Opinion **Personal Finance Advice & Comment**

Family values are well worth following for investors

Every study I know suggests that listed family firms outperform

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Hermès and H&M may be two sides of the fashion coin, but they are both highly successful family firms © Piroschka van de Wouw, Reuters/Chris Ratcliffe, Bloomberg

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You've just spent an awful lot of time with your family. Some of you will want a break. Some of you will have cooked up ideas about how you might keep doing more together. And if boredom leads to innovation my guess is that we are soon to see an explosion of family business start-ups. Even I have given in and am doing a podcast with my sister.

If one of these start-ups is yours, you won't be alone: in the UK family businesses make up a significant slice of GDP. That said, you will probably fail. About 70 per cent of family businesses vanish long before the siblings get to start arguing about whose oldest kid gets to take over.

However there is also an (outside) chance that you will make something special. Look to the listed sector and you will see what I mean. Around 20 per cent of the MSCI All Country World Index (ACWI) is made up of companies that have family involvement, in the sense that a family holds 30 per cent or more of the voting rights.

Drop that to 20 per cent and you find that in Europe around 40 per cent of companies with $1bn plus sales are family firms. Think Hermès, H&M, Schroders, L'Oréal, Estée Lauder, and Roche. And these survivors are not just plentiful: they are good.

Every study I know suggests that listed family firms outperform. Credit Suisse produced a report in 2018 which concluded that family firms had outperformed by around 4 per cent a year since 2006. Studies from UBS show a similar dynamic among mid-caps in particular and one from Hargreaves Lansdown reckons that "insider ownership" of even 5 per cent makes a difference to the performance of smaller companies.

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Finally, a new report from Pictet gives us some recent stats to add to our evidence pile. Back-testing what they define as family businesses (good daily liquidity, family ownership of 30 per cent of the voting rights, and where the company is in emerging markets it should have a minimum market cap of $10bn) they found that family firms outperformed the global market by 46 per cent from 2007 to 2019.

Much number fiddling later, no one has been able to come up with a clear explanation for this. You can't, for example, say it is because family businesses are more exposed to recently outperforming areas such as US technology than the average company. They aren't. This leads to the idea that the family involvement in itself leads to outperformance. How?

It's partly about "skin in the game". It's obvious that if you have a stake in something your incentive is to at least maintain the value of that stake. But there is more to it than that. Attempts to replicate the sense of ownership via the chucking of vastly valuable piles of options into the open wallets of non-founding chief executives haven't exactly been a huge success when it comes the creation of long-term corporate value.

The difference may be that family owners have a different kind of wealth to think about — a type of social wealth reflected in the way that their reputation and status are tied up in their firms. Your average executive may also have his sense of worth tied up in his work. But more in the sense of being important and getting pleasantly rich at any old company (check out the CVs of some of those at the top — they get around) rather than from one in particular company.

Family companies often end up with a stronger sense of social corporate responsibility and long-term stewardship than others. This, so the idea goes, gives a growth focus but a responsible one. Think lots of R&D and low leverage, something reflected in their generally lower dividend payments. The money other firms might pay out to allow chief executives to bask in temporary shareholder adoration is reinvested by family firms to make sure their payouts are sustainable in the long term. Their long-term vision extends beyond their next option vesting period.

All this results in a bias to quality and growth, one reason perhaps why these firms recovered so well from the 2008 crisis. And it is also why we should be looking at them now, when we have been firmly reminded that the first thing we should look for in our investments is their ability to weather a crisis.

This is not a perfect sector — you need to watch out for bad governance in the form of nepotism, lack of focused family ownership (too many family owners is as bad as no family owners), clashes over succession (the passing of the company to the second generation is a risky moment) or, in some cases, the confusion of what belongs to the family and what belongs to the business. Still, if you are going to put money anywhere, you will want to keep in mind this year's investing buzzword — "resilience" — and family companies may well fit the bill.

Pictet, itself a family business, is currently drumming up interest in its still small Pictet Family Fund — hence its research. This is global, diversified across sectors, concentrated (with around 50 holdings) and focused on governance, so as to avoid the pitfalls I mention above.

The only thing you might worry about with it is valuations. The Pictet portfolio comes with an off-putting average forward price/earnings ratio of 28.5 times, which is very expensive even by today's standards, and a yield of a mere 1.04 per cent, which is peanuts given you can get 2.5 per cent in Japan. However they reckon it is worth paying for the low levels of debt, the significantly higher return on equity and the higher growth forecasts in the group. Add the latter in and you get a price to growth ratio of 1.7x for the Pictet portfolio against 3.06x for the global index.

If that doesn't convince you, look for funds that, while not designed to invest in family companies, are interested in them. AVI has a fund (sadly with a minimum investment of €100,000) that specialises in undervalued family holding companies. Of more interest might be AVI's Global Trust: the top holdings include several family firms.

On a slightly different note, for a one stop investment shop with family characteristics, you might look at some of the investment trusts which have large family shareholdings. I hold shares in Caledonia (the investment vehicle for the Cayzer family) and RIT (the Rothchilds). Brunner Investment Trust and Majedie Investments are also worth looking at. My guess is that all these will all be around long after our lockdown business ideas have been forgotten.

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