The UK Family Business PLC Economy

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Overview

This research focuses on UK Family Controlled Quoted Companies, and via the prism of the UK Family Business Index, reports on their performance measured in terms of shareholder returns. It comes in response to recent empirical studies on the role and performance of family-controlled firms in stock markets across leading economies, notably that of the US, France, and Germany. More specifically, the study profiles the quoted family-controlled PLCs and draws evidence on their structure, growth and profitability. Moreover, it reports on the construction of the MBS-Family Business Index[1] which is benchmarked against the FTSE Actuaries Share Indices.

Interestingly, despite the continued diminishing role of family shareholding in the UK quoted companies (Franks et al, 2003), this research reveals that the Family Business Index outperforms the FTSE All-Share by 40%. The out-performance of UK FB-PLCs mirrors recent US findings where quoted family firms (with founding families playing an active role in ownership and management control) were found to financially out-perform their Standard & Poor's counterparts (Anderson and Reeb, 2003). In the light of the recent concerns about the effectiveness of corporate governance mechanisms to master agency costs, it emerges that, the quoted family-controlled PLC model is not a 'deficient' organisation structure.

Moreover, evidence drawn from in-depth case analysis demonstrates that, quoted firms with dominant owning families on board are characterised by paradigmatic elements of stewardship and long-term commitment, which conditions their sustainable growth pattern. Quoted family firms have evolved their own approach to master their long-term development, to align goals of owners and managers, to build relationships with financial agents, to mitigate risk and to chart effective strategic decision-making. Commentators and researchers have labelled the positive impact of the family effect on business performance (i.e. valued added and shareholder return) as 'Familiness'.

1 The MBS-Family Business Index was constructed at Manchester Business School in 2004/05 by Dr Panikkos Poutziouris (Visiting Fellow at MBS and Associate Professor in Entrepreneurship and Family Business at the Cyprus International Institute of Management-CIIM) and Rodrigo Barreto (MBA graduate from MBS).

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Executive summary

Family firms are the most prevalent form of business organization and they tend to account for approximately half of the economic activity and private employment in the UK. They are one of the engines of the UK economy and their survival, growth, and prosperity is linked to the socio-economic development of the nation.

Across the business life cycle, evidence shows that the proliferation of family owner-managed ventures is likely to wane over time. In a large part, this is due to the separation of ownership and management and more sizeable private enterprises actively seeking to fuel growth by tapping into external funds including public equity markets. In recent years, a number of studies have reported on the sustainable role and performance of family-controlled firms in stock markets across leading economies, notably that of the US, France and Germany. These studies found that, quoted family controlled firms were one of the major groups in capital markets, and they were exhibiting superior performance when benchmarked against their peers.

In light of the growing debate surrounding the role of the Family Business PLC, the MBS research team has focused on the UK London Stock Exchange in order to understand the structure and performance of the family controlled quoted companies. The two-year study involved desktop research, surveying and interviews with family business owner-managers and other executives, and this culminated in the creation of a Family Business Index. This Index evaluates the performance of family-controlled PLCs in terms of shareholder returns. A family business PLC is defined as a quoted company where the family controls at least 10% of its shares, has active family members on the board and the firm has experienced generational succession. Additionally, a quoted business could be classified as a patrimonial business where a certain family (and its units) is the dominant shareholder.

The study, via the prism of the Family Business Index revealed that family controlled PLCs outperformed their FTSE All-Share peers by 40%, during the 1999-2005 period. In addition to the quantitative analysis, the research team compiled a series of interview-based case studies to reveal a number of factors which govern this phenomenon of familiness - that is, the positive effect of active family owner-managers on business performance.

The profile of the Family Business PLC Economy can be summarised as follows:

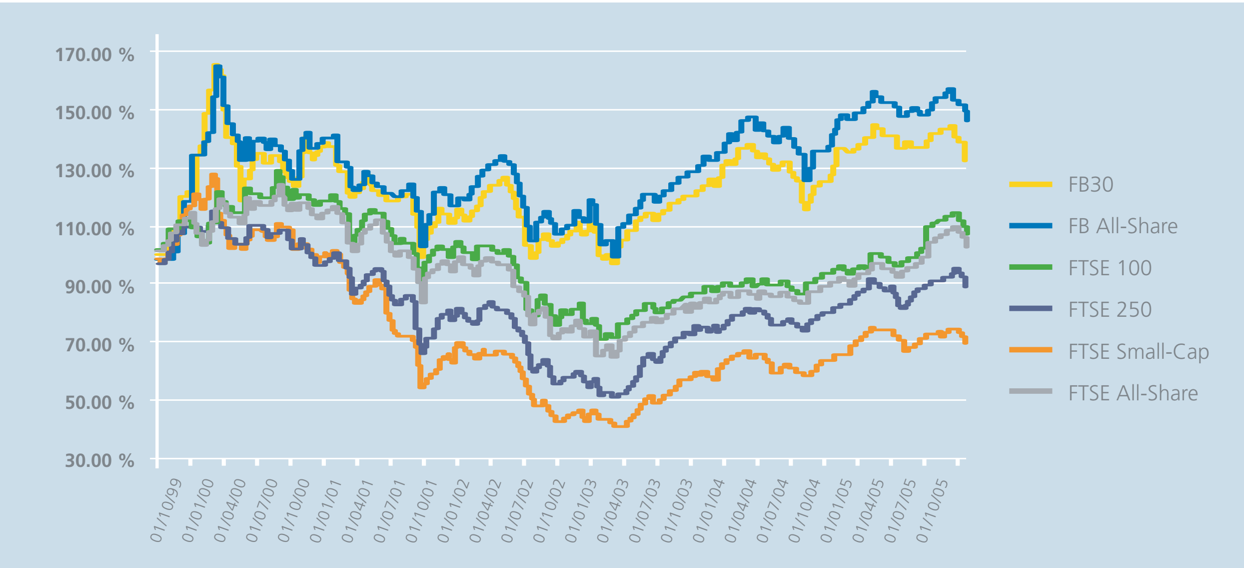
- Out of the 673 quoted companies that are constituents of the FTSE All-Share index, only 42 companies met the criteria for the classification as a family-controlled or a patrimonial PLC. Thus, the Family Business PLC Economy represents only 6.2% of the number of FTSE quoted companies across FTSE 100, FTSE 250 and FTSE Small-Cap (excluding the Fledgling sector).
- The total adjusted (for free float) market capitalisation of the Family Business PLCs is approximately £60 billion and represents 3.86% of the market capitalisation of the FTSE All-Share. Distribution of the capitalisation of quoted Family Business PLCs across the FTSE categories reveals that FTSE 100 family firms account for about 84% of the market.
- The analysis of the distribution of Family Business PLCs by SICs demonstrates a relatively higher concentration of family and patrimonial companies in manufacturing (about 45% of the sample). This sector is hospitable to more traditional and mature industrial companies.
- According to the age distribution analysis (based on the year of incorporation), it emerges that the family controlled / patrimonial companies tend to be older than their mainstream FTSE peers. It can also be argued that the family capitalism in the UK is relatively more active in traditional industries, with the new wave of family firms exhibiting less enthusiasm for flotation in the main market.

- The share ownership of families in the sample of Family Business PLCs tends to be small, with about two thirds of companies having less than 40% of ownership concentrated in the hands of a family.
- There is a tendency for the P/E ratios of family controlled and patrimonial companies to be lower than that of FTSE All-Share constituents. This is again symptomatic of the fact that family controlled and patrimonial companies tend to be discounted, perhaps due to the fear of dynastic control and culture of restrained growth.
- In terms of their capital structure, Family Business PLCs have a tendency to invest more in tangible assets and adhere more to the principles of the pecking order. They reinvest more profits; use more long-term loans and relatively raise lower share capital. Given their prudence, they exhibit lower gearing ratio.
- In terms of performance parameters, Family Business PLCs exhibit a lower growth rate in terms of sales turnover and accumulation of assets, but record higher profitability rates when compared to their FTSE peers.

The UK family business index

Following the comparative analysis of the structure and performance of Family Business PLCs, the second phase of the research involved the computation of a Family Business Index. Using a basket of ordinary shares representing Family Business PLCs, the aim was to compare their growth in capitalisation against that of the FTSE All-Share Index, during 1999-2005.

Figure 1: Performance of FB30 and FB All-Share versus FTSE Indices



Two versions of the Index for Family Business PLCs were formulated: the FB30 with the 30 securities representing higher market capitalisation weights, and the FB All-Share representing all 42 Family Business PLCs (quoted on FTSE 100, FTSE 250 and FTSE Small-Cap).

Figure 1 above illustrates the comparative performance of the growth in the capitalisation of family controlled and patrimonial quoted companies as represented by FB30 and FB All-Share during the 1999-2005 period. The graph shows that the family controlled companies performed relatively well in terms of shareholders returns during the last six year period, recording an increase of around 30 base points for the FB30 Index and around 45 points for the FB All-Share Index. Finally, the graph reveals that both FB All-Share Index and FB30 Index out-perform the FTSE All-Share Index by 40% and 25% respectively.

Qualitative analysis: case studies & interviews

In order to verify the role of family owner-managers in shaping the out-performance of family controlled quoted companies, a qualitative research investigation was pursued. The methods used for obtaining data included structured questionnaires and semi-structured interviews, secondary sources of information such as press archives and company reports from the firms and Companies House. Executives from the following Family Business PLCs were interviewed and case studies have been documented:

- Associated British Foods PLC – the global food masters.
- Caledonia Investments PLC – the long-term investors in growth.
- Huntleigh Technologies PLC – the innovators.
- Town Centre Securities PLC – the builders of value.

The interviews and case study research have highlighted a number of positive attributes that family-controlled PLCs have, which are summarised as follows:

- Devotion and commitment instilled from generation to generation since family wealth and heritage is linked to the family business.
- Long-term strategic horizon – they are not in the business of adventurous growth to impress opportunistic investors with short-term returns.
- Financial prudence is symptomatic of the drive to sustain financial health and autonomy; this is to insulate the family wealth creation from outside interferences.
- Strategic focus in the core business – the respondents had developed special capabilities to exploit (without excessive risk exposure) opportunities in their sectors.
- Stability and stewardship drawn from the dominant owning family.
- Harmonious relations with loyal investors who respect and understand the family way of governing growth and development.
- Culture of trans-generational sustainable development as they are driven by duty of responsible ownership to steer their companies across business cycles.
- Defensive ownership – they are administering control schemes, e.g. trusts that will block hostile takeovers.
- Vision to keep the family at the helm of the business, as they are custodians of their heritage and guardians of their destiny.

Considering their views as to where family ownership could pose problems, a number of issues have been identified as follows:

- Family domination coupled with absence of governance scheme to regulate the role of family members could lead to damaging conflict.
- The chasm between family values versus business practices that professional non-family managers promote could erode goal alignment of stakeholders.
- Nepotism that could not only jeopardise the business performance but also strain relations with outside investors.
- The failure of family to evolve, adopt open thinking, and be ready for change in areas such as corporate governance, financial strategies etc.
- The expropriation of special benefits for the family at the cost of other shareholders.
- Management of 'sacred cows' – the failure of family owner-directors to decide whether to divest, or dispose of, assets which has sentimental value to the family.

The future of family-controlled companies in capital markets

Despite the out-performance of family-controlled quoted companies, evidence suggests that there is a diminishing role for UK Family Business PLC capitalism. Over time, with smaller stakeholding, rising hostile takeovers, demanding institutional shareholders, increased capital market regulation and takeover reforms, families find it very challenging to sustain control. Notwithstanding the decline of the Family Business PLC economy, evidence from this study suggests that the family business model is far from deficient.

The findings from this study suggest that there is scope to re-evaluate the profile of the UK Family Business PLC economy on a more longitudinal basis, and by extending the focus on the Fledgling (smaller cap sector and other secondary equity markets such as AIM and OFEX). This will enable us to better understand the progression of quoted firms across the equity markets, and help inform policy debate on the most optimal equity market route for growth inspired family firms.

Quoted family firms under the microscope

Globally, the family firm is the most prevalent form of business organisation. For most developed economies, the family business sector is estimated to represent 60-75% of all enterprises. This includes up to a third of quoted public limited companies and accounts for about half of the GDP-economic activity and private employment (Astrachan and Shanker, 2003).

As industrial statistics indicate, the role of family firms in business activity is more central at the early stages of the business life cycle – where the founders and owner managers, and their family ties, are the main source of entrepreneurial drive and capital. With the emergence of managerial capitalism (which is fuelled by the separation of ownership and control, coupled with the growth and financial development of large private companies via public equity markets) the role of families in terms of ownership and control diminishes, but still remains important.

A series of studies indicate that the proportion of family controlled quoted companies in main equity capital markets across OECD economies is very substantial ranging from 10% to over 50% (La Porta et al, 1999; Faccio and Lang, 2002). It is argued that family shareholding in quoted family companies depends on the development of capital markets and their evolving model of regulation. Moreover, it is also governed by the family business culture and the appetite business families have for control. This need for control is achieved through various means ranging from the use of multi-classification of shares (with enhanced block holding voting power), pyramids to cross-shareholding schemes.

