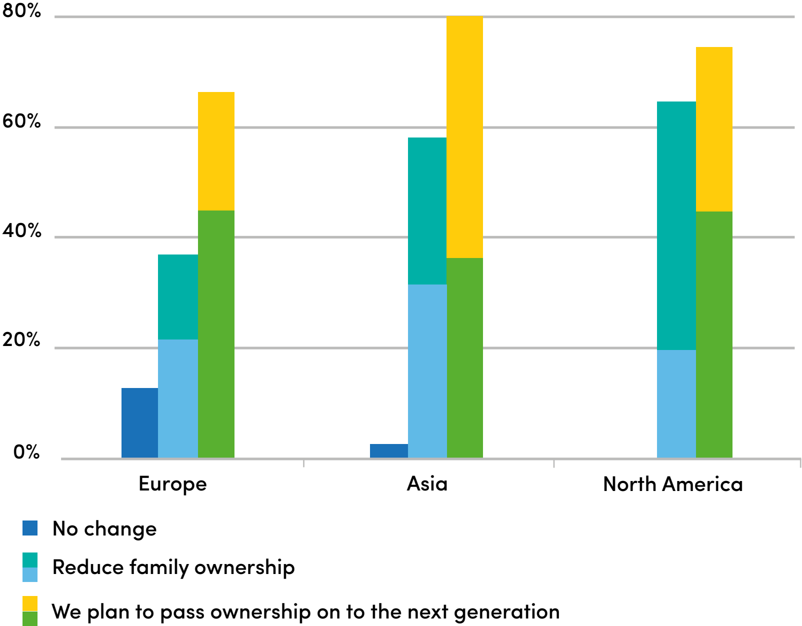


A Dutch study suggested that business transfers involve a family relationship between previous and current owners in 32% of the non-family businesses and in 73% of family businesses[7].

Family firms have come up with a specific governance model to address the varying issues raised in the three-circle model across multiple generations. It is this governance model that we regard as the essential attribute of family firms and that may be responsible for their economic and financial outperformance.

7 Flören et al. (2010).

Figure 5: Expected changes in family ownership [Credit Suisse 2017]



Source: Company data, Credit Suisse estimates

4

The governance model of the family firm

Stewards versus agents

Adolf Berle and Gardiner Means[8] identified the separation of ownership and control which "has destroyed the unity that we commonly call property" as the defining step in the creation of the modern firm. Ever since, researchers[9] and practitioners have shown that the alignment of interests between the owners (*principals)* and the managers *(agents*) they appointed would principally be imperfect. Monitoring and various governance mechanisms inexorably result in so-called *agency costs* that make a modern corporation fundamentally function less than optimally. Agency issues complicate external financing, divert resources in unproductive ways and may ultimately impede economic growth through misallocation of investments.

Family firms represent a very peculiar instance of modern firms. The distinction between principals and agents in the Three-Circle model is at the very least multidimensional and often ambiguous. Family membership, ownership and (management) control give rise to multiple governance issues. In addition to what is called "management entrenchment" in general firms – whereby managers attempt to capture as many of the private benefits of control[10] – "family entrenchment" becomes possible as well. Unlike in other firms, owner-owner agency problems between passive and active family members can occur. Inversely, self-control and altruism among family members provide governance mechanisms to better align interests that are not present in non-family firms.

Between Jensen & Meckling's argument that insiders with large stakes have less incentive to misallocate corporate resources and Fama and Stulz' *entrenchment* argument[11] that higher equity stakes create the opportunity to divert resources whilst the perpetrator cannot easily be ousted, both families and external managers are exposed to the same type of agency problem.

The reluctance of outside capital providers (shareholders and bondholders) to bear the brunt of agency costs may be heightened by the ambiguity inherent in the Three-Circle Model. That may explain why family firms have historically had

8 Berle, Adolf & Gardiner Means (1932), *The modern corporation and private property*, Transaction Publishers. Cf. also Schulze, W.S., Lubatkin, M.H., Dino, R.N. & Buchholtz, A.K. (2001), *Agency relationships in family firms:Theory and evidence*, Organization Science 12.2, 99–116. Incidentally, Berle & Means found that 44% of the largest firms in the United States in 1930 were widely held (they called them "management-controlled") whereas 22% where controlled through a "legal devise", resembling a pyramidal ownership structure.

9 The literature is extremely large. We mention the seminal contributions of Coase (1937,1960), Alchian & Demsetz (1972), Jensen & Meckling (1976), or Fama (1980).

10 Dyck & al. (2004).

11 Stulz, René (1988), *On Takeover Resistance, Managerial Discretion and Shareholder Wealth*, Journal of Financial Economics 20.1-2, 25-54.

(or looked for?) limited access to capital markets, relying preferably on retained earnings for investments and acquisitions.

Although the Three-Circle Model introduces novel agency costs and entrenchment issues, the (relative) concentration of ownership in the family's hands and their involvement in management and governance may increase firm value by minimising mutual monitoring costs. Dispersed shareholders find it difficult to coordinate the monitoring efforts and share in the agency costs. Concentrated ownership and oversight in the hands of a family can mitigate the risk of managers excessively seeking private benefits of control[12].

The link between family influence and firm performance is not unambiguous. What is important is the qualitative influence the family exerts on the business, whether through ownership, management or control. Anchoring then is not a quantitative question in itself. It should not automatically be seen as threatened if foreign shareholders enter into the share capital, diluting the incumbent family for example. If each of the parties accepts the governance instated, and if that governance allows for the appropriate mechanisms to impact strategy, the family's influence may still endure to the benefit of the firm – and the country. Good governance, at the same time providing for control, advice and risk management may help to align those interests, as for example the Belgian Code-Buysse, now in its third edition[13], aims to do. The Code-Buysse III now explicitly advocates

> *een familiaal charter [waarin de familie] haar eigenaarsvisie vastlegt. Dit is de uitdrukking van de fundamentele overtuigingen en verwachtingen van de familie met betrekking tot het familiebedrijf, onder meer op het vlak van waarden en cultuur, essentiële elementen van het bedrijfsbeleid, haar bereidheid risico's te nemen en haar betrokkenheid bij de onderneming,*

rather than only the "rules of the game" for family members.

These considerations reflect the other approach to governance that can be found in the literature. Whereas the classic principal-agent theory of the firm confronts the interests of the family-owners and their appointed managers (and sometimes "outside" shareholders), the stewardship view[14] on the contrary arguably treasures a more positive image of mankind in which self-enhancement is an important driver but the contribution to the collective is not seen as naïve or

12 Dyck & al. (2004).

13 Buysse, Paul & Jozef Lievens (2017), *Code Buysse III. Corporate Governance aanbevelingen voor niet-beursgenoteerde ondernemingen*, Instituut voor het Familiebedrijf.

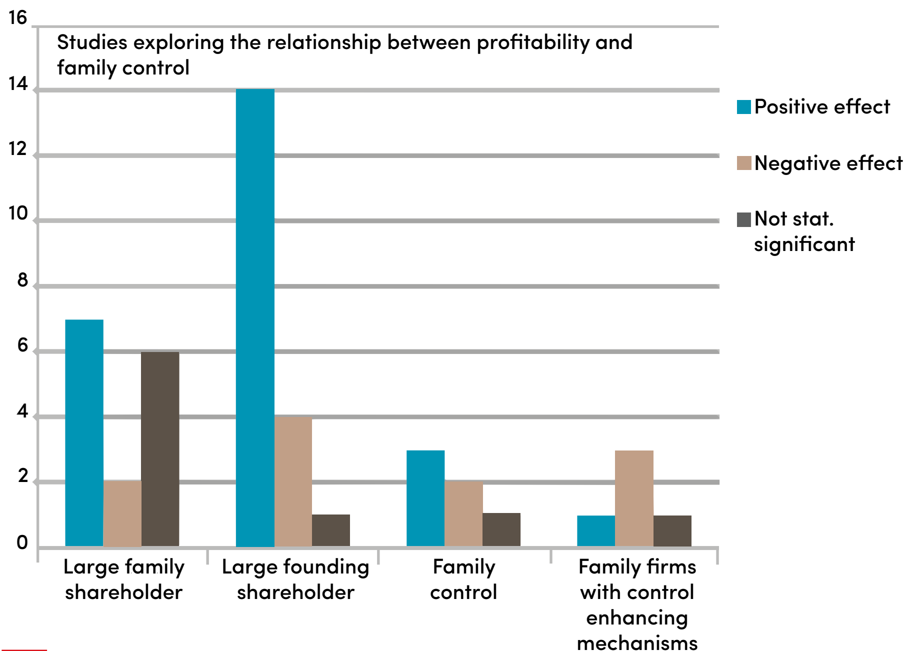
14 Davis, John H., D. Schoorman & L. Donaldson (1997), *The Distinctiveness of Agency Theory and Stewardship Theory*, Academy of Management Review **22**.3, 611-613. Eddleston, Kimberley H., Kellermanns, Franz W. & Zellweger, Thomas (2012), *Exploring the entrepreneurial behavior of Family Firms: Does the Stewardship Perspective explain differences?*, Entrepreneurship Theory & Practice **36**.2, 347-367.

"uneconomical". A stewardship culture can be characterised by long-term vision encompassing the often-complex intertwining of family and business decision-making, respect for employee human capital and participative governance.

Evidence is beginning to mount that the key aspect in which family business are different from their non-family peers in strategic behaviour and governance, is stewardship. By their very design, the idea of intergenerational transfer, of continuity of vision is engrained in these firms. The impact of having one's name and reputation linked to products and services is a very strong incentive to do better. This sense of obligation extends beyond the business in itself to the various other stakeholders we encountered in the Three-Circle Model, notably suppliers and employees. Inversely, family firms where the family shirks away from publicly representing their "stake" in the firm are detrimental both to the firm and to the family.

Research on a sample of 1.672 non-financial firms in Western Europe[15] suggests that *active* family control, even when non-majoritarian, is the differentiating factor when it comes to excess profitability due to the lowering of principal-agent agency costs. Especially founder-controlled firms outperform, whereas governance mechanisms implying an opaque structure are viewed adversely by the market. In between these clear extremes, the general outlook is much less clear.

Figure 6: The relationship between profitability and family influence [EDHEC (2014)]



15 Maury, Benjamin (2006).

Profitability correlates positively with stronger family influence: founding-family-led firms are more profitable, and active involvement trumps passive ownership. The same conclusion applies to valuation, although the variation reported in the literature is arguably large. It would appear that the manner in which a family exerts its influence on the firm's strategy is decisive, irrespective of the concrete manner in which influence is installed or structured.