In contrast to the persistence of family capitalism in continental European capital markets (La Porta et al, 1999; Becht et al, 2001, Faccio and Lang, 2002), Franks, Mayer and Rossi (2003) have reported that the UK family shareholding has been on the decline during the last century.

Despite the diminishing role of insiders and families in the UK PLC economy, the Investors Chronicle (2003) cited evidence revealing that family controlled quoted companies were outperforming their counterparts. This was in line with the findings of other business surveys and academic investigations which focused on the financial performance of family quoted firms in the US (Business Week, 2003) and in Europe (Miller, Karen Lowry-Newsweek, 2004).

More specifically, research by Thomson Financial for Newsweek (Issue: April 12, 2004), found that family controlled quoted companies were outperforming their rivals on all six major stock markets in Europe, from London's FTSE to Madrid's IBEX. The Thomson research team created an index for both family and non-family PLCs and tracked their performance over a 10 year period through to December 2003. In addition, they also produced a list of the top 10 fastest-growing family-companies in terms of shareholder returns.

Hereby in summary are the key results:

- In Germany, the family index soared 206%, led by BMW, while the non-family stocks climbed just 47%.
- In France, the family index surged 203%, led by the likes of Sanofi-Synthelabo, L'Oreal and LVMH, while its counterpart rose only 76%.
- The family controlled PLCs also outperformed their peers in Switzerland, Spain, Britain and Italy.

This analysis came in contrast to some high profile cases in North America and Europe (US based Adelphia, Swiss Erb Group, and Italian Parmalat, to name a few) that revealed certain family-controlled businesses as scandalous. In these instances, controlling families have been administering mechanisms to promote their interests at the expense of other shareholders. However, the evidence about the out-performance of the family companies could offer comfort to investors who are worrying about the practice of despotic altruism, by business family dynasts continuously administering schemes to sustain family control.

In light of renewed academic interest in the financial affairs of quoted family firms, the aim of this study is to explore the UK Family Business PLC, and identify its structure and performance over time. This research report continues with a brief literature review relating to the topic of quoted family firms and their financial affairs. Then following is the research methodology which enables the comparative analysis of the UK Family Business Index vis-à-vis London main stock market indices. This is supplemented by evidence drawn from live case studies which offer valuable insight into the role family members play in shaping performance. Finally, in conclusion, a set of implications emanating from the empirical study are briefly discussed.

Defining the family business PLC

Simply defined, a family business is a venture in which the majority of the ownership lies within a family (and its branches) and where two or more family members are directly involved in the management. A stricter definition would be that the business has experienced a transfer to the succeeding generation of family owner-managers.

In the case of quoted public limited companies, a PLC can be classified as family controlled when at least 25% of shares are in the hands of family shareholders (provided the other 75% shareholding is distributed across smaller minority shareholders) and the business has experienced generational change (Leach and Bogod, 1999). More recently, a number of studies which are reviewed later on in this report, have used lower shareholding thresholds ranging from evidence of family holding shares or board seats (in the case of Anderson and Reeb, 2003), to 10%-20% of voting rights.

The definitional parameters of this study (to be revisited in the methodology section of this report) are consistent with other recent studies, notably the INSEAD research into the 250 largest publicly traded companies in France (Blondel, Rowell, and Heyden 2001). They introduce the term ‘patrimonial firm’, a term used in reference to quoted companies where individuals or families are identified as major shareholders with at least 10% of equity at each level of the ownership chain.

Family ownership in capital markets

La Porta et al. (1999) investigated the top 20 publicly traded firms in 27 countries and found that the role of families as main shareholders, based on the cut-off of 10% of shares in the hands of the family (and its units), ranged from 5% for the UK to 70% for Hong Kong. The percentages for other countries varied as follows: 20% in the US, 30% in Canada, 10% in Germany, 20% in Italy, 55% in Sweden, and 20% in France (data referring to the end of 1995). The same study also analysed, for each of the 27 countries, the ownership of 10 medium-sized listed companies (10 of the smaller companies had capitalisation of at least $500 million for instance). Controlling families were present in 10% (Japan) to 100% (Greece) of the cases. In the UK, 60% of those companies had family owners, 30% in the US, 40% in Germany, 80% in Italy, 60% in Sweden, and 50% in France.

Faccio and Lang (2002) conducted a comprehensive study of ultimate ownership and control in 13 Western European economies and established that families (again based on the ownership cut off of 20%) were the most common type of controlling shareholders. They found that 44.3% of Western European corporations were family controlled. Family control was the lowest in the UK (23.68%) and Ireland (24.63%) whilst in continental Europe, the lowest percentages were recorded in Norway (38.55%), Sweden (46.9%), Switzerland (48.1%) and Finland (48.8%). In the remaining countries such as Austria, Belgium, France, Germany, Italy, Portugal and Spain, the family controlled firms were in the majority.

Blondel et al (2001) investigated the 250 largest publicly traded companies in France, the SBF 250, and reported on the prevalence, evolution, and degree of control of patrimonial firms. Patrimonial firms were defined as companies where individuals or families were identified as major ultimate shareholders with at least 10% of equity at each level of the ownership chain. The study established that, even in this group of quoted companies, where spread ownership would be expected to be the norm, patrimonial firms are the majority, representing 57% of all companies in the SBF 250. Patrimonial firms were present in most sectors of the economy, and their presence increased from 1993 to 1998. Their share of capitalisation was lower than their importance in terms of business numbers, reflecting their proliferation in the smaller quoted company sector. Stakes owned by families and individuals were quite high, and the use of cross-holdings and voting rights further increased corporate control by patrimonial business families.

Furthermore, in a comparative study of the role of family controlled companies in the Paris and Frankfurt stock markets, Klein and Blondel (2002), found that over 50% of the 250 largest quoted companies were patrimonial and were concentrated in the lower range of capitalisations. They found that family shareholding was relatively lower and on the decrease (in the German case this was between the period of 1993-1998).

Navarro and Ansón (2004) further reinforce the importance of individuals and families as owners of large Spanish quoted companies. Building on previous research into the degree of concentrated ownership in Spanish quoted companies and using 20 percent of ownership as a threshold in their study, the authors found that the largest shareholder is an individual or family in 56% per cent of the sample firms.

Families in control of business groups tend to use pyramids and other indirect ownership schemes such as complicated chains and cascades of intermediate firms in order to defend their investments and ensure control rights exceed cash flow rights. In the majority of cases, members of the controlling family take the CEO role. The study is useful in offering conclusive evidence that Spanish quoted family firms are facing a survival challenge, with more and more families having to reduce control and ownership power in order to widen their capital base.

Finance theories and family firms

According to the pecking-order hypothesis (Myers, 1984) companies finance their capital needs in a hierarchical fashion. Firstly, by using internally available funds, followed by debt and then, finally, external equity. Arguably, the pecking order hypothesis is particularly relevant to closely held family firms, characterised by an aversion to outside capital infusions (Gallo and Vilaseca, 1996; Romano et al, 1997; Poutziouris et al, 1997; Poutziouris et al, 1998; Poutziouris, 2001a). This is because they experience relatively more restrictive transactional and behavioural costs in raising external equity (Pettit and Singer, 1985). In the case of the growing family firms, heavy investments in organic and/or acquisitive expansion and innovation enabling technologies and global marketing [niche] strategies, could result in the exhaustion of debt facilities, and therefore compel the owner family to seek external (private and public) equity.

A stock market flotation would widen the share ownership of the firm and could ultimately lead to dilution of control by the original founding and/or descendant family owner-managers. Furthermore, this could also bring about an ultimate loss of family control following any hostile take-overs. Zingales (1995) argued that the decision of the owners of a firm to go public depends on whether they are likely to succeed in simultaneously raising capital and retaining power (shareholding and managerial control). This objective can be achieved through the free float of a limited portion of total shares combined with dilution of outside shareholdings. Alternatively, the issue of preference shares, the use of different classes of shares (which can multiply voting power) can also allow controlling family shareholders to externally issue additional capital without diluting their block holding/majority position.

There is a plethora of academic investigations into the impact of family ownership and managerial control on performance. The theoretical base of this inquiry has been the agency theory which explains the problems of monitoring costs associated with restraining the opportunistic behaviour of managers. Other problematic issues relate to the expropriation of wealth by controlling owner-managers of private benefits at the expense of minority shareholders and the emergence of arrested development. This can be due to entrenchment practices and tunnelling views by controlling families amongst other reasons.

Agency theory argues that the separation of ownership and management creates conflicting goals between principals (i.e. shareholders) and agents (i.e. managers). This could arise from divergent utility functions and information asymmetries about their views on growth, variant investment horizons, different attitude to risk diversification and takeovers etc (Jensen and Meckling, 1976). A number of scholars argue that the owner-managed family firms by virtue of their intra-familial altruistic elements, clan control, and induced goal congruence could be exempted from serious problems of traditional agency conflict (Eisenhardt, 1989; Daily & Dollinger, 1992; Ang et al 2000, Chrisman et al 2004). Arguably, the large family stakeholding could reduce agency problems due to the incentives and capabilities of highly committed (founding) shareholders to monitor management.

On the other hand, another group of scholars suggest that agency problems exist in the closely held owner-managed family firm and family controlled business groups which results from internal dysfunctions. This is often attributed to the autonomy of controlling shareholders (La Porta et al, 1999); altruism leading to favouritism for family insiders (Schulze et al, 2001, 2003); and tolerance of honest incompetence (Hendry, 2002). Morck, Shleifer, and Vishny (1988) argued that agency costs arise to minority shareholders from having an entrenched dominant shareholder. More specifically, DeAngelo and DeAngelo (2000), Bebchuck et al. (2000), and Morck and Yeung (2000, 2003) argue that agency conflicts in family firms are associated with the fact that managers may act solely for one single stakeholder – the family – and overlook the interests of the other shareholders.

Moreover, the emergence of a closed ownership regime dominated by an owing family could exacerbate the problem of information asymmetries. The underlying assumptions of asymmetric information are that owner-managers know more about the company's current earning and investment opportunities than do outside investors, and they act in the best interests of the firm's existing [dominant] shareholders. This could lead to the firm being under valued and, furthermore, restrain investment activity so that the owning family does not experience an erosion of their financial autonomy (whether by borrowing excessively and/or relinquishing control by issuing new shares).

Shareholder returns of family-controlled PLCs

Initially, practitioners directed the microscope to the role and performance of family-controlled public limited companies. In the UK, the BDO-Stoy Hayward/BBC Family Business Index in1992 analyzed a sample of 71 public family companies and compared their share price against the FTSE All-Share Index – representing the top 500 UK public companies – during the 1970 and 1991 period. The study established that, family companies with at least 25% of shares in the hands of family shareholders outperformed the FTSE All-Share Index by a margin of almost 30%.

In a similar study, the Pitcairn Financial Management Group carried out a study into the financial performance of 165 US companies, using a threshold of 10% family shareholding. The findings revealed that family quoted companies outperformed the Standard & Poor's Index, during the 1969-89 periods. More specifically, the cumulative returns for family companies over the period were more than double that of the S&P 500.

In a separate study focusing on the United States, there were two indices tracking the share performance of publicly held family firms, the Family Business Stock Index (FBSI), and the Loyola University Chicago Family Firm Stock Index (LUCFFSI). The first, FBSI, follows more than 200 of the largest family controlled companies nationwide whilst the latter tracks 38 publicly traded, family-controlled firms headquartered in the Chicago area.

The FBSI was developed by NetMarquee Online Services Inc. of Needham, Massachusetts, and Robert Kleiman, an associate professor of finance at Oakland University, in Rochester, Michigan. A study of the 20-year performance of FBSI companies showed average annual returns of 16.6%, compared with 14% for the Standard & Poor's 500-stock index. During some shorter time periods, however, the FBSI lagged the S&P Index. For example, for the year that ended with the first quarter of 1996, the FBSI showed a total return of 18.2%, compared with 31.9% for the S&P Index.

McConaughy, Mendoza, and Mishra (1996) developed the Loyola University Chicago Family Firm Stock Index (LUCFFSI) to track the performance of publicly traded, family controlled firms headquartered in the Chicago area. The LUCFFSI, over the period from September 28, 1990, to July 28, 1995, outperformed local and national indices. The second study compared the performance of the LUCFFSI with the Dow Jones industrial average and Crain's Chicago Stock Index from September 1990, to July 1995. The LUCFFSI increased 94% during that period, compared with 92% for the Dow and 65% for Crain's.

According to family business practitioners, the main source of family business competitiveness was attributed to the following factors: consistent management objectives and long-term strategic view of family owners which restrain short-term opportunistic managerialism. Other factors also included the positive influence of the family network and culture, the reduced vulnerability to takeovers, and a conservative approach to risk taking.

Subsequently, the aforementioned pioneering studies stimulated academic interest in the affairs of family firms. In recent years, a series of investigations have been published in highly rated journals reporting on the financial performance of family controlled PLCs.

The financial performance of family-controlled PLCs

In a widely publicised study into US-quoted family firms, Anderson and Reeb (2003) examined the relation between founding-family ownership and firm performance. They established that family shareholding is both prevalent and substantial; family control was identified in one-third of the S&P 500 and on average it accounted for 18% of outstanding equity. However, their study has been criticized for using a rather broad definition of what constitutes a family controlled venture. More specifically in their effort to resolve the contestable issue of what is family ownership control in quoted companies, they simply employed a dummy variable that equated to one, when founding families held shares in the firm or when founding family members were present on the board of directors.

Contrary to their conjecture, they found family firms to out-perform their non-family counterparts, in terms of financial performance metrics. Their results suggest that family-controlled quoted firms record superior performance in terms of profitability (Return on Assets) and other market based measure of shareholders value (Tobin's Q values). They conclude that the greater profitability for family firms, relative to non-family, results from those firms led by a family CEO. Family owner-managers tend to better understand the business and view themselves as the stewards of the firm. Focusing on the impact of family members as CEO, indicates that founder CEOs and 'hired-hand' CEOs are associated with the greatest value gains. Their analysis also reveals that the association between family ownership and firm performance is not linear. It emerges that performance (either measured in terms of accounting or market-based Tobin's Q values) is first increasing and then decreasing across higher levels of family ownership. Put simply, this warns that families have to optimise their level of control to mitigate for the danger of higher entrenchment and poor performance. Overall, Anderson and Reeb's findings are an antithesis to the argument that minority shareholders are adversely affected by family ownership. The family owner-managed business model is an effective organizational structure.

In a similar study into the financial affairs of publicly quoted companies, Anderson, Mansi, and Reeb (2003) established that in general the debt costs of family businesses are lower compared to the debt costs of non-family businesses. They argued that families represent a special class of large shareholders that potentially operate unique incentive structures, have a strong voice in the firm, and special motivation to act as stewards of their firms. The unique incentives that founding family owner-managers have, suggest that these may alleviate agency conflicts between the firm's debt and equity claimants, and subsequently benefit the firm from lower debt costs.

More recently, Villalonga and Amit (2006), utilizing Fortune 500 data (and using as a threshold 5%+ of the firm's equity in the hands of founders/ descendant blockholders) have found that family ownership creates value only when the founder is active in the business either serving as the CEO of the family firm or as its Chairman with a hired CEO. Their study also revealed that family voting enhancement tactics, such as dual share classes, pyramids, and voting agreements, reduce the founder's premium. Paradoxically, they found that family descendants serving as CEOs tend to destroy firm value. Moreover, family firms run by a descendant-CEO were characterized by higher agency costs between family and non-family shareholders compared to the agency costs characterising owner-managed non-family firms.

In the light of the aforementioned review, this report aims to address the following questions:

(i) What is the role of family ownership control in the main UK equity market?

(ii) How UK family controlled PLCs perform against their peers?

This report will only offer the preliminary findings of the MBS/IFB investigation into the structure and performance of the UK Family Business PLC economy. It is envisaged that the next phase of the research will attempt to examine the hypotheses governing the positive impact of family ownership on business performance employing econometric models.

Data and methodology

The review of Family Business PLC focused literature has enlightened the research team on research methodologies employed in similar studies. The role and performance of quoted Family Business PLC companies is governed by a number of internal (i.e. family role in terms of cash and voting ownership rights, managerial positions of power etc), and external factors which differ across countries, capital markets and business sectors.

Definition and Criteria for Sampling Quoted Family Business PLCs

The first guideline employed is to restrict the sample to companies that were constituents of the FTSE All-Share and have been listed at the London Stock Exchange, for the period 1999-2005. With the exemption of FTSE Fledgling companies, this includes FTSE 100, FTSE 250 and FTSE Small-Cap companies.

The decision to exclude FTSE Fledgling constituents, despite the fact that smaller quoted family firms would most likely be present in this category, was due to two reasons. Firstly, Fledgling constituents have less than 0.2% of market capitalisation compared to the full market capitalisation of the FTSE Small-Cap. More importantly, they do not meet the liquidity criteria – turnover of at least 0.5% of shares in issue per month – for their participation in the FTSE All-Share Index (see FTSE 2004 and visit www.ftse.com).

The second guideline was to select FTSE quoted companies where more than 10% of the issued ordinary shares were ultimately owned by a family or by an individual (directly or by means of a family trust or another investment vehicle). It has proved extremely difficult to verify the active roles of family members on the board. Furthermore, the relaxation of the condition for at least one intergenerational transition from founders to the next generation of owners was deemed necessary so as to allow comparative analysis of the research sample.

Companies meeting these two criteria typically fall into one of the following three categories: quoted family firms, patrimonial and entrepreneurial firms.

Family firms: are quoted companies that have at least 10% family ownership, have experienced generational transition, and where at least one family member sits on the board. In a couple of cases a partnership involving siblings (founders) has been considered a family business (e.g. Antofagasta, CLS Holdings and Goldshield). Also, a more subjective judgement is made that the family owner-managers are inclined to sustain the level of family ownership and control.

One classic example of a family firm, according to our definition, is Associated British Foods headed by the Weston family. The family holds a major interest since its foundation and next generation family members are geared to preserve the control of the company. A succession process was recently completed at ABF when George G. Weston was announced as the replacement for the CEO Peter Jackson who retired in April 2005. Peter Jackson was appointed CEO in 1999, when the late Garry Weston was forced to step down as CEO for health reasons.

Patrimonial firms: defined as companies that do not conform fully to the aforementioned criteria (i.e. degree of family shareholding; generational succession; and family board involvement) but are characterised by an intention to keep ownership of the business in the next generation of family owner and/or managers. One example of the patrimonial firm is J Sainsbury PLC. In this case executive control is not with the Sainsbury family anymore but the family is still the dominant shareholder either directly or as trust beneficiaries.

Entrepreneurial firms: defined as firms where the founders or other individuals (e.g. directors after an MBO) hold a substantial proportion of shares, but there is no clear evidence whether the company will be passed on to the next generation of family owner-managers. One example of an entrepreneurial firm is easyJet (floated in 2000) where the founder Stelios Hajioannou and his family are the major shareholders (about 40%). However, Stelios relinquished his rein a few years later only to be re-appointed in a non-executive role more recently. Thus, there is uncertainty as to future plans about the retention of family control.

For the purpose of this report, the sample of family business PLCs is restricted to family controlled and patrimonial firms that can provide the solid base for further empirical analysis on a longitudinal basis. Such long established traditional family controlled companies are less prone to big market capitalisation variations or to family exiting from the business.

Sources of Information

All information regarding share prices and market capitalisation for the FTSE indices positions was retrieved from Thomson's-Datastream database. The financial information for the construction of the sample of family firms and for the FTSE All-Shares constituents was retrieved from Bureau van Dijk's, from the FAME database. FAME was also used for retrieving the financial data. The FTSE webpage was the main source for information about the UK series of the FTSE Actuaries Share indices. The London Stock Exchange webpage was used to retrieve communications to the market that could help towards the verification of family shareholding. More historical information regarding the role of families in quoted companies was also used from the Sunday Times Rich List, The Investors Chronicle-studies and the BDO Centre for Family Enterprise. Finally, the Institute for Family Business (UK), with its growing network of family business members, corroborated our selection process and supplied a list of potential constituents of the family business PLC economy.

The profile of the UK family business

In an examination of the 673 companies that are constituents of the FTSE All-Share index, only 42 met the criteria for the classification of a quoted company either as a family-controlled PLC or as a patrimonial business. Thus, the sample of family companies represents only 6.2% of the number of FTSE quoted companies, and are categorized as follows:

Table 1: Distribution of Family Business PLCs by category (absolute numbers, and by %)

	FTSE 100	FTSE 250	FTSE Small-Cap	FTSE All-Share
Family-controlled firms	8 (8%)	7 (2.8%)	14 (4.3%)	29 (4.3%)
Patrimonial firms	2 (2%)	6 (2.4%)	5 (1.5%)	13 (1.9%)
Family and Patrimonial	10 (10%)	13 (5.2%)	19 (5.9%)	42 (6.2%)
FTSE constituents	100	250	323	673

It emerges that there is a relatively higher concentration (10%) of Family Business PLCs (i.e. both familial and patrimonial) in the FTSE 100 category. These are mainly long-established large corporate firms that have traditionally been in the hands of dominant family shareholders e.g. Reckitt Benckiser, ABF, DMGT, Sainsbury, Morrison, Sky, Liberty International, and Alliance-Unichem.

On the other hand, the distribution of quoted Family Business PLCs across the FTSE categories indicates that about half are FTSE Small-Cap constituents whereas one half of patrimonial quoted firms are in FTSE 250 category.

Table 2: Distribution of Family Business PLCs by category, % of FTSE All-Share

	FTSE 100	FTSE 250	FTSE Small-Cap	FTSE All-Share
Family-controlled firms	27.6%	24.1%	48.3%	100%
Patrimonial firms	15.4%	46.2%	38.5%	100%
Family and Patrimonial	23.8%	31.0%	45.2%	100%
FTSE constituents	14.9%	37.1%	48.0%	100%

Market Capitalisation of Family Business PLCs

The total adjusted market capitalisation of the Family Business PLCs in the selected sample is approximately £60 billion. The market capitalisation for the family-controlled and patrimonial companies and all FTSE constituents are adjusted by the free float factor, as follows: Market Capitalisation = Share Price x Number of Ordinary Shares Issued x Free Float Factor (see www.ftse.com for methodology).

Table 3: Market capitalisation of family-controlled companies per category (£ million)

	FTSE 100	FTSE 250	FTSE Small-Cap	FTSE All-Share
Family-controlled firms	33,254	4,002	2,367	39,624
Patrimonial firms	16,756	3,606	664	21,026
Family and Patrimonial	50,010	7,609	3,031	60,651
FTSE constituents	1,317,078	203,289	49,726	1,570,095

In terms of capitalisation, the family-controlled and patrimonial companies represent 3.8% of the market capitalisation of the FTSE All-Share constituents.

Table 4: Market capitalisation across FTSE index by category (%)

	FTSE 100	FTSE 250	FTSE Small-Cap	FTSE All-Share
Family-controlled firms	2.52%	1.97%	4.76%	2.52%
Patrimonial firms	1.27%	1.77%	1.34%	1.34%
Family and Patrimonial	3.80%	3.74%	6.10%	3.86%
FTSE constituents	100%	100%	100%	100%

Distribution of the capitalisation of quoted Family Business PLCs across the FTSE categories reveals that FTSE 100 firms account for about 84% of the market.

Table 5: Market capitalisation by category and in relation to FTSE All-Share (%)

	FTSE 100	FTSE 250	FTSE Small-Cap	FTSE All-Share
Family-controlled firms	83.92%	10.10%	5.98%	100%
Patrimonial firms	71.69%	17.15%	3.16%	100%
Family and Patrimonial	82.46%	12.55%	5.00%	100%
FTSE constituents	83.89%	12.95%	3.17%	100%

The discrepancy between the role of quoted Family Business PLCs measured by the percentage of quoted companies (7%) and the percentage of market capitalisation (3.5%) in relation to FTSE All-Share, is mainly due to the fact that they have a higher incidence in the lower ranks (in terms of market capitalisation) of each of the FTSE index.

Taking into account that we are working with adjusted market capitalisations, it is quite natural that Family Business PLCs have on average a relatively lower free float multiplier compared to non-family mainstream FTSE constituents thus making a lower contribution to adjusted market capitalisations.

The trend for quoted family-controlled and patrimonial firms to account disproportionately for a lower proportion of market capitalisation in relation to the number of quoted family firms in the stock market was also observed in France (Blondel, et al, 2001), and Germany (Klein & Blondel, 2002).

Sectoral Distribution of Quoted Family Business PLCs

When compared to the distribution of FTSE All-Share constituents in the different business sectors, family and patrimonial businesses present some interesting divergences. The presence of Family Business PLCs in the highly conglomerated Resources and Utilities sectors is relatively low. Blondel et al. (2001) and Klein & Blondel (2002) found the same trend in France and Germany. Normally, companies in these sectors are in general former state owned monopolies characterised by high capital intensity and regulation - which constitute barriers of entry for Family Business PLCs. It is evident that the family-controlled and patrimonial companies are relatively more active in cyclical consumer goods services.