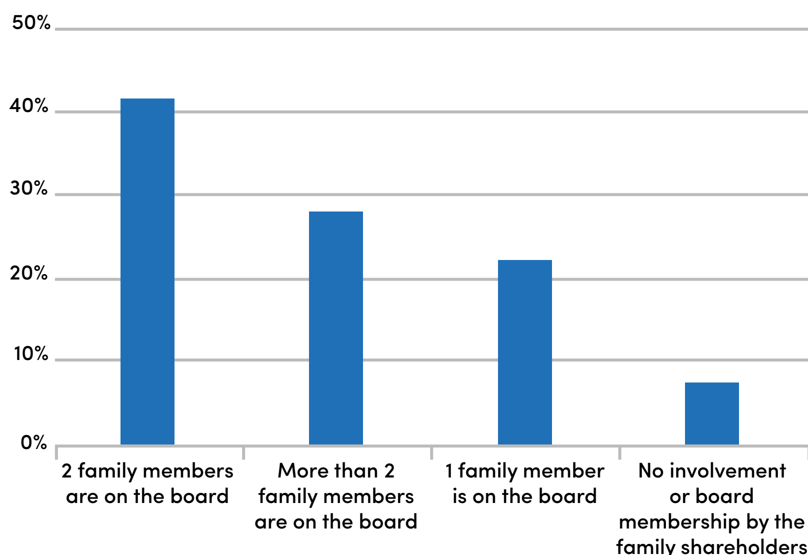
The stewardship model, the idea that the family shareholders do not own the firm but only safeguard it to pass it on to the next generation, is at the heart of each of these strategic choices. Stewardship implies concentration of ownership or control in the hands of stakeholders with an explicit objective to sustain the firm's longevity. Family shareholders collectively have lived through the often chequered past of the firm and act as a living long-term memory. Crucially, family shareholders have a substantial portion of their aggregated wealth invested in the firm without much diversification outside of the family firm. By design, the family closely monitors corporate waste – "bezzle" – and mitigate most agency issues that may arise in the modern firm. Their name is on the line – often literally so.

At the same time stewardship has the potential to address the agency issues inherent in the three-circle model specific to the family firm. Concentration of control and influence comes with its own set of agency risks, often summarised as family entrenchment: the maintenance of control for the family's benefit irrespective of the firm's performance. Conflicts among shareholders, in particular passive and actively involved family members, can impede firm welfare. Stewardship promotes the sustainability of the firm and discourages the current owner generation of "consuming" firm wealth during their lifetime, in the process lowering conflict thresholds among (family) shareholders. It is striking that the research clearly finds that founder-(family)-controlled firms vastly outperform other firms. Why do these stakeholders, who are likely to have considerable influence and control, not extract private benefits from corporate assets? We argue that such behaviour can largely be attributed to the idea of stewardship.

But the impact of ownership is non-linear. When family control is too high (and shareholder protection is low), owner-owner issues between the family and "outside" shareholders could potentially be value-destroying. Talented employees may be discouraged to show intrapreneurial behaviour if they believe rewards will disproportionately be captured by family interests. There appears to be an inflection point at approximately 40% beyond which family involvement is no longer strictly beneficial[16].

16 Lopez-de-Silanes, Florencio & Timothée Waxin (2014), *Family Firms and Performance: Where do we stand?*, EDHEC Business School.

Figure 7: Involvement of family members in the business [Credit Suisse 2017]



Source: Company data, Credit Suisse estimates

This result to some extent mirrors the findings[17] that market valuation of a firm's assets is non-monotonic in managerial ownership: conditions necessary for management entrenchment[18] correlate strongly with ownership beyond 5%, after which the effect is less pronounced (or even negative) before increasing again when ownership starts to exceed 25% and the convergence of interests between owners and managers grows stronger. A similar nonlinear relationship was reported by Anderson & Reeb (2003): outperformance of family firms initially rises before falling off again as family ownership increases too much. On an aggregate level, researchers found[19] that the prevalence of family firms has an inverted U-shaped relationship with economic growth. To put it somewhat extremely: too few family firms are not good for the country, too many may lead to a lack of heterogeneity among firms. We will see that family firms have a par-

17 Morck, Randall, Andrei Shleifer & Robert W. Vishny (1988), *Management ownership and market valuation,* Journal of Financial Economics **20**, 293-315.

18 Fama, Eugene & Mark Jensen (1983), *Separation of ownership and control,* Journal of Law and Econometrics **26**, 301-325.

19 Memili & al. (2015).

ticular look on business strategy in general and innovation in particular. Differences of opinion among firms spurs innovation and provides growth incentives – group thinking is not favourable to welfare.

It requires accountability and responsibility on the part of all stakeholders, the family in particular, to make stewardship work. This sense of responsibility does not come automatically. It depends on a very specific education of a family's members and of the context in which they are active. Family shareholdership does not come with a manual. The benefits – even perks – of being a family shareholder imply the willingness to stand behind one's actions, and the obligation to leave what you have received in an even better condition for the future. The concept of stewardship turns the concept of ownership around: being the shareholder of an institution is entirely different from being a shareholder of an anonymous corporation.

Stewardship aligns interests at a given point in time among the various stakeholders in the Three-Circle Model. In addition, stewardship provides a long-term perspective *through* time, perpetuating the vision of the family firms' founder(s). It is important within the ranks of the family: the passing generation acting as a custodian rather than as a consumer of the accumulated wealth, the coming generation accepting their responsibility of not selling their shares. Stewardship requires family shareholders to "bring forward their better angels" as an international thought leader in family entrepreneurship has called it[20].

The strategic advantages to the firm and its stakeholders of the family owners investing in their unity are not to be underestimated. Stewardship is enshrined in governance to keep the owners united and engaged, when the generations succeed one another, and the shareholder group extends. In particular when a transfer is at hand or a corporate event has required the firm to contemplate transfer that the issue of stewardship in governance becomes apparent. How to get the people (passive shareholders, descendants, in-laws) that were not instrumental in the build-up stage committed to continuity?

Depending on which interest group in the Three-Circle Model one considers, either the principal-agent view or the stewardship idea may be more prevalent. The outside shareholders look to the signals the family shareholders send about how each party to the Three-Circle Model plays its role. Outside observers such as financial analysts are more often than not unaware of the realities in that model.

Families are called upon to make the world outside of the model understand what their particular role is, and how stewardship is central to that role. In particular, from the perspective of the family, the maintenance of control usually is a

20 Lansberg, Ivan (2019), *private communication.*

defining concern, impacting strategy and decisions such as which innovation to pursue or how to structure the firm.

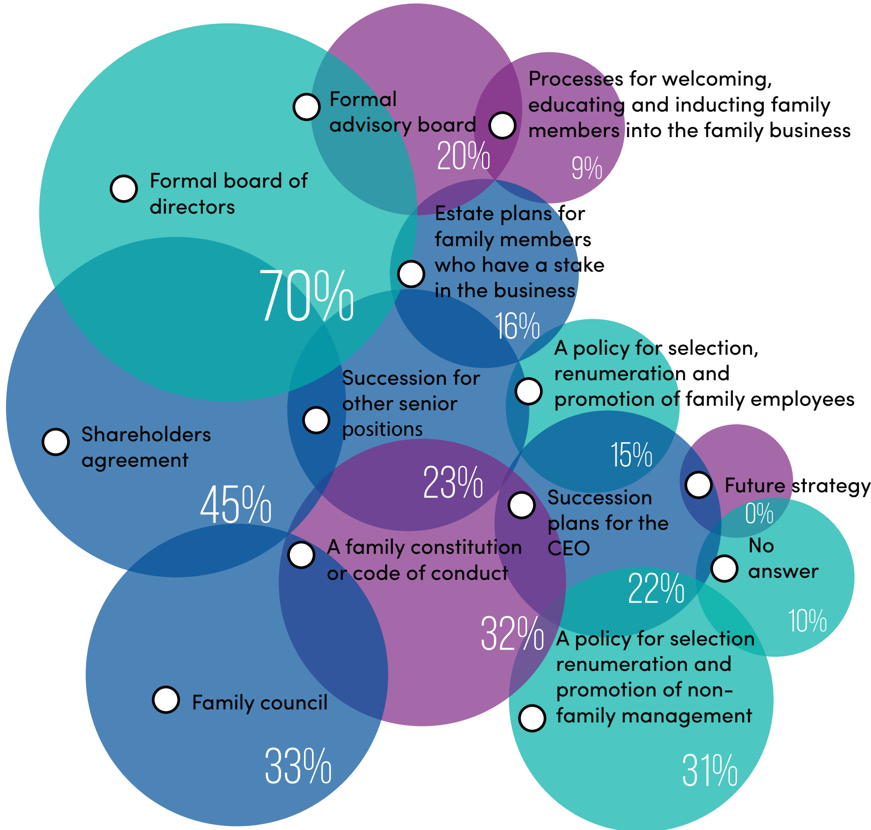
Control mechanisms are in general often contemplated by family businesses to provide for continuity over the generations. All too often, their use is, in the eye of the general public, conflated with abuses targeted at protecting weaknesses from advantageous takeovers or creative destruction. Any instrument to create a wedge between economic and decision-making rights must not be allowed to perpetuate non-viable family entrenchment, to create an absolute majority where there should be none, or to allow control to exist without checks and balances. Particular attention must be paid to the agency risk that smaller claims on cash flows relative to decision-making rights might induce controlling shareholders to divert corporate resources.

Used appropriately however, governance mechanisms strengthen each of the dimensions of family, ownership and business. Any policy aimed at better anchoring family firms therefore must pay due attention to the optimal design of such mechanisms, whether formally or informally.

Use and abuse of governance mechanisms to foster stewardship

Our aim in this paragraph is not to set out an exhaustive list of governance mechanisms and practices that apply to family firms. We wish to discuss a number of mechanisms that may prove instrumental – or act as a deterrent – when considering the anchorage of family firms in Belgium. When viewed through the lens of stewardship, the mission to safeguard the family's influence across generations and economic cycles may better explain why family firms maybe more often than their non-family peers make use of these mechanisms.

Figure 8: Governance mechanisms and practices [KPMG 2017]



Family charters and shareholder protocols can provide the necessary understanding among (family) shareholders with respect to decision-making rights and the manner in which family values are implemented in the business. Being a family shareholder involves on the one hand a historical conscience, a heritage that expresses itself in a sense of purpose or obligation. “I cannot simply do whatever I want to do, I am only a steward.” “Can I grow those shares to a level comparable or higher than what I inherited?” The other aspect is a future-directed one: how can I safeguard the future of this company, knowing the environment in which it operates, the opportunities and risks it represents. The sense of being able to influence the future development – as opposed to a passive shareholdership in a publicly listed firm – is what drives family shareholders. The crucial question is how to develop and crystallise a vision on these aspects so that the entire family shares that feeling. That is what a family charter represents.

Two-tier boards essentially separate executive and non-executive directors, each with their well-defined role related to control, strategy and service. Whereas corporate governance in our country is based on a one-tier or monistic model in which a single Board of Directors comprises both types of directors, in the Netherlands both the monistic and dualistic system exist next to one another. A survey in the Netherlands across monistic and dualistic directors suggested that the dualistic system appears[21] to be better in safeguarding the independency of the non-executive directors while the monistic model may be more effective in terms of strategy and control, without one or the other model being objectively superior. The respondents made clear that it is the skills and experience of the individual directors – and the college of directors as a collective – that is the precondition for effective oversight.

Inspired by our neighbouring countries, the new corporate legislation in Belgium will allow – although not require – naamloze vennootschappen/sociétés anonymes to replace their board of directors with a management board on the operating side, and a board of oversight to discuss strategy matters. Both boards will have exclusive responsibilities, implying that no individual can be a member of both.

External advisors – sometimes formally instated as an advisory board to the firm or as observers in the family council – and non-executive (and/or non-family) directors typically act as arbiters to distinguish in an appropriate manner between family and business matters in the Three-Circle Model.