Table 6: Sectoral distribution of Family Business PLCs (by SIC)

	FTSE All-Share	Sample of FB-PLCs
Agriculture, hunting and forestry; fishing	0.3%	--
Mining and quarrying	3.8%	2.4%
Manufacturing	24.7%	45.2%
Electricity, gas and water supply	2.3%	--
Construction	4.4%	2.4%
Wholesale and retail trade; repairs	9.6%	19.0%
Hotels and restaurants	2.3%	2.4%
Transport, storage and communication	6.0%	4.8%
Financial intermediation	26.7%	9.5%
Real estate, renting and business activities	16.8%	11.9%
Education	--	--
Health and social work	0.3%	--
Other community, social and personal services	2.7%	2.4%

Analysis of the distribution of Family Business PLCs across industries demonstrates the high concentration of family and patrimonial companies in manufacturing (about 45% of the sample). The sector is hospitable to more traditional and mature companies.

Age Distribution of Family Business PLCs

There is a significant difference between the age distribution of FTSE All-Share constituents from the sample of family and patrimonial companies.

Table 7: Age distribution of family business PLCs

Year of incorporation	FTSE All-Share	Sample of FB - PLCs
prior 1899	7.41%	12.50%
1900 - 1924	8.44%	12.50%
1925 - 1949	9.78%	18.75%
1950 - 1974	13.93%	29.17%
1975 - 1999	51.11%	27.08%
2000 +	9.33%	*

Note: * this due to sampling criteria

According to the age distribution analysis, which is based on the year of incorporation, it emerges that the family-controlled/patrimonial companies tend to be older than their mainstream FTSE peer companies. It can also be argued that family capitalism in the UK is relatively more active in traditional industries, with the new wave of family firms exhibiting less enthusiasm for flotation in the main market.

Concentration of Family Share Ownership

The share ownership of families in the sample of family-controlled quoted companies tends to be low, with about two thirds of companies having less than 40% of ownership concentrated in the hands of the controlling family.

Table 8: Distribution of Family Business PLCs by shareholding

Family control - as % of issued ordinary shares	Sample of Family Business PLCs
10% - 25%	45.2%
25% - 40%	16.7%
40% - 55%	23.8%
55% - 70%	9.5%
70% - 100%	4.8%

This might be symptomatic of the factors (offering additional rounds of issued shares, coupled with strict regulation governing minority protection, takeovers etc) conditioning the diminishing family ownership, as suggested by Franks et al. (2003).

Dividend Yield and P/E Ratio

Overall, there are no statistically significant differences between the dividend yields and P/E ratios of the Family Business PLCs compared to that of FTSE constituents. The analysis is based on the 2004 results.

Table 9: Dividend yields of family-controlled (FC) & patrimonial companies (PC)

	FTSE 100		FTSE 250		FTSE Small-Cap		FTSE All-Share	
	FCs	PCs	FCs	PCs	FCs	PCs	FCs	PCs
% Average - FB-PLCs	2.36	4.04	2.59	3.34	2.89	2.32	2.68	3.00
% Average - FTSE All	3.32	3.32	2.65	2.65	2.46	2.46	2.66	2.66
t-statistic	-1.16	0.36	-0.17	1.38	1.77	-0.22	0.16	-0.99
Significance	0.31	0.78	0.87	0.21	0.08*	0.83	0.88	0.33

The only exception relates to lower dividend yield and P/E ratios for family-controlled companies categorised in the FTSE Small-Cap. The two groups are statistically different at 10% and 5% level of significance, respectively. Although not statistically confirmed, there appears to be a tendency for the P/E ratios of family/patrimonial companies to be lower than the P/E ratios for FTSE All-Share constituents.

Table 10: P/E ratios of family-controlled (FC) & patrimonial companies (PC)

	FTSE 100		FTSE 250		FTSE Small-Cap		FTSE All-Share	
	FCs	PCs	FCs	PCs	FCs	PCs	FCs	PCs
Average - FB-PLCs	16.27	13.90	17.66	11.91	11.84	15.66	14.18	13.69
Average - FTSE All	15.58	15.58	16.06	16.06	16.72	16.72	16.30	16.30
t-statistic	0.28	-0.29	0.19	-1.79	-2.48	-0.17	0.84	-0.95
Significance	0.81	0.82	0.86	0.10	0.02*	0.87	0.41	0.35

This again is symptomatic of the fact that the family-controlled and patrimonial companies tend to be discounted, perhaps due to the fear of control and culture of restrained growth.

Comparative analysis of balance sheets

The following outlines the comparative analysis of the balance sheet structure of Family Business PLCs when compared to that of FTSE All-Share companies. The analysis is based on the period 1995-2004.

Table 11: The balance sheet structure of Family Business PLCs

	Sample of FB-PLCs	FTSE All-Share	t statistic	Significance levels	FTSE All-Share*	t statistic	Significance levels
Fixed assets							
Tangible assets	41.58	24.97	10.371	0.000	35.20	3.873	0.000
Intangible assets	8.82	8.81	0.008	0.993	10.53	-1.782	0.075
Total fixed asset	**57.58**	**56.78**	**0.558**	**0.577**	**49.78**	**5.288**	**0.000**
Current assets							
Stock and work in progress	10.48	9.21	1.965	0.050	14.19	-5.257	0.000
Trade debtors	13.93	11.70	2.481	0.013	16.15	-2.416	0.016
Bank and deposit	8.39	9.69	-2.366	0.018	10.15	-3.080	0.002
Total current asset	**42.42**	**43.19**	**-0.530**	**0.596**	**50.22**	**-5.286**	**0.000**
Current liabilities							
Trade creditors	12.30	8.63	4.952	0.000	11.75	0.731	0.465
Short term loan	5.24	5.47	-0.609	0.543	6.10	-2.110	0.035
Current liabilities	**34.74**	**30.59**	**3.430**	**0.001**	**36.29**	**-1.253**	**0.211**
Long term liabilities							
Long term loan	15.60	14.07	1.547	0.122	16.37	-0.769	0.442
Other long term liabilities	5.21	3.61	0.436	0.663	5.67	-0.859	0.391
Total long term liabilities	**21.49**	**18.08**	**0.900**	**0.368**	**22.59**	**-0.973**	**0.331**
Capital and reserves							
Issued capital	7.26	9.05	-2.545	0.011	9.74	-3.327	0.001
Share premium	10.66	23.11	-11.711	0.000	22.99	-10.301	0.000
Revaluation reserves	5.35	1.76	6.920	0.000	2.56	5.241	0.000
Retained profits	17.54	1.41	6.704	0.000	5.13	4.889	0.000
Shareholder funds	**43.77**	**47.66**	**-2.447**	**0.015**	**41.12**	**1.658**	**0.098**

* Excluding Financial Institutions Note: rounding of figures explains discrepancies

The filtered list eliminates financial institutions that tend to have different asset and capital structures. All variables calculated represent the average for the 1995-2004 periods and are expressed as a percentage of total assets. In summary, the comparative analysis of the financial structures of the family controlled companies (familial and patrimonial) versus that of their FTSE All-Share companies demonstrate the following key differences:

- Family Business PLCs have the tendency to invest more in tangible assets – they are often regarded as symbols of financial autonomy since they can be used as collateral for external debt.
- Family Business PLCs tend to use more long-term loans – perhaps because they can secure better deals, and more importantly they can refrain from issuing more external equity, at the cost of family control.
- Evidently, and in line with the pecking order hypothesis, Family Business PLCs issue relatively less share capital, including additional rounds. Since they also reinvest enthusiastically, they are more prudent with the distribution of profits.
- The higher 'Revaluation Reserves' could be due to keeping tangibles up to market values in order to comfortably command external debt.

Performance of Family Business PLCs versus FTSE companies

The performance of Family Business PLCs has been compared to that of the list of FTSE All-Share constituents, which again has been filtered to exclude financial institutions. The analysis is based on performance parameters covering the period 1999-2004.

Table 12: Comparative analysis of growth and profitability

	Sample of FB-PLCs	FTSE All-Share	t statistic	Significance levels	FTSE All-Share*	t statistic	Significance levels
Growth rates							
Sales growth	13.44	20.18	-3.119	0.002	12.22	0.599	0.550
Employment growth	9.36	13.13	-2.243	0.025	9.43	-0.039	0.969
Asset growth	16.46	19.41	-1.129	0.259	14.38	0.796	0.427
Profitability ratios							
Return on total asset	9.95	4.60	8.925	0.000	8.10	3.232	0.001
Return on total equity	25.65	14.87	4.931	0.000	19.82	2.680	0.007
Return on capital employed	16.00	9.03	3.280	0.001	14.03	0.933	0.351
Profit margin	12.21	8.74	4.603	0.000	9.28	3.892	0.000
Gearing ratio	69.15	158.92	-10.090	0.000	76.50	-1.434	0.152

* Excluding Financial Institutions

In summary, the following key statistically significant results emerge in relation to the performance of the Family Business PLCs:

- They exhibit a lower growth rate in terms of sales and assets, compared to mainstream FTSE All-Share companies (although this is not a statistically significant observation).
- They are more profitable in each of the performance parameters (although not statistically confirmed for ROCE when compared to the filtered list of companies).
- They have lower gearing (defined as short-term loans & overdraft + long term liabilities over shareholder's funds).

These comparative results indicate that in general the sample family controlled and patrimonial companies are characterised by 'cash cow' features as they tend to be more mature, slow in growth and yield superior profitability margins.

The UK Family Business index

The final part of this report deals with computation of a Family Business Index. Using a basket of ordinary shares representing the Family Business PLCs, the aim is to compare the growth in capitalisation of the Family Business PLCs against the FTSE All-Share Index during 1999-2005.

Since the early 1990's, the FTSE All-Share Index replaced the FT All-Share Index and the methodology for the Index computation has since been revised. Besides that, the landscape for quoted family firms has changed dramatically given the increased mergers and acquisition activity, tightening of capital market regulations, and the economy enduring different cycles. The latter has certainly put to test the market attractiveness of certain Family Business PLCs.

It has been argued that the prevalence of quoted family business is diminishing. In recent years, we read about public-to-private deals involving family companies e.g. William Jackson & Son Ltd and Silentnight; the sale of family controlled firms e.g. Weetabix, Brake Bros etc., and financially distressed firms e.g. Courts (placed into receivership) which undermine the role of controlling families in quoted PLCs.

In order to establish some longitudinal trends characterising the UK family business PLC, Poutziouris (2005), used the 1992 BDO list of family controlled companies as a standing point to identify those that are active in primary and secondary equity markets. Key findings revealed that the primary factor governing the shrinking role of families in family controlled PLCs are takeovers (42% of family controlled PLCs in this case). This longitudinal trend epitomises the recent demise of the UK family business economy, and constitutes the main factor explaining why the great majority of owner-managers of privately held family businesses are sceptical about the flotation route (Poutziouris and Wang, 2004).

In light of this trend, a Family Business Index is developed and its performance is benchmarked against FTSE Index covering the years 1999-2005. The aim is to test whether the superior shareholder return performance of the UK family quoted companies registered in previous decades still holds.

Building the Family Business Index – The Methodology

Two versions of the Index for the Family Business PLCs were formulated. Firstly, the FB30 with the 30 securities representing higher market capitalisation weights; secondly, the FB All-Share representing all 42 family controlled PLCs, quoted on FTSE 100, FTSE 250 and FTSE Small-Cap.

The selection of quoted family companies follows the methodology outlined before in the discussion of criteria for the categorization of the family controlled and patrimonial companies. For the selection of the 30 securities that are constituents of the FB30 index, the securities were ranked at each period (on a weekly basis) according to their absolute market capitalisation in relation to the sum of absolute market capitalisations of all securities in the sample. This ranking was calculated for each week in the five year period from 01/10/99 to 01/10/05.

The composition of the FB30 index was reassessed at the end of each interval of six months (reassessment dates: 31/03/00, 29/09/00, 30/03/01, 38/09/01, 29/03/02, 27/09/02, 28/03/03, 26/09/03, 26/03/04, 24/09/04, 25/03/2005, 23/09/2005). The securities chosen for each of the periods were those that featured in the top 30 positions during the previous six months period (understandably the selection for the first period was based on that period itself).

Market Capitalisation Adjusted for Free Float

For the calculation of adjusted market capitalisation, the free float factor was taken into account. This represents the proportion of shares for a specific security that is readily available for public trading, i.e. that which is not held by a major shareholder such as a family member.

The case of Associated British Foods is used by the FTSE (2004c) to exemplify the use of free float adjustments: "Free float is not purely restricted to which listed companies own what proportion of other listed companies, but also takes into consideration interests held by other parties. An example of this case could be Gary Wesland[1], who owns 53% of Associated British Foods. This would lead to a possible free float of 50%."

To be consistent with the benchmarking of the FTSE UK indices, the series of free float factors for each one of the securities was derived from information available in the FTSE website. For the latest free float factors, 'the FTSE UK Index Constituent Rankings document' was used. For each company under consideration, the information regarding the number of ordinary shares issued and fully paid was extracted from the notes to the latest accounts available. The number of shares of each company was then multiplied by the share price available in the FTSE document resulting in the absolute Market Capitalisation of the company. The free float factor was then determined by dividing the Market Capitalisation informed in the FTSE document (adjusted for free float) by the Market Capitalisation resulting from the calculation.

The changes in the free float factor throughout the period under analysis were determined from the annual notes released by FTSE with the modifications made to the UK Actuarial Series during each year. The dates (in the weekly series) in which there were changes to the free float factor for the securities under consideration were: 15/06/01, 17/05/02, 21/06/02, 21/03/03, 19/09/03, 19/12/03, and 17/09/04. With the time series of free float factor in hand, and the matching time series of absolute market capitalisation for each of the securities obtained from the Datastream, the adjusted market capitalisations were determined.

Computation of the FB30 and FB All-Share

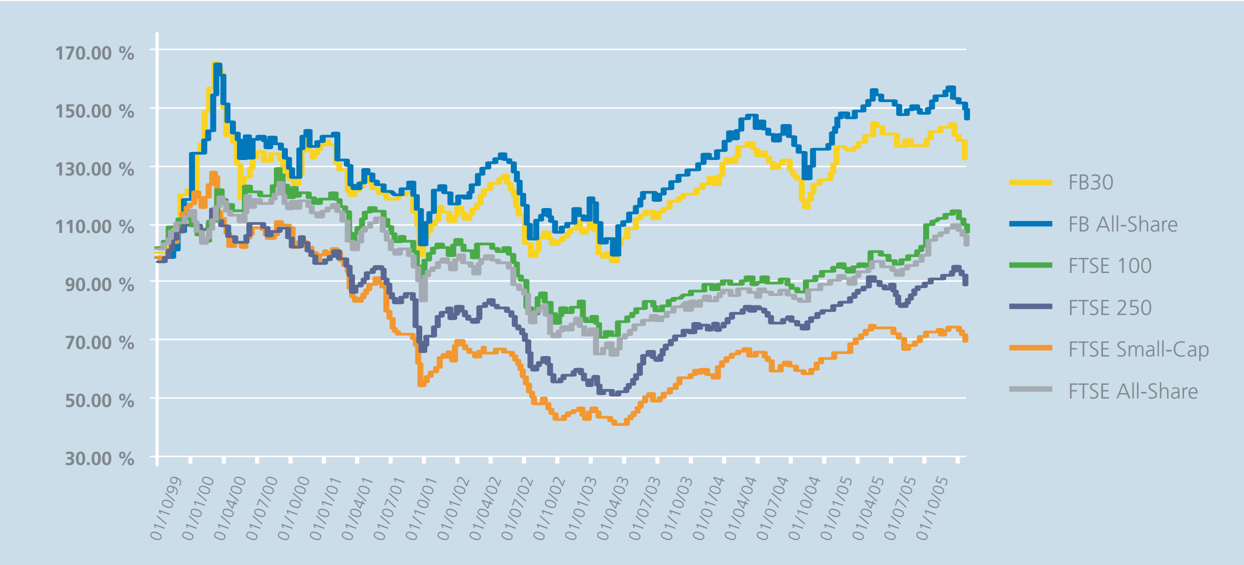
The value of each of the indices was determined, on a weekly basis, by the division of the sum of market capitalisations (adjusted for the free float factor) by a divisor. The first divisors were calculated so that indices could start at 100. Thereafter, every date with changes in a free float factor or with changes to the basket of companies in the index, called for a new divisor to be calculated for the next week. The new divisor was calculated by dividing the week's total market capitalisation by the value of the index in the previous week.

1 Gary Wesland is a reference to Garfield Howard Garry Weston who died in 2002. The share ownership of ABF is kept under the family investment company called Wittington Investments.

The UK Family Business index versus FTSE indices

Figure 1 below illustrates the comparative performance of the growth in the capitalisation of family-controlled and patrimonial quoted companies as represented by FB30 and FB All-Share during the 1999-2005 periods.

Figure 1: Performance of FB30 and FB All-Shares versus FTSE Indices



The graph shows that family-controlled and patrimonial companies perform quite well in terms of shareholder returns during the last six years period, with an increase of around 30 base points for the FB30 Index and around 45 points for the FB All-Share Index. Finally, the graph reveals that FB All-Share Index and FB30 Index out-perform the FTSE All-Share Index by 40% and 25% respectively.

Further investigation is warranted in order to establish the factors that govern the out-performance by Family Business PLCs:

- To what extent do smaller family-controlled quoted companies, with more concentrated family shareholding and active founding family business entrepreneurs, have the tendency to perform better in terms of shareholders return and/or return on equity?
- Does the methodology used to select companies for the FB30 Index, which is based on the ranking in the preceding six months, tend to influence the comparatives?

What is the role of the family in shaping performance?

This report provides evidence about the demographic profiles, in terms of the financial structure and performance of UK family controlled quoted companies (familial and patrimonial PLCs). The Family Business Index reveals that the family-controlled PLCs outperform their FTSE counterparts. In a previous explorative study, the research team established that when it came to control over sectoral effect, the share price performance of family-controlled companies can be something of a mixed blessing. Generally, a third of family-controlled businesses outperformed their peers; another third under perform whilst the remaining register similar performance. However, despite the evidence about the out-performance of family business, the above signals that PLCs can offer ammunition to the defenders of family business capitalism (although more research in the field is needed to corroborate the findings).

Scholars have since long been arguing that family firms possess certain dynamic capabilities, value-adding familiness and access to idiosyncratic social capital advantages which fuel their competitive advantage. The competitive edge of family-controlled companies is more evident when the economy and capital markets under perform and is relatively suppressed when market conditions are buoyant. Stein (1988) demonstrated that quoted companies with shareholders characterized with longer investment horizons suffered less from managerial myopia and opportunism. This is primarily due to the fact that they are less likely to forego good investments for the sake of boosting short-term profits. On a similar terrain, James (1999) argues that within family firms there is a general commitment to perpetuate ownership onto succeeding generations. This commitment acts as a major incentive for family business owners to invest more efficiently and prudently according to market rules. Furthermore, Anderson, Mansi, and Reeb (2003) found that one implication of families maintaining a long-term presence in family firms is that the firm will enjoy certain economies, such as a lower cost of debt financing.

Value Adding Familiness via the Prism of Case Studies

Reviewing the literature, a number of key factors have been attributed for the superior performance of the Family Business PLCs. This is as follows:

- They develop as a socio-commercial institution that is well endowed with elements of social capital. This includes trusts, bonds and long-term relationships as well as the ability to marshal resources/capital and build alliances. This is also characterised by the ability to demonstrate strategic and operational flexibility, transferable knowledge and pool of expertise across generations.
- They concentrate in certain business sectors; this sectoral congregation is mainly evident in construction, retailing, food-processing.
- They are tuned to long-term views and traditional practices – like investing in customer service and building their asset portfolio and subsequently overlook short-term growth adventures.
- They are into niche-orientated market penetration and tend to reap the economies of specialisation.
- They can tap into family wealth and easily use family assets to secure competitively priced financial solutions.
- They can manage to mitigate the negative implications of agency problems – they achieve goal congruence via overlapping owner-managerial power.

In order to verify the role of the family in shaping the out-performance of family-controlled quoted companies, we pursued a qualitative research study. A range of methods was used from unstructured to semi-structured questionnaire interviews, and secondary sources of information such as press archives, observation and company reports sourced from the firm and the company's house. Critical views on governance and the role of family members as investors and directors with the responsibility to oversee the strategic development of the firm were triangulated in order to establish validity. More specifically, in certain cases we managed to have more than two executives contributing to the inquiry; an executive responding to the structured questionnaire and another one taking part in the interview.

Case study reports on quoted family-controlled PLCs

- Associated British Foods PLC – the global food masters
- Caledonia Investments – the long-term investors in growth
- Huntleigh Technologies – the innovators
- Town Centre Securities – the builders of value

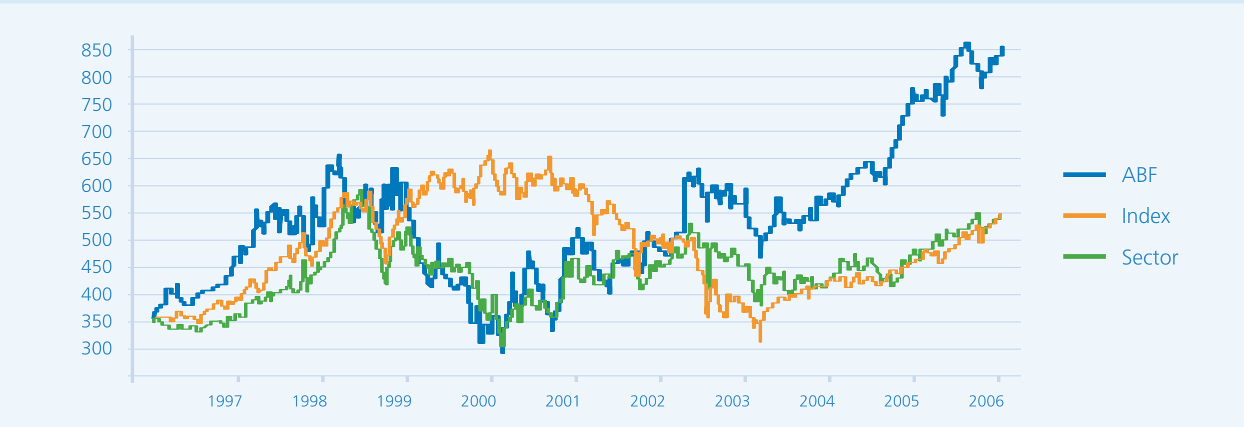
The interviews and case study research revealed that in the Anglo-Saxon model, special schemes to allow dominant family shareholders to enhance voting power in excess of cash rights are very scant. In the company case studies featured below, there was no use of special classes of shares, pyramidal structures and cross-shareholdings via multiple control chains, continental Europe seeking to strengthen family control power. However, in all companies there is in operation, either a trust or an investment company, which is the vehicle for the dominant owning family to exercise control and use it as a defence in the event of a hostile takeover threat.

Associated British Foods PLC – the global food masters

Associated British Foods (ABF), is a highly respected FTSE 100 company, being one of the leading international food ingredients and retail groups with presence in Europe, New Zealand, Australia, China and the U.S. The business is heavily focused in the processing and manufacture of food for global markets, and more recently, with an increasing presence in the textile retailing in the United Kingdom and the Republic of Ireland.

As Figure 1 demonstrates, in recent years ABF has been outperforming its FTSE 100 and sectoral peers by about 90% and 60% respectively. The company has been recording a 5-year cumulative average growth rate of 5% in terms of sales turnover; 14.2% in pre-tax profit; 10% in terms of normal EPS and 9.9% in DPS.

Figure 1: ABF PLC share price performance against its sector and FTSE 100 Index



Source: Hemscott Note: Market sector is Food Producers and Processors

As Figure 2 demonstrates, the business is characterized by its stable growth, financial health and steady profitability that benefit all stakeholders i.e. the majority owning family and other shareholders, employees and customers. It is evident from the financial numbers that the Westons have been busy adding value to the business. Despite the fact that the Westons have been labelled as conservative and risk averse, they have managed over the years to continue "making the right moves" and thus accomplish their mission: "to concentrate our energies and our expertise on segments of the market where we can establish a market leading position."

Figure 2: The financial profile and performance of ABF PLC (000's)

Profile	2000	2001	2002	2003	2004	2005
Turnover	4,406	4,418	4,545	4,909	5,165	6,220
Profit (loss) before taxation	247	357	420	457	494	447
Net tangible assets (liab.)	2,924	2,983	3,204	3,318	3,423	3,040
Shareholder funds	2,763	2,881	2,991	3,272	3,469	3,603
Profit margin (%)	5.61	8.08	9.24	9.31	9.56	7.95
Return on shareholders funds (%)	8.94	12.39	14.04	13.97	14.24	12.41
Return on capital employed (%)	8.03	11.29	11.71	11.94	12.30	11.12
Liquidity ratio	2.18	2.44	2.57	2.53	2.55	1.11
Gearing ratio (%)	13.46	12.70	22.10	19.87	17.76	33.61
Number of employees	34,372	33,989	34,957	35,416	35,584	42,281

Source: Bureau van Dijk's FAME Database

Last November, we have administered an interview with the CEO of ABF PLC, Mr George G. Weston, a member of the third generation of the majority owning family, and sought to examine the role of the family in shaping the superior performance of the company.

Pillars of Success

Although ABF is a public company, its control is retained in the hands of the Weston family, whose underlying belief is that "we are very largely tied to the success of this company" (G.G. Weston, 2005). The Weston family owns around 63% of the shares in ABF – mainly through Wittington Investment, a Weston family company with 54.5% of the shares – which clearly demonstrates a high level of concentration in terms of share ownership. There is no other disclosed holder who owns above 3 percent of this £6.5 billion business.