Care is called for when general corporate governance rules interact with the management of family interests and conflicts of interests. Members of the board are usually – and appropriately – held to abstain from decisions when a conflict threatens in which they have a personal interest. If such abstaining also implies that the relevant directors cannot take part in the discussion beforehand, in extremis a situation is conceivable in which a family will no longer be able to decide on the well-being of the family firm.

Double voting rights have the negative connotation that they are an abusive instrument to retain control over businesses, especially when combined with cascading holding structures (cf. infra). **Dual-class equity shares** are a more general mechanism enabling a family – or any other controlling shareholder such as the state – to stay in control of a company by retaining more decision-making rights while holding economic rights to proportionally less of the value of the company. The class of shares held by the family entitle them to disproportionally exert control, through the appointment of board members or determine the long-term strategy of the company. In doing so, the family can safeguard the company from

21 De Moor, Charlotte (2014), *Board effectiveness: one-tier versus two-tier boards*, University of Ghent.

the short-term pressure (and myopia) of the public stock market. Deliberately upsetting the "democratic" one share-one vote pari passu principle may render such companies paradoxically more responsible and their management and board more accountable, proponents argue. Precondition is then that the checks and balances of the principal-agent model of dispersed shareholdership are suitably replaced by a proper functioning stewardship model.

In Europe, about 20% of family firms are characterized by special voting rights[22], compared to about a third in the US and 10% worldwide, but this does not reflect itself in a difference in total shareholder (economic) returns. Even within Europe, regional differences are large[23]. The greatest discrepancy between ownership and control through dual-class shares can be obtained in Sweden and Switzerland where, on average, the lowest minimum percentage of shares is required to ensure 20% control. Close to two thirds of Swedish companies make use of multiple share classes with differentiated voting rights. Perhaps surprisingly, these two countries are often singled out as examples of the success of family firms.

To some extent, the newly proposed corporate legislation in Belgium also relinquishes the "one share one vote" principle. Publicly-listed companies will have the opportunity to opt for a double-voting rights scheme that rewards loyal shareholders. In addition, contributions-in-kind, in particular knowhow and inventions in start-ups and research-intensive companies, are now allowed to be rewarded in the share capital.

Another mechanism to guarantee continuity of ownership and/or control is the use of **foundations or trusts**. These institutions are perceived in countries such as the Netherlands, Scandinavia or the United Kingdom not to maintain control at all costs but to allow for continuity with a view towards social or collective objectives.

One of the most extreme examples must certainly be Robert Bosch. The firm is more than 90% owned by the Robert Bosch Stiftung although the foundation has no voting rights. These have been transferred to the Robert Bosch Industrietreuhand, a trust in which the family's agents, management but also independent directors hold almost no shares but more than 90% of voting rights. The Bosch family finally has about 10% of shares and corresponding voting rights. Most of the profits are invested back into the firm but nearly all of the earnings distributed to shareholders are devoted to humanitarian causes.

22 Credit Suisse (2018).
23 Faccio et al. (2002). Institutional Shareholder Services (2015).

Belgium has a complicated relationship with foundations, due in part to a number of high-profile media cases. Certification of shares is possible in Belgium, along the same lines as a Dutch STichtingAdministratieKantoor but take-up is sporadic at best. Law proposals have been submitted to abolish the institution, a tell-tale sign of the sensitivity and the lack of legal insecurity in Belgian regulation and legislation.

We include **public listings** here as a governance mechanism due to their capacity to "discipline" management and block shareholders. Typically, publicly listed family firms perform well when (i) large block-holding families have strong incentives to monitor professional executives, and (ii) the existence of transparent and liquid capital markets in turn assures effective monitoring of family owners. The effect of ownership or voting rights may thus again be nonlinear.

Public listings have not been unambiguously positive for family firms. A specific issue is that family owners typically had no idea how much their stock was worth whereas such stock may represent sometimes 90% or more of their wealth! Shareholder pacts inspired by stewardship typically include formulas that are based on book values of equity. Public share prices including a premium for goodwill and sometimes even for family control are usually much higher. The corresponding paper wealth may induce current family members either to spend more lavishly – or to shrink back for fear – in the process generating new agency issues for stewardship to address.

Yet in a sense, a public listing (or any other form of "disciplining" external financing, for example by institutional investors) ought to form the natural objective for any family firm. Not specifically to raise capital but rather to act as a mirror, an instrument of governance against and through which the family can better play its role as steward and anchor.

Pyramid control. The separation of ownership and control is perhaps most acute when controlling shareholders, not seldom families, hold and exercise decision-making rights in excess of their economic cash flow rights by means of pyramids or cascades of holding companies. Within such pyramids, cross-holdings of equity may further allow a firm to ultimately control its own shares.

The ground-breaking study of La Porta & al. in the nineties – data is mainly from 1995 – on who owned or controlled large corporations around the world still featured as its "possibly most complicated example" the holding structures involving Electrabel/Tractebel. The study also highlighted the well-known case of the Wallenberg family, reported to control at least 40% of the entire Swedish economy, in particular through controlling stakes in about half of the most valu-

able companies in the country (ABB, Saab, SEB…) held through pyramidal constructions[24].

Pyramid constructions occurred only in 1 in 20 publicly-listed family firms[25], suggesting that pyramid control is much less prominent in all but the largest-capitalisation firms. Often, unlisted firms too feature in pyramids ultimately controlling publicly-listed firms. 90% of these unlisted firms were again controlled by families, both domestic and foreign, in Germany, and more than 99% in Italy. In France, families were identified as the largest owner of at least 56% of unlisted firms, which must surely be an underestimate as most of the remaining firms were again directly controlled by an unlisted firm. In the UK 78% of unlisted firms were fully controlled by a single shareholder.

Recent regulation on ultimate beneficial ownership attempts to do away with the often deliberately obfuscating pyramid structures meant to avoid or evade taxation. The Belgian law of 18 September 2017 is explicitly meant for "the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and limitations to the use of cash."

The reason for which family firms use holding structures for the purpose of fostering stewardship is of course not implied herein. Pyramid ownership structures and other control mechanisms typically act as an "internal" capital market. For example, when setting up a new stand-alone firm, the founding family would have to make use of "personal" (i.e. non-incorporated) money. The use of an existing firm to set up a new affiliated company allows to access the accumulated earnings in that firm. The downside is that managing the internal market may divert management talent and resources from maximizing the firm's "external" performance[26].

Pyramid control internal markets by design imply capital flows within the structure. Cash pooling makes it possible to allocate capital where it can best be exploited. This must not be confused with *tunnelling*[27], the unwarranted upstreaming of dividends of the firms at the base of the pyramid to the holding companies at the apex, often under the guise of intragroup transactions: transfer pricing,

24 To date, ABB's Vice Chairman Jacob Wallenberg is also Chairman of Investor AB, which owns 10,71% of ABB (not including the shares Mr. Wallenberg holds in his individual capacity). Investor is controlled by the Wallenberg foundations, whose aggregate holdings amount to 23,4% of the share capital and 50,1% of the voting rights, amongst others through a majority of 57,5% of class-A shares. This share class represents 40,6% of the capital but 87,2% of votes. Incidentally, ABB itself originated in 1987 out of the merger of Brown, Boveri & Cie, where the Swiss Schmidheiny family acted as anchoring shareholder and Sweden's ASEA, controlled by the Wallenbergs.

25 Faccio & al. (2002).

26 Compare Stein, Jeremy (1997), *Internal Capital Markets and the Competition for Corporate Resources,* Journal of Finance **52**.1, 111-133.

27 Johnson, Simon, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer (2000), *Tunneling*, American Economic Review **90**.2, 22-27.

royalty payments, capital provisioning… Suffice to say that the risk of tunnelling is not a prerogative of family-controlled pyramids.

Dynastic thinking in Belgium

A crucial factor in anchoring family firms is the willingness and ability to in fact establish a dynasty lasting multiple generations. Doing so requires at least the legal, fiscal and financial possibility to hold the family share capital – and decision-making rights – together.

From the previous generation's point of view, the willingness to build dynasties is not equally distributed across countries, if the generational analysis we presented above is a reliable indicator. It has been proposed that the often-negative perception of wealth and status in Belgium can lead family shareholders to avoid the spotlight at all costs. Paradoxically, the Belgian environment may inspire others, founders, to sell out dearly rather than perpetuate the business through their descendants. Selling the company functions as a status symbol then. (Compare with Ernest Solvay whose conferences too could be considered as a status symbol or a conspicuous demonstration of wealth.)

Belgium must take especial care to ensure that its large Family Firms-to-be make the transition from founder-controlled, say, up to 100 MEUR revenue companies to truly large Family Firms. How can we as a country induce these shareholders not to "sell out" but rather grow into a world-leading multigenerational Belgian Family Firm? Could the capital required to transition beyond conquering the Belgian market to a sustainable internationalisation be made available from the general public, (the very few existing) institutional shareholders or possibly the government to prevent Belgium losing – again – a family jewel? To what extent is a Belgian entrepreneur less prone to think in dynasties, in structures that concentrate and perpetuate family power in the hands of the most fit – be that a family member or an external CEO – is a question we want to address in individual cases later.

Without sufficient incentives to build dynasties, anchoring is of course difficult. Policy makers aiming to offer fertile soil for multiple-generation family firms must create the appropriate institutions and incentives to nurture them.

The pivotal generation is the generation that achieves a break-through – which does not need to be the first. In such a break-through generation a majority is conscious of the issue whether and how to leave something behind that survives after they have passed. Entrepreneurs sell out the moment they believe they cannot go further on their own: because of a lack of expertise or resources or because internationalisation exceeds the limits of the family capital.

Institutional investors, whether related to the government or not could act as capital provider for large would-be-anchorers. Belgium has too few of such institutional investors, or at the very least none that appear to be up to the challenge and put up the resources to firmly root world-leading family firms in our country.

We are happy as Belgians with our country but take little pride in it. We must ask ourselves whether Belgium creates a sufficiently rich sociological context in which family businesses-in-spe feel the urge to continue here. Can we as a society generate the recognition for their success in a manner that does not equate such success with selling dearly to the highest bidder?

5

How stewardship defines strategy

In the previous chapter we indicated how the governance model of family firms, and the instruments they use to implement that model, is driven by the idea of stewardship, the mission to "pass on" the family firm in the best possible condition from generation to generation.

In this chapter we wish to show how stewardship also explains strategic choices that family firms make in the way they do business. Research strongly suggests that these choices may well be the source of family firms' financial outperformance. As such, the concept of stewardship can provide valuable lessons for all types of firms. The contribution of family firms to their host country's economic (and social) welfare may warrant policy makers' attention too. It is our opinion that careful attention to the way in which the stewardship model addresses potential stakeholder conflicts in family firms can suggest important measures to better commit, anchor, family firms in Belgium.

Do family firms outperform their non-family peers?

The literature shows that differences in size, age or industry are considerably less important than specific characteristics common to family firms in general. An often-cited characterisation[28] of family firms is their propensity to be *parsimonious* (or prudent, as it concerns their own money), *personal* (decision-making is often quite direct) and *particular* (each family firm "behaves" in its own idiosyncratic manner).

Importantly, the specific features of a family firm are path-dependent: they were learnt and absorbed through a series of unique obstacles and opportunities during their individual life cycle. This shared common history is a strong bonding among members of the family, even across generations. It is the interplay among these features in their strategy that provide family firms with their specific outcome and sets them apart from other types of firms.

But do these features make family firms perform better? One of the most cited papers in all of the family firm literature is Anderson & Reeb's investigation of the relation between founding-family ownership and firm performance[29]. At the turn of the millennium, families were present in one-third of the S&P 500, the United States benchmark index for large-capitalisation stocks. The authors found

28 Carney, Michael (2005), *Corporate governance and competitive advantage in family-controlled firms*, Entrepreneurship Theory and Practice **29**, 249-266.

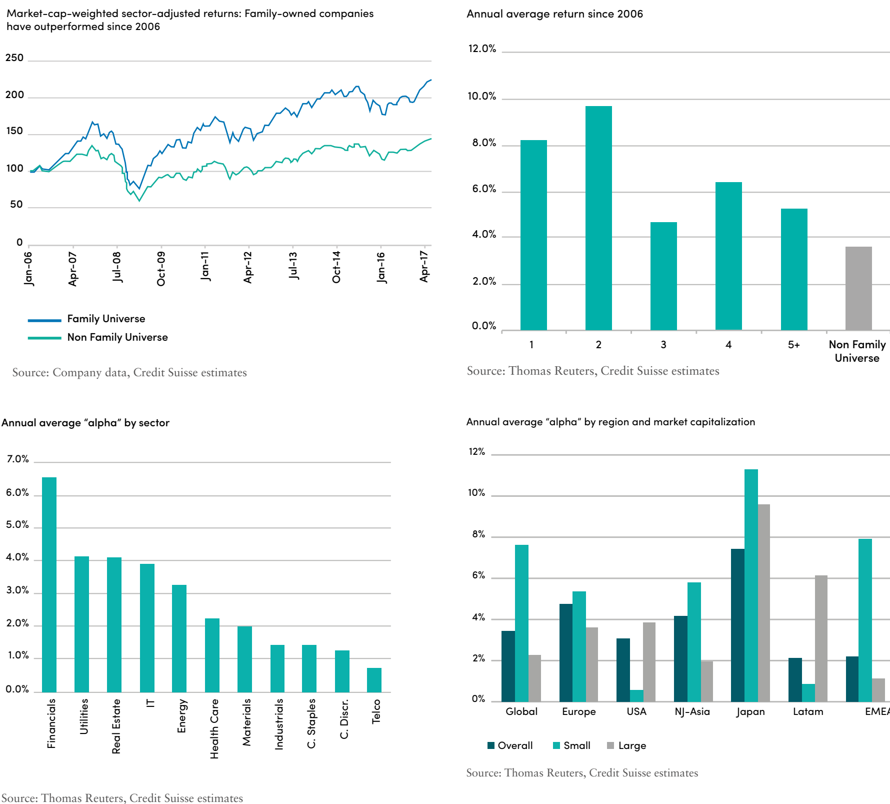
29 Anderson, Ronald C. & David M. Reeb (2003), *Founding-Family Ownership and Firm Performance: Evidence from the S&P 500,* Journal of Finance **58**.3, 1301-1328.

"contrary to our conjecture" that family firms in the S&P 500 outperformed their non-family peers, and even more so when a family member served as CEO on top.

Since then, Anderson & Reeb's ground-breaking conclusion that family firms are more profitable than other (large, listed) companies has had to be nuanced somewhat[30]. The universe of family firms is much too heterogeneous to be able to draw general conclusions as to what causes the outperformance.

Be that as it may, large-capitalisation indices such as the Credit Suisse Family 1000 indeed do better than similar indices of general firms, irrespective of region, size or industry.

Figure 9: Family firms outperform [Credit Suisse 2017, 2018]



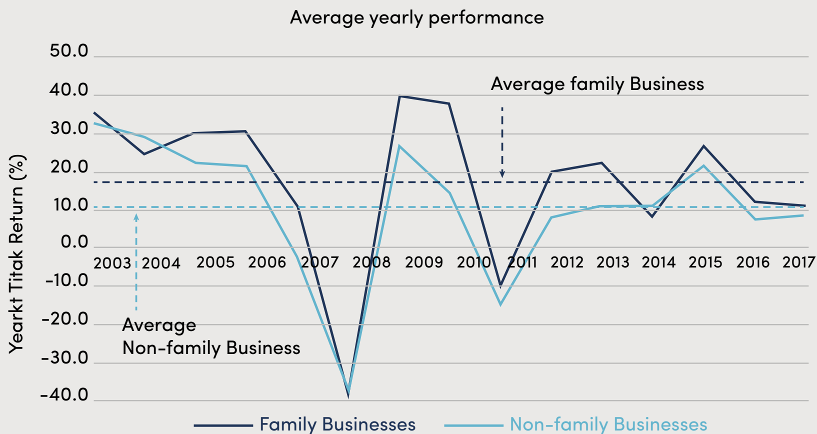
30 For an excellent overview, see Lopez-de-Silanes, Florencio & Timothée Waxin (2014), *Family Firms and Performance: Where do we stand?*, EDHEC Business School.

The financial outperformance of family firms is to a great extent explained by their faster growth in revenues relative to their peers, a robust finding across all industries and regions. In addition, the smaller companies – relatively speaking – are more profitable as well. Early-generation firms structurally outperform their more mature peers: it is not clear whether the driver here is a stronger commitment or management acumen, or simply the higher growth rates witnessed in smaller-cap companies.

Do Belgian family firms outperform?

Deminor[31] commissioned Guillaume Dasnoy, teaching assistant at Solvay Brussels School of Economics and Management, to investigate whether Belgian family businesses did better than their non-family peers. (A follow-up paper will examine possible reasons why.)

The study considered fifteen years – 2003-2017 – in its analysis and 169 companies of which 50 were deemed family firms. (Deminor has its own definition of a family business which considers a relevant stake to exert significant influence; a family board member and possibly family managers; and a longer-term vision established over more than one generation.)



Family businesses outperformed by 7% on an annual basis. Inversely, among the best performing shares, more than three in four were issued by family firms.

31 Deminor (2018).

The literature has not rested to isolate those characteristics of family firms that directly correlate with success. Credit Suisse for example highlighted family firms' consistency (and persistency) – long-term commitment, identifiable ownership, track record during adverse times – and the alignment of owner and management interests as their key strengths, or a cautious and effective management of a strategy focused on value-added products and services.

"Bivalent attributes"

In general family firms' character traits are ambivalent[32]: they may enhance success – but the same traits may also render these companies more fragile or more prone to mishaps: their financing history, the dependency on a strong founder, the overlapping roles in the family business system… We single out four strategic choices that are decisive to the firm and their economic contribution. They act as conduits that channel the effect of family stewardship on firm and country performance.

Diversification

Family firms tend to be focused – largely determined by the founder's initial area of expertise – with a preference for exploiting niches.

The mutually reinforcing relation between Hermann Simon's so-called "hidden champions"[33] and their host nation Germany may apply to family firms in general as well. Intrigued by Germany's export performance, second only to China and on the same level as the United States, Simon argued that the country's export strength could not be explained by only focussing on the biggest corporations such as Volkswagen or Siemens – both family firms, incidentally. Simon looked for and found hundreds of largely unknown firms, many of which again family-owned, that are global market leaders in their niche. The hidden champions' strategy of specialisation in product and manufacturing knowhow; combined with global marketing and selling through their own subsidiaries; and a penchant for customer proximity is championed by many family firms.

Family firms grow by attempting to repeat this specialisation strategy in adjacent niches. The question then is how to keep the focus and avoid (wealth) dispersal among heirs. As a rule, families dislike free-standing firms, even if agency problems related with conglomerates and large business groups could be exacer-

32 Tagiuri & Davis (1996).
33 Simon (1990, 1996, 2007).

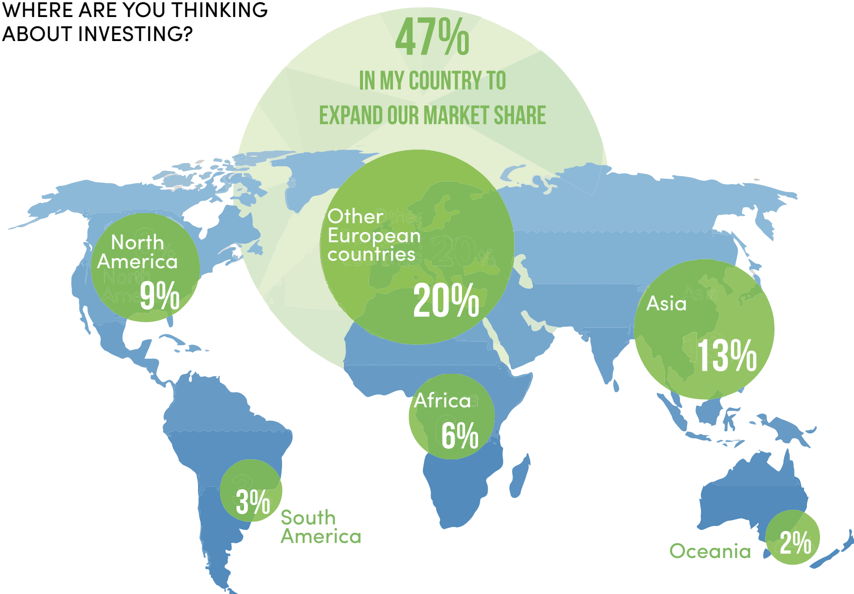
bated by family ownership[34]. That may be the reason why pyramidal structures, rather than stand-alone firms, dominate many economies around the world[35], although their influence and use may be starting to wane in recent years.

Internationalisation

Conditional on the size of the local market, family firms tend to underinvest in internationalisation.

Family firms support a country's export strength and competitiveness with their capacity for production efficiency and their mastery of short and relatively simple value chains. Export strength however is not the same as internationalisation. There is no significant positive effect on outward foreign direct investment from family firms at the country level.

Figure 10: Family firms exhibit a home bias [KPMG 2014]



34 Morck, Randall & Bernard Yeung (2003), *Agency Problems in Large Family Business Groups,* Entrepreneurship Theory and Practice 27.4, 367-382.

35 Morck & al. (2005). Faccio & al. (2002). La Porta & al. (1999). Aminadav & al. (2018).

These international findings apply a fortiori to Belgium. The perception is that Belgian family firms are managed "intuitu personae" rather than systematically, which may be a disadvantage when it comes to setting up business abroad. Ad hoc joint ventures with foreign incumbents or minority participations in international consortia tend to lead to situations where the strongest partner takes over – and more often than not the Belgians are bought out.

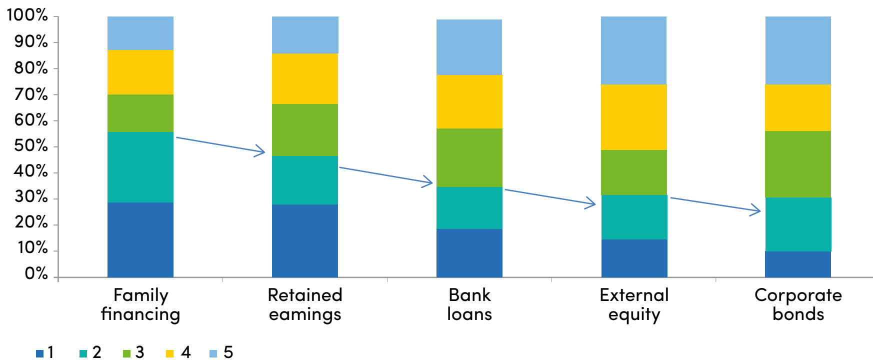
Financing

Family firms share a preference for long-term equity and retained earnings as a source of funds.