Especially since the year 2002, ABF has outperformed its FTSE peers and sectoral competitors, sustaining its growth in earnings and dividends per share on a continuous basis. George G. Weston attributes this trend to the fact that "the company strategy has been well-laid and well-focused", in addition to a fruitful acquisition programme and the tightening of management processes. Moreover, cash flow reinvestment back into the business and – (who won't say it) – some luck, have also contributed to the continued success, making the company "a safe place to put money in" (G. G. Weston, 2005).

Shareholder Returns Performance during the Cycles

Likewise, it is important to highlight that as most family firms, ABF has a long-term perspective regarding growth and other strategic decisions, making it more focused on stable and sustained development. ABF has a defensive stock with a robust cash flow. In GG Weston's words: "ABF doesn't boom in growth periods nor has particular hard times". The latter, is thanks to the "conservative" nature (risk averse) of the family owner management. On the other hand, it has to be said that the food sector generally sees steady growth. As G. G. Weston puts it "people will keep on eating".

Focused Strategies

Family traditions, dreams and future goals are always present when deciding which strategies should be adopted. Indeed, ABF acquisition plan is primarily based on keeping the path the company has chosen in the past. Staying in the food industry and not departing a lot from their core businesses is an approach that reaffirms the family belief that ABF is "the right place to have our [/their] investments" said G. G. Weston. In response to commentaries that perhaps the growth of the retail clothing and textile business signals the era of diversification, G.G. Weston clarified: "it hasn't represented a diversification; it represents ABF supporting a successful investment over a very long period of time". As in the case of other family firms, this is symptomatic of long-term strategic commitment. The rationale behind this move is that ABF has owned this retail division represented by Primark – which operates over 124 department stores with around 2.5 million square feet of total floor space – in the UK and Ireland (under the Penneys brand) since 1968. In fact, this is longer than most other brands that the company holds.

The Weston Familiness

The Weston way of adding value to ABF is based on some punctual and always present factors. This includes involving the family in the company in order to acquire know-how of the business, having strong and shared views on the sorts of businesses that the company should be investing in, and understanding the methods and manner in which those companies should be run. Mr Weston argued that this includes assessing according to the family traditions, capital and sense of stewardship, a well balanced degree of risk aversion, a longer ("but just right for ABF and the family") time horizon, and a conscious alignment between the performance of the company and the family wealth.

In the George G. Weston words, "I wouldn't want to overemphasize it, but again in the past it would have been quite strong. I think that family-owned operations can build up greater levels of loyalty from within the company, because to some extent family members personify what the company is. Some of the ties between management and ownership in ABF are relatively stronger than what prevails in other organizations"

Familial Acquisitive Strategy

Being a family-controlled business has played a key role not only in ABF's growth strategy and also in the way acquisitions and post acquisitions were/are/will be accomplished. Even though G. G. Weston admitted that in the past ABF used to buy-out more family businesses than today, especially when the family management was still active in the company, this tactic was rendering the acquisition strategy from a financial-growth practice into an empathetic and synergetic process of mutual understanding in the pursuit of business development.

Mr. G.G. Weston stated: "The reasons why families sell are many and varied, but one of them is because the family's gone too broad and not enough members of the family are still involved in the management and they want their money out, but sometimes that leaves behind members of the family who do still feel very closely towards the business that their family used to own, and they stay on [in ABF] and do a great job because they have empathy towards the business, they have a devotion to it". Indeed, some of ABF's successes have come from those businesses which were characterized with traditional active family owner-managers. A good example of this is Twinings Tea. In more recent times, companies (and brands) that ABF have acquired generally been in the hands of professional management.

Family Business Culture and Governance

Being a patriarchal family firm, ABF has a certain style, and it reflects specific and unique beliefs. Over the years, the Weston style and beliefs have been sculpted, transmitted and applied, giving the company "stabilizing input into the governance". ABF's strong values of efficiency, quality, shareholder value and growth have encouraged and supported its sustained growth, making it one of Europe's top food companies. However as major shareholders, the family firm has developed a close relationship with board representatives of other owners and the long serving management respects that "we [the family] have views on style, on risk, on timeframe and on the sort of businesses that ABF should be owning" said Mr G.G. Weston.

Arguably, the competitive advantage coming from its “familial’ unique way of handling business matters can sow also the seed of failure, especially if no corporate governance mechanisms are set in place in order to handle future transitions. People, new or growing with the company feel its culture. This phenomenon stems from the fact that firm had been under the helm of Mr Garry Weston (father of G.G. Weston), who for over 30 years as the Chairman and CEO, did not merely run it, but had ruled it – with great success.

The Future

Today, the current leader – (as the guardian of the family heritage) – has on his back the job of charting the strategic path for ABF over the next years. This includes establishing governance mechanisms to assure a smooth transition in the future especially since the shadow of his patriarchal father, is still around raising comparisons and evaluations. Finally, when Mr G.G. Weston was prompted to comment about the future, he declared that the family is in harmony: “we have been in a happy position that the firm has succeeded for generations, this is the right place to have our investments”.

For more information: www.abf.co.uk

Caledonia Investment PLC – long term investors in growth

Caledonia Investments PLC is an investment company created by the Cayzer family, which in 1987 received the bulk of the family's proceeds following the sale of British & Commonwealth (B&C). B&C was created when the Clan Line (the cargo shipping business founded by Charles Cayzer in 1870) made a successful takeover of the Union Castle Line in 1955. Since then, Caledonia has been a successful investment company which converted to an Investment Trust in early 2003. The Cayzer family own 44.4% of Caledonia either directly or via the Cayzer Trust Company. Continuity with the past is maintained by the active involvement of members of the fourth and fifth generation of the Cayzer family in the management of the business. The business is currently led by Peter Buckley (Chairman – family) and Tim Ingram (CEO – non family). Four of the seven executive directors are family members.

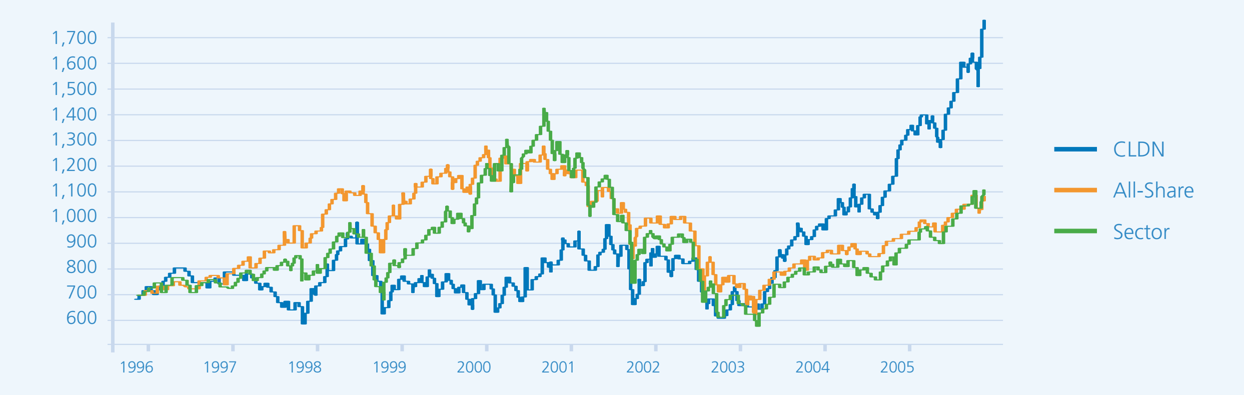
The Caledonia Investment Strategy

Caledonia takes significant stakes in companies where there is an opportunity to build value. Active management will usually be achieved by working closely and constructively with the investee management teams, often through board representation and as a long term supportive shareholder. Risk is managed by holding a diversified portfolio, with at least 50% of the funds placed in quoted securities or liquid assets. In line with their financial prudence and hands on approach, Caledonia self-manages its portfolio, using in-house expertise; in certain cases they use third party managers who specialise in particular asset classes or geographical areas. Although Caledonia usually aims to have an influential minority stake, it will, on occasion, be prepared to take a controlling interest where this will enhance shareholder value. The strategy for each investment, including the returns and the timing of disposal, is reviewed regularly. Investments are realised when funds released can provide a better long term return if invested elsewhere, without of course undermining Caledonia's reputation as a supportive long term investor. Whilst the source of funding for new investments generally comes from its own resources, Caledonia may at times seek to enhance returns by taking on moderate levels of debt.

Performance

Caledonia Investment PLC is a highly respected FTSE 250 company that has consistently outperformed the FTSE All-Share index during the last decade. More specifically, their Total Shareholder return has outperformed the FTSE All-Share index by 152% over the last 5 years and 179% over the last 10 years. The Total Shareholder return (which includes dividends) has been supported by the increase in share price, which as Figure 1 demonstrates, has been climbing from year to year (from 642.5p in 2003 to 1017p in 2004; hitting 1980p at the 2006 year end), which in turn helped reduce the discount to net asset value (to around 4%, down from 20% in 2004) at which Caledonia stock was trading.

Figure 1: Caledonian Investment PLC – Share Price versus its peers and the FTSE All-Share Index



Source: Hemscott

The company's first year as an authorised investment trust was highly successful and Caledonia was awarded the 'Brightest Newcomer 2004' by the Investment Trusts magazine. As Figure 2 demonstrate its investment portfolio has been growing strongly thus boosting its share price (and total shareholders return) to outperform FTSE peers.

Figure 2: The financial profile of Caledonia Investment PLC

Caledonia performance (March YE)	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Discount to asset value							
Caledonia net assets per share (pence)	1,276	1,214	1,189	915	1,282	1,543	2,061
Share price (pence)	772	798	848	643	1,017	1,367	1,980
Share price discount to net assets	40%	34%	29%	30%	21%	11%	4%
Annual total return (Note 1)							
Caledonia total shareholder return	9%	17%	9%	-22%	63%	38%	48%
FTSE All-Share total return	10%	-11%	-3%	-30%	31%	16%	28%
Caledonia out/(under) performance	-1%	28%	12%	8%	32%	22%	20%
Dividend/share (pence) (Note 2)	**23**	**24**	**25**	**26**	**27**	**28**	**30**

Note 1: You SHOULD include the two special dividends in the above chart and the elective dividends
Note 2: Special dividends in addition to normal dividend in 1997 of 30p and in 2000 of 70p also an elective dividend in 2004 of £2.33 and another elective dividend announced for 2006 of approximately of £2

Aligning Investors Horizons

Despite internal and external challenges, Caledonia's stock offers rich returns. As the charts above demonstrate, the share price of Caledonia is continuing to out perform the FTSE AllShare Index by 20% in 2006. Moreover, the business has achieved 39 years of continuous dividend growth. There is strong evidence to conclude that Caledonia is traditionally in the business of steady growth and the recent rally of its share price tends to suppress commentators views that "it's a family affair doomed to restrained development".

During the early part of this decade some of the family shareholders in the Cayzer Trust Company had short-term liquidity requirement's which were at odds with the long-term investment strategy of the Cayzer Trust Company's principle asset Caledonia. Thus, the solution was a liquidity event where, all shareholders were offered the opportunity to receive an elective special dividend, on up to two-ninths of their shareholdings, of an amount based on an 18% discount to the company's net asset value per share, with subsequent cancellation of those shares on which the dividend was paid through a Court approved reduction of capital. In addition to Cayzer Trust and Hermes – only 1% of investors opted for this. As a result of the elective special dividend £88M was returned to shareholders. Cayzer dissidents obtained cash and those investors with long-term investment horizons are able to continue to enjoy the benefits of Caledonia's investment strategy.

In November 2005, we visited the company and interviewed Mr Tim Ingram (non-family member – CEO) and Mr Jamie Cayzer-Colvin (family owner – director) on the factors contributing to the superior performance of Caledonia, and explored also the role of the Cayzer family in shaping the structure, conduct and performance of Caledonia.

The Cayzer Way of Adding Value

This is a family dominated business world. There is significant family involvement in executive positions as well as non-executive roles. "Family owner-managers have an in built drive for business and this acumen is inherited through generations; they are also characterised with an undiminishing long-term commitment to build value" said Mr Ingram. In contrast, according to Mr Ingram, "institutional shareholders are by nature short-termist", as they invest and expect in quick returns on their money so that they can cash in and declare: "thank you very much….that was it." He continued to argue that institutions evaluate everything on a short-term time horizon because that is how they are judged.

It is widely argued that family firms, almost by definition, tend to have long-term horizons. Their owner-directors follow policies with a longer view and exhibit intensity of devotion to the company's affairs, and often this is both at the non-executive and executive level. "In my experience, directors who have a substantial part of their personal wealth tied up in the company, are more likely to watch for that company than independent non executive directors who are partly responsible, but have very little of their wealth there. It is natural for family owner-directors to go the extra mile compared to the non-executive directors who are there to provide objective professionalism. They are really concerned and diligent on where the company goes… and they are there to stay", Ingram said.