Family firms' proverbial *patient capital* owes to a desire for sustaining the family-owned or -controlled business over multiple generations. Correspondingly, their return expectations and horizon may well weigh the components of Return on Investment (= Current Yield + Return on Capital Invested) differently from other companies.

Figure 11: Family firms' preferred financing options [Credit Suisse 2017]

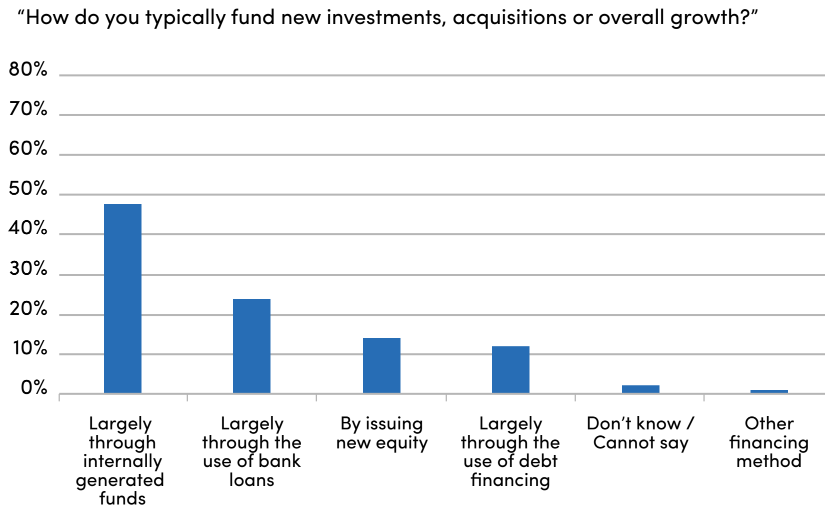
"Rate the following financing options from 1 (= most) to 5 (= least)"



Source: Company data, Credit Suisse estimates

Next to family equity, family firms rely on retained earnings over any other financing option to fund operations and expand their asset base through investments or acquisitions, conceivably also in an effort to maintain family ownership and control over the firm.

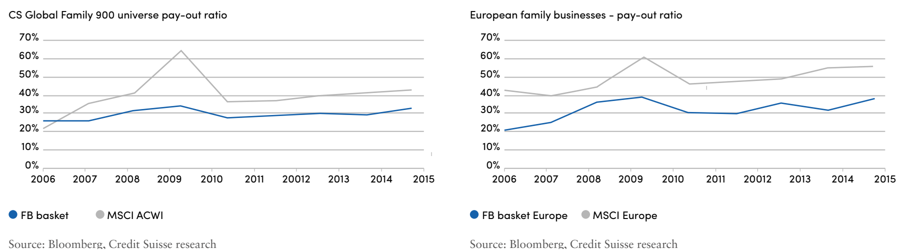
Figure 12: Internally generated funds trump other financing [Credit Suisse 2017]



Source: Company data, Credit Suisse estimates

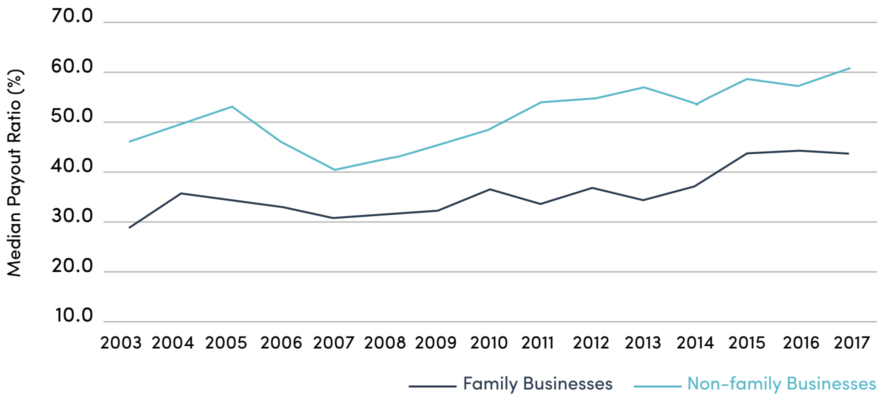
Retaining earnings versus distributing these as dividends is an important aspect of a family firm's strategy. In contrast perhaps with pervasive perceptions of how (wealthy) families earn their income, the pay-out ratio of family firms is structurally *lower* across the world than in their non-family counterparts. The difference is even more pronounced in Europe…

Figure 13: Pay-out ratios at family firms are lower [Credit Suisse 2015]



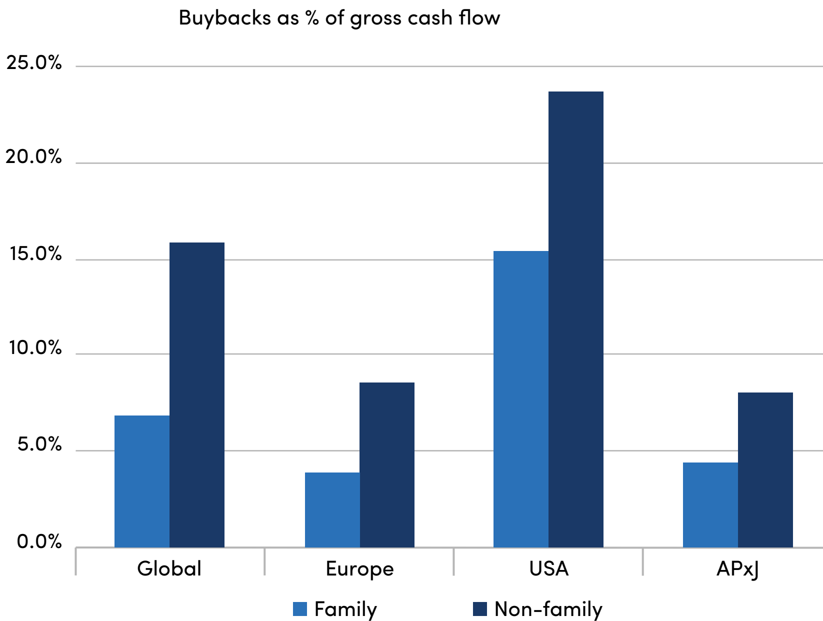
… and in Belgium.

Figure 14: Median Pay-out ratios in Belgian family firms [Deminor 2018]



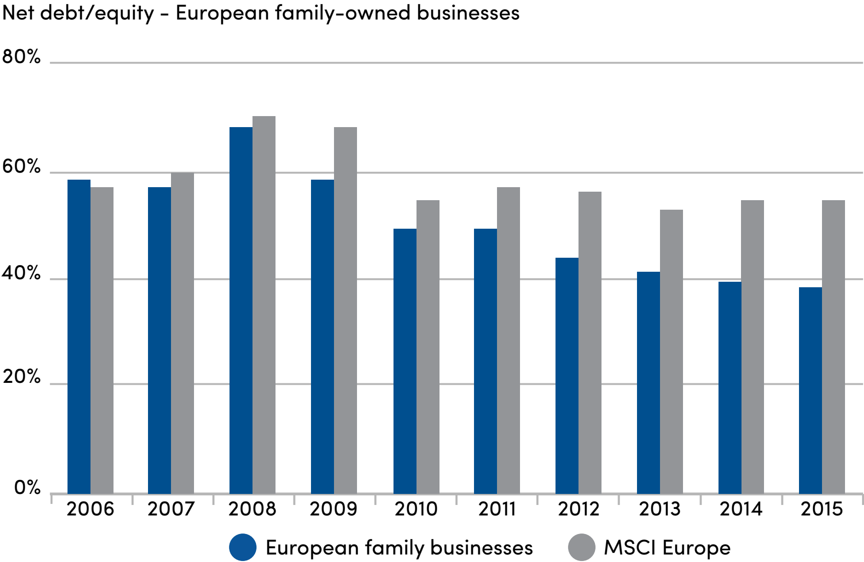
In addition, family firms spend significantly less than half of their gross cash flow on buy-backs for instance.

Figure 15: Family firms buy back shares less than non-family peers [Credit Suisse 2018]



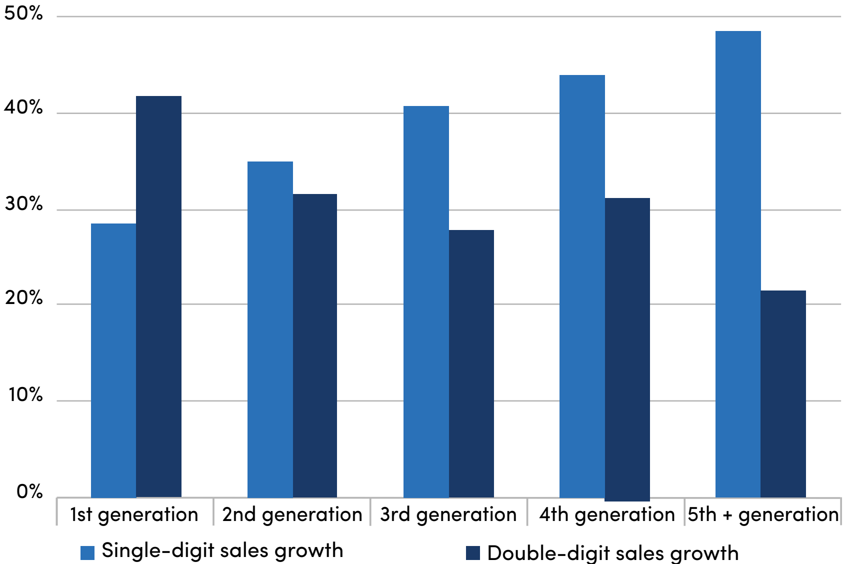
As a result of these financing choices, European family-owned businesses in particular are less indebted than general firms.

Figure 16: Family firms' net debt/equity is lower [Credit Suisse 2015]



Source: Company data, Credit Suisse estimates

Figure 17: Sales growth across generations [PwC 2018]

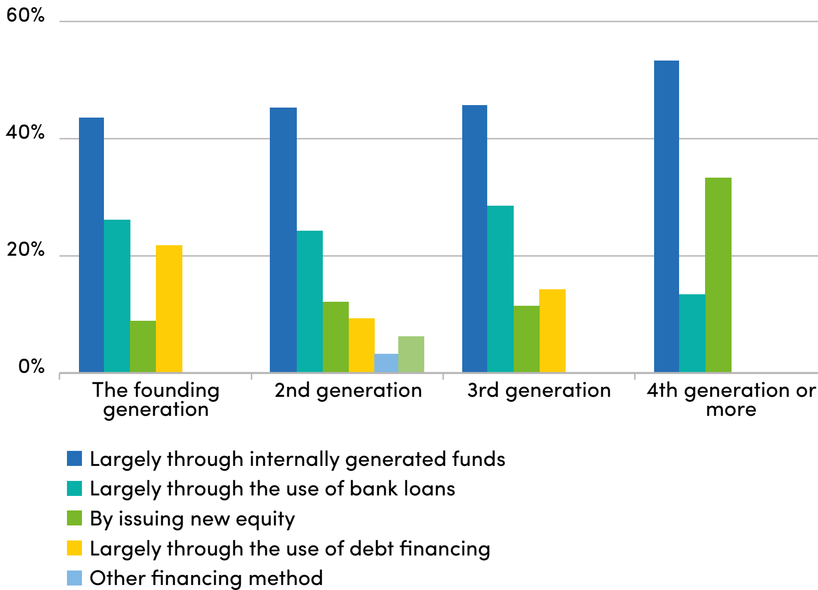


Source: PwC (2018), Global Family Business Survey 2018

The tendency to adopt a more conservative strategy is even more pronounced for later-generation family firms, potentially at the cost of more aggressive growth and profitability.

Arguably, families attempt to safeguard accumulated wealth: risk aversion increases, together with the use of governance devices to strengthen family control. But the preference for internally generated funds is quite persistent across generations.

Figure 18: Financing strategy is persistent [Credit Suisse 2017]



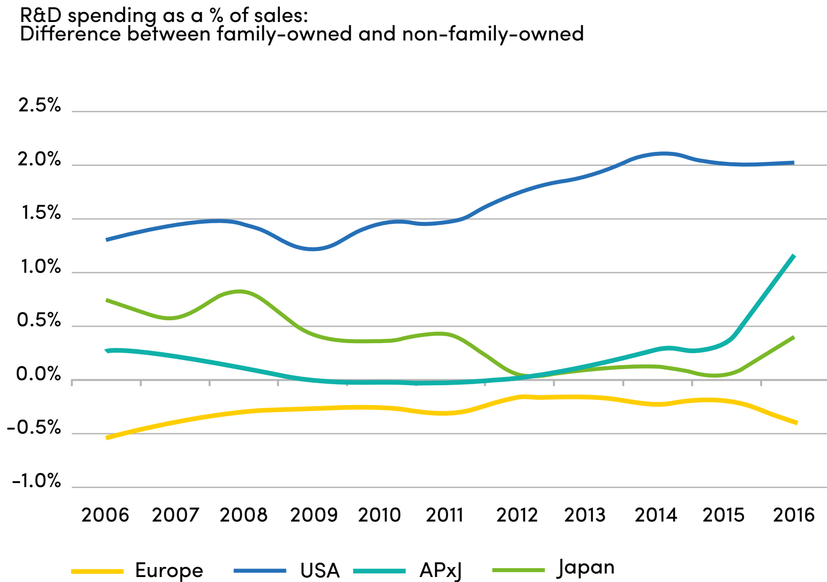
Source: Company data, Credit Suisse estimates

Innovation

European family firms engage less in innovation – but they are more effective at it.

Family firms, in Europe at least, tend to underinvest in innovation. The reasons are manifold, and different for every individual firm: because of inertia, lack of specialised talent, emotional ties with existing products and assets, traditions restricting change, reluctance to risk the family's reputation, unwillingness to use external financing, or diversion of resources to preserve socioemotional wealth.

Figure 19: European family firms have a lower R&D intensity [Credit Suisse 2017]

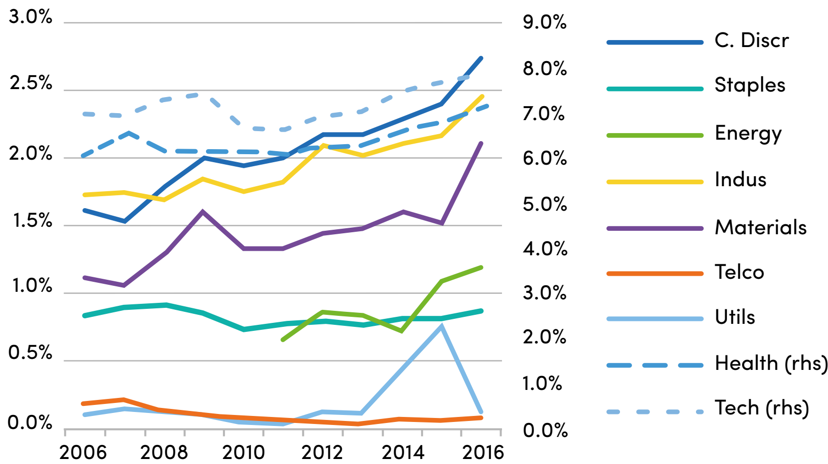


Source: Company data, Credit Suisse estimates

A notable exception is Switzerland, home to a number of the world's longest-lived family businesses. As in other countries, the Swiss family firms' biggest worry is the need to innovate and the quest for talent to head off global competition. Swiss family firms have the familiarly modest pay-out ratios, but their exceptional overall net cash positions allow them to invest more in R&D relative to revenue than other family firms, and only slightly less than non-family competitors.

There is, of course, quite a difference in R&D intensity across industries. The prominence of healthcare companies in Switzerland will greatly contribute to the exception we noted above. Similarly, technology family firms invest much more in R&D than other sectors would.

Figure 20: Sector investments in R&D [Credit Suisse 2017]



Source: Credit Suisse, Thomson Reuters Datastream

Before jumping to conclusions, there is an important caveat. Family firms may possibly spend less on R&D than firms in general, but they tend to have a greater Return on Innovation[36]. The reasons for this superefficiency are hard to identify. Perhaps family firms are endowed more than other firms with tacit, non-codifiable and socially complex knowledge, which is difficult to be learned or imitated by competitors – a finding not unlike those in the "hidden champions" literature. Innovation at family firms may be managed differently than in non-family peers[37]: a correlation exists between the type and extent of innovation activities and family control. In particular, families are reluctant to engage in, say, technological innovation that may (ultimately) escape the family's control or diverge from the

36 This finding parallels the beneficial role of institutional investors in disciplining the "lazy" (and career-conscious) CEO to innovate more effectively. See Aghion, Philippe, John Van Reenen & Luigi Zingales (2013), *Innovation and Institutional Ownership*, American Economic Review 103.1, 277–304.

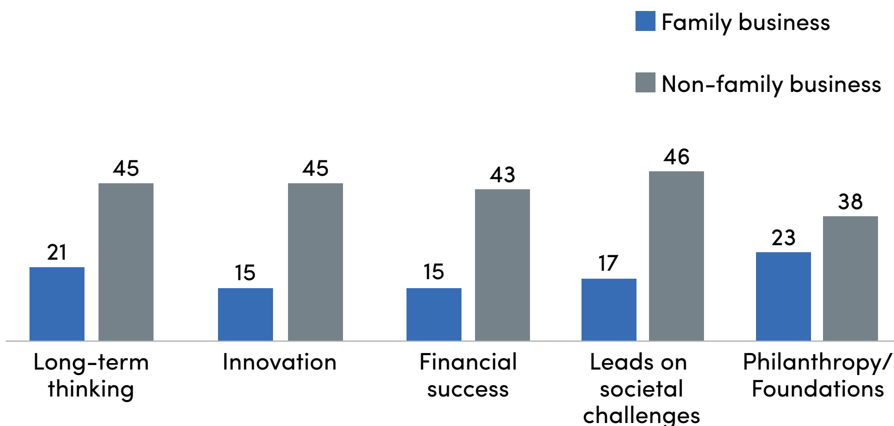
37 De Massis, Alfredo, Federico Frattini & Ulrich Lichtenthaler (2012), *Research on Technological Innovation in Family Firms: Present Debates and Future Directions*, Family Business Review 20.10, 1-22. De Massis, Alfredo, Federico Frattini, Josip Kotlar, Antonio M. Petruzzelli & Mike Wright (2016), *Innovation through Tradition: Lessons from innovative family businesses and directions for future research*, Academy of Management Perspectives 30.1, 93-116.
Cf. also: Brinkerink, J.A.H. & Yannick Bammens (2018), *Family influence and R&D spending in Dutch manufacturing SMEs: The role of identity and socioemotional decision consideration*, Journal of Product Innovation Management 35.4, 588-608.

family's traditions. But when they do invest in innovation, they do so conscientiously and effectively.

And, as always, every family firm is different. Whereas the first – or more generally, the "break-through" – generation benefits from the commitment and knowhow of the founder, the return on innovation appears to persist in later generations as well. The literature tentatively identifies individual mission-driven family members with the ambition to go against the grain as a key driver. In more cases than not, it is not the eldest children but the "rebels" struggling for attention that instigate break-through innovations.

Unfortunately, family business is much less likely to be perceived as engaged in long-term thinking, innovation or financial success by the respondents.

Figure 21: Family firms perceived as behind on innovation [Edelman 2017]



There is a clear need for better communication by family firms, policy makers and opinion makers on the achievements of family firms in each of these respects.

6

The institutional role of family firms

Belgium finds itself on the balance between the French *dirigiste* tendencies and the Germanic *Rhine capitalism,* characterised[38] by a long-term economic view sustained by self-financing enterprises and social consensus among labour market stakeholders; a developed welfare state that refrains from too direct economic intervention; and bank rather than capital market financing with a strong independent central bank. In contrast with the Anglo-Saxon variety of capitalism, relationships rather than market mechanisms (or hierarchy) take centre stage. Collective wage bargaining, vocational training and specialisation, coordination rather than competition, or patient capital are the keywords for companies.

In this environment, family firms and institutions complement one another. Institutions such as industrial policy may mitigate some of the negative tendencies ascribed to family firms. In return family firms may "make up" for the lack of beneficial institutions through e.g. their reputation for honesty, their reliance on retained earnings, their reluctance to downsize workforce or cut wages in adverse times…

We have already seen that families – but the same applies to nation states – make use of control mechanisms to influence decision-making in excess of their economic rights. Such structures are typically perceived as negative, relating to tax avoidance or tax evasion. Extensive research[39] has corroborated the central hypothesis of the law and finance literature that concentration of ownership and control can be considered an attempt to substitute for weak shareholder protection. Inversely, legislation facilitating shareholders to sue managers-agents that may have abused their position is systematically stronger in countries where ownership is most dispersed. At the same time, countries where a considerable share of firms can be deemed to be controlled by families or states typically have relatively stringent labour market legislation.

As a rule, families are quite proud of their origins. This maybe shows most critically when their home country is in trouble and the state is failing. Families tend to go to impossible lengths to preserve some beachheads, even if the country has fallen into disarray and chaos, with the hope of returning and reinvesting where their roots are deep. In Europe in particular, the ebb and flow of history is well reflected in our longest-lived family firms: even if conflicts have had a severe impact on these families, when they can, they return. Actions of family shareholders act as a cushion or an incentive to other stakeholders.

That does not make family firms more "pure" in general. But within their universe, some families behave in such an ethically conscient, locally concerned manner that government, opinion makers and the public at large must acknowledge their contribution, in the process promoting anchoring.