The long tenure of key family owner-directors that proudly carry the family flagship is at the epicentre of long-fruitful relationships with portfolio companies in which Caledonia invests. In the words of Jamie Cayzer-Colvin: "When I sit down and look at an investment with a group of people, I can quite genuinely look them in the eye and say: I hope that for the next 15-20 years time I will still be the person managing the relationship with you…. that's partnership".

There appears to be a trans-generational culture of development prevailing when you walk down the corridors of the Cayzer House. As family owner-directors, who have made the decision to serve their firm, they are custodians of the heritage and guardians of the future. "There is an element of passion in ones work when your own name is so linked with the company. Also, the eyes of your forbearers look down at you from walls in the Boardroom, they instil a certain pride and responsibility to make that extra effort" said Jamie Cayzer-Colvin.

Share Price Performance

As with other family controlled PLCs, who are in the business of stable growth and prudent financial practices that are not promising quick short-term returns, the share price performance of Caledonian Investments has the tendency to under-perform during bullish years and out-perform during bearish period. This is not symptomatic of restrained growth but it epitomizes the chasm in investment horizons. In the words of Tim Ingram: "Generally this is due to the fact that during boom periods investors are seeking short-term returns. In family dominated businesses, the family is naturally interested in long-term wealth creation. Statistics show that the long-term approach does seem to have better long-term returns than a series of short term cycles."

Sensitivities to Market Judgment

It is often the case that City analysts voice concerns and criticize family controlled PLCs that in the name of family control they adopt family-tuned strategies or institute eroded governance practices. It is a challenging task for the CEO and the board to accommodate the concerns of all constituencies: dominant and minority shareholders; management, employees, as well as analysts and commentators who judge business performance and practices with alternative criteria, frameworks and time horizons.

Mr Ingram argued that the presence of the Cayzer family as a major shareholder who has been traditionally more interested in the long-term approach to investment has proved that this is the way to outperform the market. "In the absence of the dominant shareholder (more or less controlling the company), and the proliferation of shareholders with different objectives, naturally unnecessary conflict could emerge" he said. Indeed, in the early 2000's, there was thinking fuelled by outsiders' calculations that if the company was liquidated, shareholders would end up with slightly more value than the market share price dictated value. However, the recent performance of Caledonia shares demonstrates that such a liquidity event would have been the wrong call and was not in accord with the interests of the shareholders as a whole.

Competitive Advantage

In terms of investment strategy Caledonia Investment claims the following main competitive advantages:

(i) Favoured Access – stemming from their long established and valuable reputation as a supportive long term investor which attracts a strong deal flow of opportunities not always available to others, which enables them to be highly selective in its investments;

(ii) Long experience – Caledonia's management team has long experience of actively working with the management teams of investee companies to identify and promote business growth opportunities. They look to support SMEs with growth potential that are perhaps not so attractive to some of the more traditional financial institutions.

In certain cases, historically there was a tendency to back some family controlled ventures like that of the Kerzners and AG Barr. Nowadays the company will not only invest in owner-managed businesses, as their investment portfolio suggests, their strategy follows other patterns too.

In the words of Tim Ingram: "Our philosophy is to back companies where there is really good management to create value and I am hardly surprised that you have the phenomenon of synergetic maximization of shareholders value (backed up by statistics) especially in businesses where management have quite a large stake in the company." The Caledonia investment team and owner-managers naturally develop better empathy due to similarities in owner-managerial ethos, and understanding that control is a sensitive issue. It is axiomatic that private owner-managers do not always like the private equity houses with their exit strategies. "Family companies get together because they have the same long-term interests. It is very easy when you share the same business philosophy and culture, you talk the same business language and when trust is built in this setting investing becomes much easier" said Jamie Cayzer-Colvin.

Family Triggered Issues

It has been argued again and again that the future of family-controlled companies, could be in jeopardy if the family at the helm fails to institute a governance scheme to control and optimise the role of the family members (at the board and in the ownership regime), and fails to prepare timely for leadership succession across generations. In the case of the quoted Family Business PLCs it is of paramount importance that governance mechanisms are promoted that will safeguard effective managerial functions and sustain healthy relations with investors, especially during transitions.

The disadvantage for family firms in general that Tim Ingram sees (which has not happened to Caledonia Investments) relate primarily to human capital issues. More specifically, "certain positions in the company will not necessarily be open to outsiders because the family wants to be in these positions of power". There is always the danger for nepotism, where certain family appointments are not meritocratic. The second dimension is that "if you appoint mainly family members and the firm becomes a heavily family dominated affair, there is a risk of family dispute, which can impinge on the company itself. Admittedly, during the open Cayzer dispute, new deal flow did dry up a bit".

Business Family Governance

Following the 2001-2004 period when the Cayzers were not all acting in unity, Caledonia Investments introduced a Governance Committee, which is entirely independent from the executive directors and the family. The committee's role is to make sure that the company is run for the interests of all shareholders.

The family obviously is a separate issue and it incorporates different individuals with common interests but also with evolving objectives and priorities about their investment. Today, trans-generational business families operate governance schemes that will help better connect the consortium of cousins and optimize the role of the family in developing the business. When prompted to comment on what governance mechanisms the Cayzers operate, Jamie Cayzer-Colvin said: "The Cayzer family is a series of families with a common ancestor. Each of these families has varying requirements. We can't keep everyone happy all the time but we can try to give them consistent long-term growth and ensure we always listen to all their concerns. People spend a lot of time on governance when there is a lack of performance." He explained that the company is in regular communication with the family, however "they will be treated exactly as any other investor in Caledonia. We cannot treat them in any other way".

Mr. Jamie Cayzer-Colvin went on to argue that, in the case of the Cayzer Trust, that they do have a system where they try to build up some liquidity in order to buy out those people that feel the model is not for them. "A tree is kept healthy with a little pruning every so often".

Family Vision for the Future

Tim Ingram expects that the family will want to continue to dominate the shareholder register of the company for one simple reason: "the long term investment strategy model will continue to generate wealth for all. If the family shareholding were to be too diluted, there is a risk that Caledonia Investments will get high-jacked by the sort of arbitrage type of hedge funds".

Jamie Cayzer-Colvin declared: "As far as Caledonia is concerned, it is more of the same. That means constantly evolving the business plan. Over the years we have evolved and changed, but without I don't know. We will stick to the plan but always have an eye for an opportunity."

For more information: www.caledonia.com

Huntleigh Technology PLC – the innovators

Huntleigh Technology PLC is a highly respected FTSE Small-Cap operating in the competitive healthcare industry dealing with the design, manufacture, distribution and rental of medical equipment and instrumentation for medical applications. Huntleigh is the leading UK manufacturer and provider of patient support and ultrasound equipment for the global healthcare industry. Product areas include prevention and treatment of pressure ulcers, hospital beds, intermittent pneumatic compression devices for the prevention of DVT, and hand-held ultrasonic diagnostic devices. The firm was floated in the 1980's following an MBO instituted by Rolf Schild – the patriarch of the family controlled business that passed away in 2003. The business is currently led by Julian Schild as Chairman and David Schild as CEO. The Schild family controls about 44% of voting shares.

Financial Profile and Performance

The company exhibits solid return on investment and has been outperforming the median of its peer group. In the UK, the company's performance is greatly tuned to developments in the NHS. For this reason, Huntleigh has embarked on an increasing effort over the years to diversify operations on a more global basis. More specifically, via the "controlled expansion strategy", they are seeking to progressively roll out its complete product range on an international basis, but primarily into those countries where it has direct representation.

Huntleigh is also cautiously developing a manufacturing base overseas in order to protect margins against currency movements and provide the group with a base from which to competitively cater for other geographical markets. More specifically, it has recently acquired the assets of Viasys which allows more diversification. In addition, this non-organic expansion will free up operational capacity for more research and development and also accommodate the long anticipated increased NHS orders. Figure 1 illustrates the company enjoys steady growth, profitability and financial health.

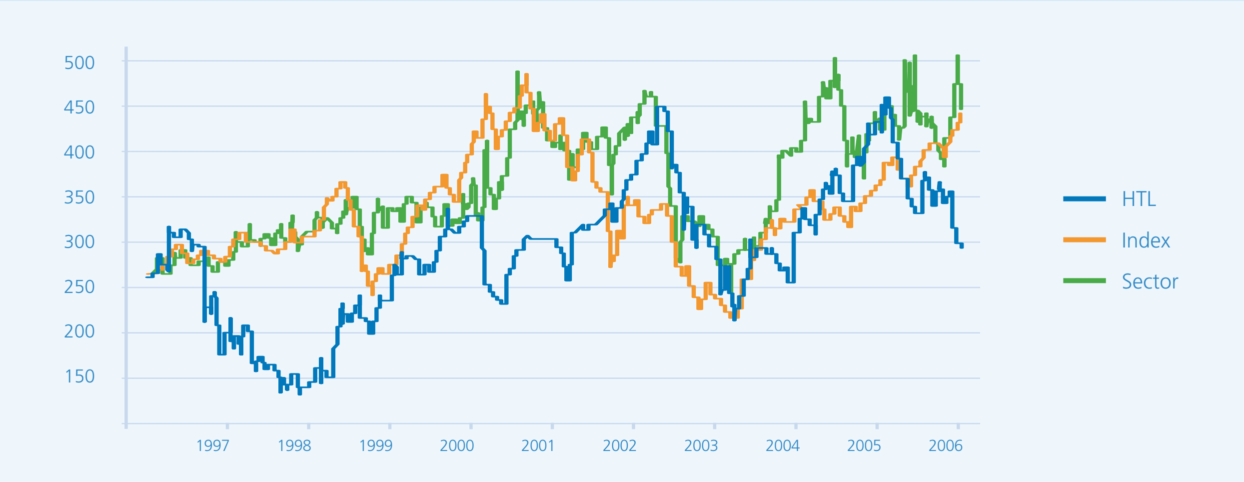
Figure 1: The financial performance of Huntleigh Technology PLC (£000's)

Profile	2000	2001	2002	2003	2004	2005
Turnover	131,778	170,432	176,416	187,205	198,689	199,746
Profit (loss) before taxation	17,005	20,286	21,670	23,105	27,565	22,245
Net tangible assets (liab.)	62,083	72,090	85,460	96,755	103,580	124,195
Shareholder funds	49,286	58,130	68,577	79,506	91,001	95,514
Profit margin (%)	12.90	11.90	12.28	12.34	13.87	11.14
Return on shareholder funds (%)	34.50	34.90	31.60	29.06	30.29	23.29
Return on capital employed (%)	26.87	26.72	24.04	22.84	25.59	17.03
Liquidity ratio	1.25	1.29	1.35	1.52	1.59	1.59
Gearing ratio (%)	55.48	61.24	57.11	42.97	40.01	59.68
Number of employees	1,539	1,750	2,200	2,330	2,530	2,542

Source: Bureau van Dijk's Fame Database

In terms of shareholder return, as Figure 2 indicates the share price of Huntleigh historically has been in line with its FTSE Small-Cap and sectoral peers. However, it is often the case that smaller companies are not in the business of primarily impressing the financial markets but rather for building value for loyal investors characterized with long-term investment horizon.

Figure 2: HTL Shareholder returns against its market sector and FTSE Small-Cap



Source: Hemscott Note: Market sector is Health Care Equipment & Services

In recent years, Huntleigh has been recording a 5 year cumulative average growth rate of 10.9% in sales turnover; 13.4% in pre-tax profit; 7.37% in terms of normal EPS and 11.34% in DPS. The company consistently demonstrates stable development mainly via conservative organic growth routes. This sustainable growth has been achieved without raising additional equity funding given the fact that the company is extremely bankable.

The balance sheet continues to be strong, and despite ongoing investment in R&D and rental assets, external loans and net gearing remain relatively modest, under 20%, which is one of the lowest in the industry. The Schilds at the helm of Huntleigh Technology have been busy over the years adding value to the business without undermining financial stability to the benefit of all stakeholders. This includes the owning family, minority shareholders, employees and the UK PLC at large – as demonstrated by its sustainable profitability and export performance.

Last December, we visited the company and interviewed Mr Julian Schild on the factors conditioning the performance of Huntleigh Technology PLC, and explored the role of the Schild family in shaping the development of this high tech export champion.

Pillars of Success

As in most of family-controlled corporations, the hands on approach of the Schild brothers, together with their participative management style, create a non-hierarchical organizational structure, which offers all managers a lot of opportunities to participate in decision making" as Julian Schild commented. He went on to argue that their culture is especially appreciated by the new managers coming from larger companies, where decisions on projects and practices tend to take longer to be delivered by the head-quarters.

J.Schild summarised the pillars of the company's success : "The commitment and long-term view of family owners, who are active on a daily basis, offer security to employees, as they know who is making the strategic decisions. In contrast to the large conglomerate, these are not done remotely by managers who primarily aim to make the share options realizable so that they cash in and move on". He continued to highlight the positive role of the Schild family as the major shareholder, with the overall responsibility of charting the growth of the firm across generations: "The family offers stability, and steers the company with financial prudence. We tend to be conservative in terms of exposure to financial risk, but we act very quickly when it comes to a decision on a project that will involve manageable business risk; projects do not get stuck in layers of management and committees."