38 Albert, Michel (1991).

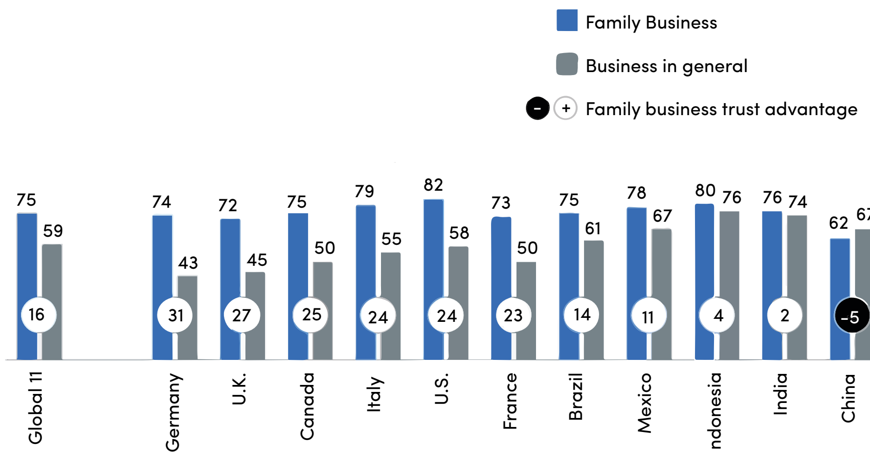
39 Associated with, and building on the work of La Porta & al. (1999) that focused on the largest corporations in 27 wealthy economies. For an overview, see La Porta & al. (2008).

Promoting such behaviour instils a sense of pride in family firms and in Belgian family firms in particular. (Compare with Times Square in New York!) In examining these emblematical firms, what immediately comes to the surface is their sense of belonging somewhere, their roots. The "halo" effect spills over to the other constituencies we encountered in the Three-Circle Model.

Family firms are trusted – but do not get credit for their contributions

Family businesses are trusted considerably more than their non-family peers, according to a special report in the 2017 Edelman Trust Barometer[40].

Figure 22: Family Firms enjoy a trust advantage [Edelman 2017]



Family firms, and family shareholders, could do more to harness this sense of trust. Their age-old sense of discretion is threatening to evaporate in the context of society today. Family firms have been slow to respond, and any effort to hang on to their privacy makes them more suspicious in the eyes of many. Of course, family members' personal life must not be publicised, as other individuals' life must not either. But the things that the family does to hold together, to sustain their commitment, to enhance the firm's performance deserve to be made public.

40 PwC (2018), *Global Family Business Survey 2018. The values effect.*

And yes: making explicit the values and policies that regulate the company, in return makes family shareholders accountable.

An important aspect of trust is heritage: family businesses could promote where they come from and how they go about their business.

Figure 23: How to enhance trust [Edelman 2017]

Less than half of the respondents in the 2017 Edelman Trust Barometer with its special focus on family firms know which companies they buy from are family businesses – and if they knew, they would pay considerably more!

Figure 24: The "profit" of being perceived as a family business [Edelman 2017]

Percent who know which companies they buy from are family businesses

Globally
51%
"I know which companies I buy from are family businesses and which ones are not"

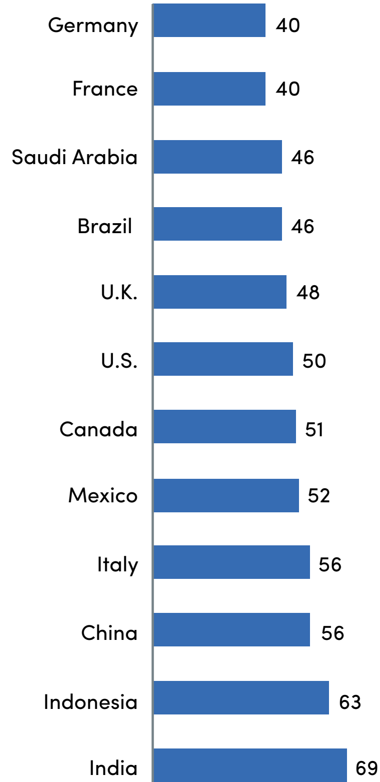
Percent who will pay more for products or services offered by family business, comparing those who know which companies they buy from are family businesses vs. those who do not

Willing to pay more for products or services offered by a family business

66%
Knows which is family business

21%
Does not know which is family business

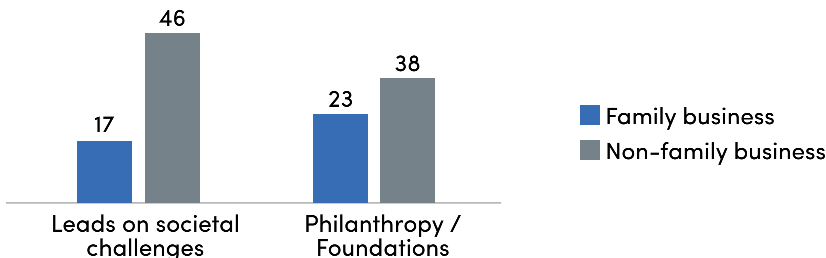
+45 pts
more likely to pay more if they know which company is a family business



Despite their trust advantage, family firms are believed to be less in tune with societal changes and challenges.

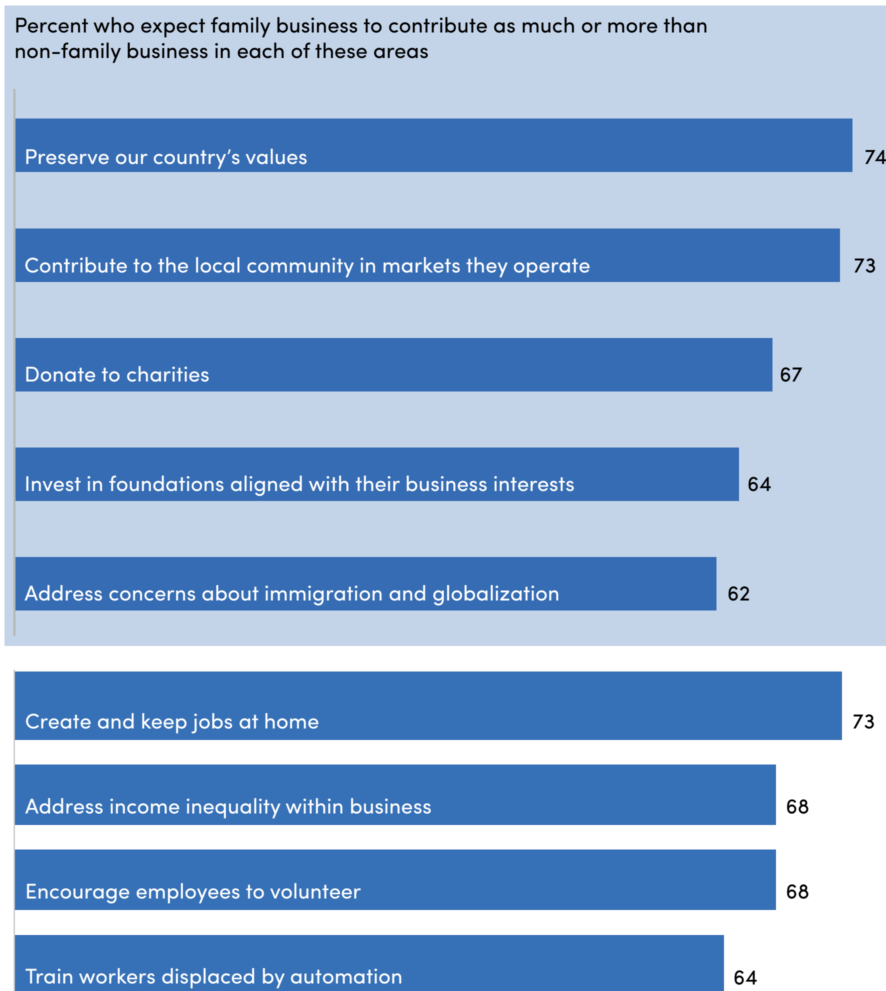
Figure 25: Misperceived contributions to society [Edelman 2017]

Percent who believe each is more likely to be true of family business vs. non-family business



An overwhelming majority of respondents indicate that they expect more of family firms locally.

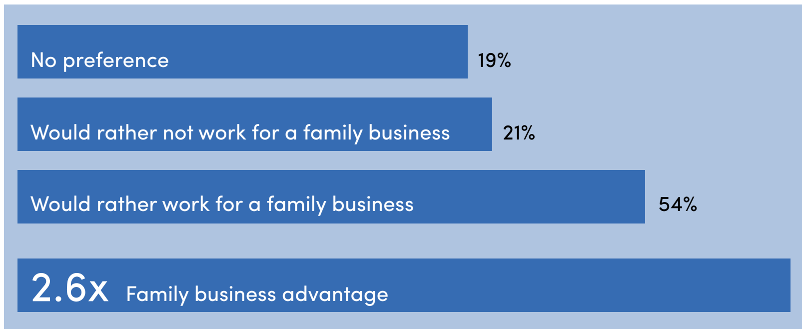
Figure 26: Do good locally [Edelman 2017]



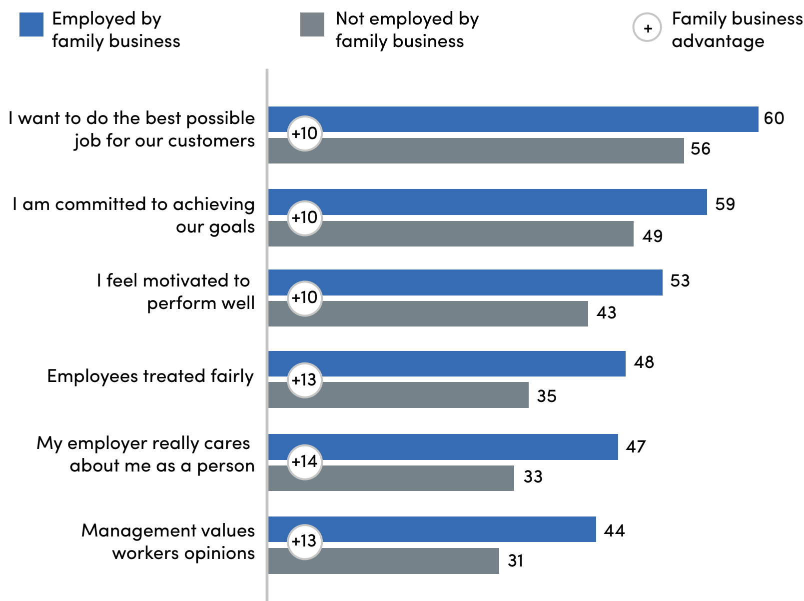
A very important dimension of local impact is employment. Family firms are expected to do more than their non-family peers when it comes to safeguarding local employment.
Crucially, family firms do not get the credit they serve when it comes to employment. Less than one in three see family firms as job creators, whereas we know that they employ at least half of the work force in most countries!

Employees at family firms themselves are significantly more committed than their colleagues elsewhere, but their ambassadorship does not translate into more general public appreciation.

Figure 27: Strengthen employee commitment [Edelman 2017]



Percent who strongly agree with each of the following statements, family business employees vs. non-family business employees



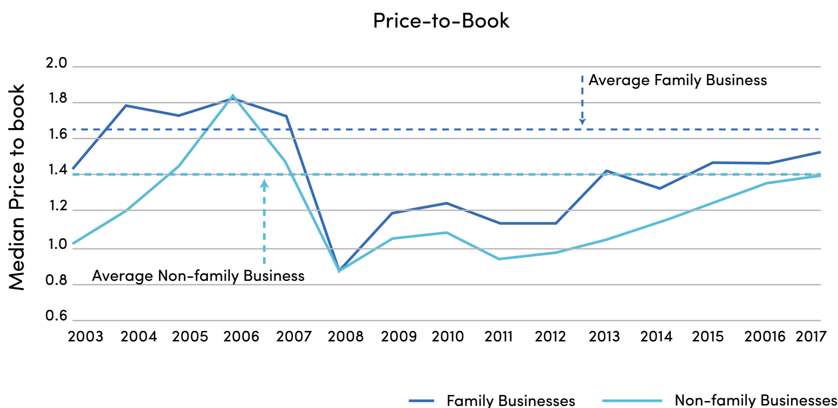
Germany's "hidden champions" we mentioned earlier may be quite unknown on the world stage outside of their niche but more often than not they are considered heroes in their local environment. Employment, certainly outside of the larger cities, is often supported by family firms that act as automatic stabilisers. Family firms are more socially oriented, with more attention for those disadvantaged by

life, and more loyalty towards senior employees. Here lies a considerable opportunity whereby family firms and Belgium's economy can mutually reinforce themselves.

Family firms represent an asset class on their own

From an investment management point of view, the "share class" of family firms enjoys certain characteristics that sets them apart from other equity investments. In the traditional dichotomy of stocks as growth stocks or value stocks, stewardship-governed stock is not comfortably categorised. Family firm shares typically are quoted at a premium to non-family shares, i.e. their ratio of market value to book value exceeds that of other firms' shares.

Figure 28: Price-to-book ratio of Belgian family firms [Deminor 2018]



In that respect, they resemble growth stocks, rather than undervalued value stocks. But we have already seen that the type of growth they pursue – in terms of diversification, internationalisation or innovation – is characteristically different from the general universe of firms. As a result, their growth pattern appears more stable, less volatile and much less (stock market) cycle-dependent than a typical growth stock would show, in a sense more resembling value stocks.

Importantly, the outperformance family firms' shares structurally have relative to equity investments in general is not due to aggressive financing or excessive risk-taking.

The combination of well-defined characteristics that differentiate family firms from other companies and the documented outperformance of their stock prices should make a welcome addition to the investment opportunities for portfolio managers worldwide. The considerable (and highly risk-averse) wealth owned by Belgian nationals could consequently be allocated to family firms, providing an alternative for Belgium's conservative bias towards real estate and savings accounts.

Can the trust people have in family business help convincing the public to invest in family firms? In economies where information on financial sustainability is hard to come by and institutional devices to signal "credibility" are inadequate, external financing is a scarce resource.

Of course, banks finance family firms as well but the interaction between personal and corporate credit and the monitoring costs of often opaque family behaviour for all but the largest family firms lower the willingness and ability to take risk.

Trusted family businesses can make up for that. We have already seen how a structurally lower dividend pay-out ratio retains earnings to invest. Well-intentioned pyramidal structures attempt to harness the best of both worlds: retaining family control (over and above the family's capital ownership) while gaining controlled access to public capital. Incidentally, the existence of internal markets for capital but also management talent, skilled labour or innovative ideas signal un(der)developed markets and related institutions.

Belgium has few, if any, institutional investors nor a deep liquid capital market. The few institutional investors Belgian features are often formally or informally linked to government. Not unlike sovereign funds in other areas and regions, government could create financing alternatives to upscaling family firms, in the process strengthening the coordination with the family shareholder on governance, strategy and policy.

Family firms and the promotion of entrepreneurship in Belgium

Family businesses anchored in Belgium can help accelerate growth, harbour innovation and preserve talent. Any sympathy that already exists for such companies can nurture the perception of entrepreneurship in general and make up for Belgium's serious lack in entrepreneurship over and above the one-person enterprise, and in serial entrepreneurship in particular.

In the boom of the (second) industrial revolution – railways, electricity, chemistry – it was mostly families of good standing that took to entrepreneurship, where quite a lot of our prominent family firms have their roots. Why was that?

What is required to recreate such a “hype”? Does it have to be exclusively young “stand-alone” “geeks” now? Or is there an additional institutional role to play for family firms?

Entrepreneurs, both long-standing family shareholders as well as pioneers, must harness the combination of family tradition and upstart disruption to further promote an entrepreneurial climate in Belgium. The recurrent problem of succession and generational transfer provides an opportunity to do so, at the same time preserving “anchored” companies: those firms need not be created anew, they already exist!

The loss of traditional companies is not unambiguously beneficial creative destruction, if factors other than strictly economic arguments are the cause of the demise. There is no guarantee that losing even more established companies will be fully compensated by start-ups.

Stewardship, the idea that family shareholders do not “own” a family firm but rather “treasure” and “safeguard” it for the next generation, arguably is the defining characteristic of family firms and adds significantly to their economic and financial performance as we have seen. In an effort to promote entrepreneurship the ideas of stewardship may be of considerable value; its idea of safekeeping, of custody may well appeal to the Millennials and Generation Z, further anchoring family firms in the heart of the Belgian economy for the generations to come.

7

Epilogue – Towards anchoring family firms in Belgium

We have seen how the constituency of family firms, through their stewardship model, contributes to the national economy where they are active. Stewardship allows family firms to manage governance issues in the interplay of family, ownership and business exemplified in the Three-Circle Model. In addition, stewardship forges a defining band bridging the life stages of a family firm by means of a highly significant commitment across successive generations of family shareholders. There is however a third dimension in which family firms are faced with a fundamental strategic choice.

The threshold here is the firm size where family firms have grown large enough to be able to consider whether delocalisation out of Belgium has become an option. Belgium must take especial care to ensure that its large family firms-to-be make the transition from founder-controlled to truly large international family firms anchored here. As a working hypothesis and to set a reference, the critical transition may occur at firm revenues amounting to, say, 100 MEUR. At that point, family firms have created the resources and the opportunity for themselves to effectively move their operations elsewhere.

Globalisation and technological evolution are redrawing the worldwide structure of the economy with significant impact on individual firms. Nations have long ceased to be the meaningful level on which global value chains are defined. “Multinational” companies are increasingly less organised by country, but rather by product or service for instance. A significant amount of trading now takes place *within* companies or business groups. National borders have become more a fiscal and legal complication than a functional frontier to cross.

Our country must forestall de-anchoring by providing these family firms themselves with an offer they cannot ignore. Such an offer transcends the micro-economic focus on the success of individual firms. It concerns the 360° economic, regulatory and cultural “macro” environment that adds to – or subtracts from – a firm’s success. In a follow-up paper we wish to examine whether the tipping point for families to loosen their commitment to Belgium has come nearer – and what can be done to mitigate the risk of triggering the threshold.

We provide some perspective. Every two years since 2006, the German *Stiftung Familienunternehmen* commissions the highly-regarded *Zentrum für Europäische Wirtschaftsforschung* to assess Germany as a potential home location for large family firms – revenues exceeding 100 MEUR – relative to its global competitors. The index considers the following criteria: taxation (corporate and inheritance taxation, international trade, and complexity), labour market (labour costs vs. productivity, human capital resources), regulation (including labour market flexibility, international trade, corporate establishment and governance), finance (credit conditions, financial stability), institutions (legal security and political stability) and infrastructure (transport and communication), and energy (costs, security, import dependence).

Switzerland traditionally holds the top rank, largely due to its outstanding institutions and regulation. Germany has dropped four places, which led to concern in the media and among family firms. Despite the stability of its financial system, the German labour market and the fiscal treatment of family firms is perceived as less than favourable. In addition, the effects of the *Atomausstieg* and the *Energiewende* cause uncertainty. Italy closes, at a distance, the ranking: the country fails to reform in the eyes of the family firms that largely made its fortune in the preceding centuries.

Figure 29: Länderindex Familienunternehmen [ZEW/Stiftung Familienunternehmen (2019)]

Country index family businesses

Land	Rang 2018	Rang 2016
Switzerland	1	1
Far. Kingdom	2	3
V.S.	3	4
Canada	4	2
The Netherlands	5	5
Finland	6	6
Sweden	7	8
Denmark	8	7
Czech Republic	9	11
Ireland	10	9
Austria	11	10
Poland	12	13
Belgium	13	15
Hungary	14	17
Portugal	15	18
Germany	16	12
Slovakia	17	14
Japan	18	16
France	19	19
Spain	20	20
Italy	21	21

Source: Calculations from ZEW and Calculus Consult

Belgium has improved in the 2018 ranking, in particular because of favourable changes to inheritance taxes. Our country on the other hand scores disturbingly low when it comes to the financing environment for large family firms. Although banks are modestly tolerant of family firm credit risks, Belgium ranks quite low on the World Bank's "Legal Rights Index" (creditor protection) and "Credit Information Index".

Belgium has few, if any, institutional investors nor a deep liquid capital market, where the capital required to anchor and scale up our family businesses here could typically come from. There may be a role for government-related institutions to create financing alternatives to anchor family firms in Belgium. The authorities could devise the institutions and incentives whereby family firms are viewed as an investment opportunity for (the risk-averse) capital in Belgium and provide an alternative for our national conservative bias towards real estate and savings accounts.

We add that the factors that convince a family firm to try and thrive in Belgium are not identical to those convincing the firm's family shareholders. It is quite possible that family members want to remain connected and involved to the firm but choose to relocate as a family. The ripple effect of these considerations through a family shareholder group is not to be underestimated, to the extent that these private decisions may impact the family firm as well.

The non-trivial interplay among family, ownership and business implies that anchoring family firms to Belgium requires measures that target each of the seven combinations of family, ownership and business in the Three-Circle Model, consider the legitimate objectives of the stakeholders in each of these positions, and the interdependence among one another.

Centre stage in the European definition of family firms are family members who own or control a dominant part of the decision-making rights and at least one family member is formally and actively involved in the governance of the firm. Would that imply that only such firms (and families!) in this category are worthy of policy makers' attention?

A governance issue of overriding importance to family firms has to do with the proper relationship between the active family members and their passive cousins who are represented in the family council, hold shares but do not manage or work at the firm. Active shareholders want impact on strategy and the implementation of owner vision; passive shareholders are concerned with the opportunity cost versus other forms of investment. But they share a common project and desire their host country to provide the appropriate legal and corporate instruments to shape their relationship.

A particularly important type of "outsiders" to anchoring in the Three-Circle Model are those shareholders that also are actively involved in the firm, sometimes as employees but typically as directors or managers. Even "outside" family members, that neither hold shares in the firm nor play any active role whatsoever

may, at least in the eye of the general public, represent the family, not unlike non-governing members of a royal family would. This category of stakeholders is particularly important if it includes members of the younger generations that are destined or groomed to actively take up responsibilities later on. A brain drain of any of those talented youngsters can be detrimental to Belgium as well as to the family firm.

Anchoring, to conclude, transcends tangible economic or legal considerations. Families, through their shared history in Belgium, have forged a bond linking memories, emotions and the territory. The place where they were born continues to exert its influence, not only through the family firm itself but for example also through the family's philanthropic activities. The so-called socioemotional wealth a family derives from the non-financial aspects of owning or controlling a family firm is a significant determinant of where to locate the firm and is highly dependent on the cultural context of the host country.

8

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