Share Price Performance

Evidence suggests that there is a tendency for the share of family controlled firms, such as Huntleigh Technology, to under-perform during bullish years and better perform during bearish periods. J Schild argued that "Huntleigh Technology is not going out aggressively to grow their market share through acquisitions", in order to generate high returns in short-term period. They are perceived to be defensive, therefore they tend to outperform in times when the market is generally doing poorly. The company still depends for about 45% of its turnover on the UK market and projected sales of capital projects to the NHS do not always materialize – given the NHS funding debate. The company is now investing in an export development and diversification strategy so that it can reduce further the dependence on the UK market. The export side is continuously growing and the company is enjoying the fruits of growing overseas business.

Julian Schild, when prompted to comment on the relationship of the company with investors, said: "we are developing investor relations and we are adhering as much as possible to the governance code so that we can reach into those institutional and individual investors that can understand us and are happy with our prudent, long-term strategic approach that has been proved as the right platform to build the future". He quoted one of their loyal investors as saying: "if I buy Huntleigh shares, I don't need to disturb my night's sleep".

Focused Growth Strategies

The Huntleigh strategy is associated with stable growth, geographic diversification, financial prudence which will sustain autonomy, and of course as a high-tech company, continuous investment in research and development to yield new innovations. In recent years, the company embarked on a couple of acquisitions which are geared to stimulate the growth potential of their main product divisions. Their financial strategy is in line with the pecking order: using internally generated funds i.e. retained profits; then raising money externally via loans; and as a last resort, reverting to the issuance of additional shares. This sustains the financial health and autonomy of the family business during the changing economic cycles.

In the words of Mr Julian Schild: "We have very good relationships with our key bankers who have told us they would be supportive should we wish to make acquisitions for cash. We would be happy to issue shares, as well, for that great acquisition, but we are not looking just to pursue acquisitive growth for the sake of growing. It has to fit in with what we are doing at the moment, our core business activities. Our people are hands on managers and they need to understand what they are doing. We are not a financial conglomerate, rightly or wrongly, that's not our style."

Family Business Culture and Governance

The family-controlled company has loyal external investors which understand and have faith in the Schild way. The board has a good balance of outsiders and independent non-executive directors. Succession is not a pressing issue as the Schilds are still young, in their mid 40's. Where the family business culture could emerge as a problem, is in the case of "an executive who aspires for the chief-executive role, that isn't on offer at present." said, J. Schild. The business is deliberately encouraging very good middle-managers and indeed senior-managers, to ensure sustainable supply of talent to support the future growth of the firm. The family does not operate any governance schemes to regulate the role of the family in the business as the siblings' partnership regime is very simple: there are only four family shareholders, two of them work in the business plus the third generation is all children at this stage. In fact, the family operates a family trust which means, "that any strategic decision about shareholding control has to be taken by everyone" said Mr Schild. Reflecting on their governance structure, the message is clear: business comes first, as they advocate responsible ownership and governance. "Any dividend and remuneration policy is independent of any personal family liquidity requirements – that's how it has always been" Mr Schild declared. The board has the responsible authority "to chart dividend and remuneration policy to look after the interests of all stakeholders – any family liquidity issues would have to relate to the trading of shares."

The Schilds' Vision for the Future of the Family Business?

The Schild family predominantly controls a successful and profitable firm which is operating in an industry characterized with fierce competition and capital intensity. Moreover, their business is geared towards further investment in their internationalization strategy. So, will they consider outside equity partners to help finance growth and perhaps pursue global expansion? This of course will entail relinquishing control; alternatively, they could perhaps partially exit by selling certain parts of the business and diversify the family wealth.

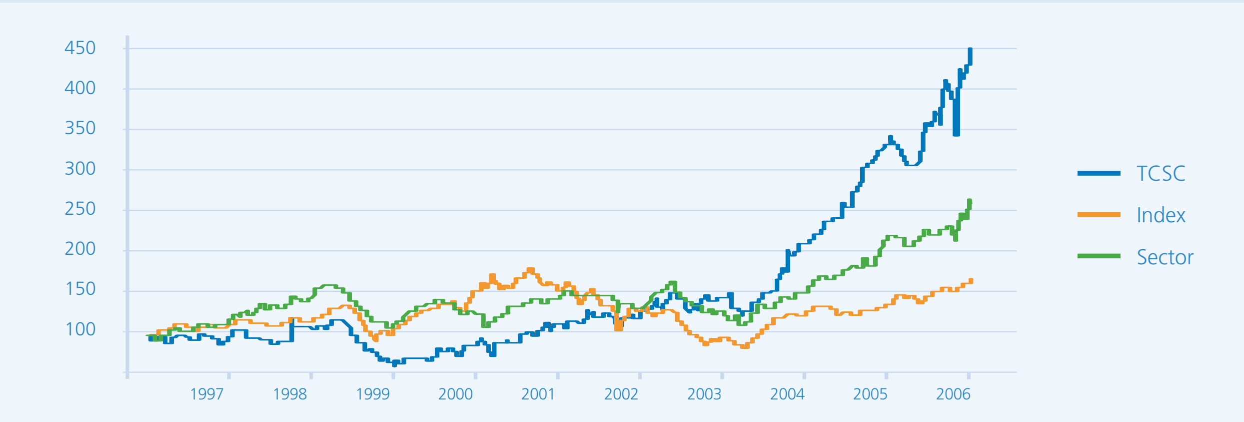
In the words of J Schild: "The only reason for changing the traditional way of stable growth would be if a good opportunity came along but we are not looking to have any major bids at the moment. There is no point being sentimental because sentimentality doesn't pay the bill, doesn't pay the wages, and if you look at what we have done over the years, we have sold parts of the business that we felt would be better off in other hands". So in commerce, nothing is sacred in that respect. Huntleigh Technology is committed to go for more international business and they cannot afford to keep any poor performing units that would only draw resources from the best parts of the business. In his closing remarks, Mr. Schild concluded: "the world is a highly competitive place and the market although sometimes fails to generously credit excellence, rarely fails not to punish inefficiencies".

For more information:
www.huntleigh-technology.com

Town Centre Securities PLC – builders of value

Town Centre Securities PLC (TCS), the Leeds based property investor and developer, is one of the growing stars of the FTSE Small-Cap. It has a core investment portfolio of 40 prime properties, and two major development sites in Leeds and Manchester, along with a 10% JV interest in major retail led mixed use development of over 1m sq ft in Leeds. Arnold Ziff founded TCS PLC in Leeds in 1959, and its flotation on the London Stock Exchange followed in September of 1960. The company began as a traditional property investment company collecting rent and re-investing profit. The Ziff family, led by Arnold, developed their appetite for the property in parallel with their interests as owner-managers of the Stylo shoes retail chain (a quoted company in its own right), which later on evolved into a multi-brand group. Stylo PLC, now quoted on the AIM market, trades from over 300 shops, mainly under the Barratts and Priceless brands. Arnold Ziff, the patriarch of TCS remained Chairman, until his death in July 2004 and was succeeded by his son Edward Ziff, who is the Chairman and CEO of the company. The Ziffs have built TCS into one of the most successful players in the real estate/property development market and TCS has outperformed the FTSE Real Estate sector by almost 100%.

Figure 1: TCS PLC shareholder returns against its market sector and FTSE Index - for Real Estate



Source: Hemscott Note: Sector is for Real Estate

Financial Performance

The long term financial performance of the company is aimed at improving both income and capital returns value for all shareholders. An investment of £1,000 in TCS shares in 1960, ignoring dividends, was worth £1,460,000 in February 2006. The dividends per share have steadily increased from 3.7 pence in 1996 to 8.2 pence in 2005. The net assets of the company have increased from approximately £160 million in 1996 to over £240 million in 2005, which is an average of 6% increase per year for almost 10 years. In common with other family-controlled firms, TCS is financially prudent, the gearing ratio has decreased substantially since the 1990's and is currently in the 50-60% range (which is at the lower end of the industry). The company is steadily growing, which is in line with the Ziff family strategy.

This growth is due to strategic action geared towards the restructuring of the property portfolio into larger units in the best locations whilst at the same time using capital release from the sale of underperforming property to buyback equity at substantial discounts to NAV. This matches the mission statement, which is as follows: "we aim to maximize shareholders returns over the long term through the acquisition and active management of investments and developments with secure and improving income in good locations." During the 2004-05 period, the net assets per share increased by 25% and the profitability increased by 29% (from £6.6 million in 2004, to £8.5 million in 2005), thus boosting earnings per share by 96%.

Figure 2: The financial profile of Town Centre Securities in recent years (£ millions)

Profile	2001	2002	2003	2004	2005
Turnover	38.0	23.9	24.6	24.4	24.2
Profit before taxation (FRS3)	16.9	11.1	8.67	6.57	8.48
Net tangible assets	289.2	317.2	326.1	353.3	400.5
Shareholder funds	153.3	160.1	170.3	203.7	240.5
Return on equity (%)	4.52	3.92	3.28	2.8	2.58
Return on capital employed	7.9	6.3	6.1	5.6	5.0
Gearing ratio (%)	75.30	47.87	53.78	53.81	58.5

Source: Bureau van Dijk's Fame Database and Hemscott

Last November 2005, we visited the company and met with Edward Ziff, to discuss its performance under the stewardship of the Ziff family. Below is a summary of that interview explaining the role of the family in shaping the superior performance of TCS PLC.

The Development of TCS

Historically, father and son have steered TCS through tough business cycles, and have demonstrated to the financial community – which often have been at odds with Senior Ziff – that the Ziff way has been the catalyst for the remarkable growth in terms of valued added and shareholders return.

Unlike other industrial sectors, historically, when inflation was alive, the fate of the property industry was often governed by the interplay between inflation, interest rates and growth. "During the downturn in the early 1970's, TCS survived due to steady rental income, secure debt and low gearing conditioned by a prudent financial philosophy", Mr. Ziff commented. Inflationary trends allowed the property sector to mushroom and by the 1980's the real-estate market was booming.

As Mr. Ziff explained, when inflation was higher than interest rates, leveraging the balance sheet with debt was not destabilizing because property values grew faster than inflation and in effect reduced gearing. As interest rates and inflation fell, rental income increased and profitability rose. In addition, the interplay between interest rates and property yields meant that capital values at TCS and other property companies increased.

During most of the 1990's there was little growth in the real-estate industry, however, by 1998, the property industry as a whole and TCS in particular were trading at a significant discount to net asset value. These discounts resulted in a significant number of public-to-private transactions and sector consolidation through merger activity. In1998, TCS net asset value per share was £1.50, whilst the shares traded down to £0.65 per share, a discount to asset value of 57%. At the time, TCS were advised that the company could have been taken private at less than £1.00 per share. After lengthy discussions, the family and the board decided to remain publicly quoted but to drive value back into the share price.

In the words of E. Ziff: "We got inspired by the fact that profits per share were twice that of dividend per share. TCS's underlining earnings per share in 1999 was 7p and we were paying 4p in dividends. The City was not prepared to value the company properly". The City discounted retained earnings and increases in asset value to such an extent that as E. Ziff stated: "we embarked on a new aggressive strategy, to sell underperforming property assets, reinvest part into locations where property would grow more aggressively, in both rental and capital terms and use the surplus to take advantage of the undervalued share price and buy-back shares for cancellation".

The New Strategy of Maximizing Shareholders Value

The family as the dominant shareholder and the board launched a four point strategy:

- "'Tidy up' the property portfolio and make it more efficient". Over the last 7 years, TCS has reduced its property portfolio from 150 sites (worth £300 million, with 5,500 tenants) to 50 properties that are now worth about £400 million and have less than 1,000 tenants.
- Larger, better quality properties attract better quality tenants. A major retail led mixed use scheme of 1m square feet in central Leeds, in partnership with Hammerson PLC (a FTSE 100 company), is proof of the ambition to invest in large, high quality assets that have the potential to grow in value.
- In 2001, TCS exited from the car park business (retaining some of their freehold parks) that was characterised by depreciating management contracts (essentially goodwill) extracting maximum value to further concentrate on freehold property. However, they have just developed a freehold multi storey car park and intend to develop the business and acquire further car parks once again.
- The company bought back shares for shareholders who wished to realize value. During the last six years, TCS bought 55% of its equity for cancellation. The Ziff family currently own over 50% of the shares and have doubled their stake as result of this strategy. "What is interesting is that we did it at an average of less than £1.20 per share, compared to the current price of over £5.00. Had we not done it, perhaps someone else would have taken the business over. On the basis we have bought for in over 50% of the equity at £1.20 per share, so too could someone else!" (E. Ziff, November, 2005)

The Ziff Stewardship

Today, TCS is a financially strong, more efficient and profitable business and its property portfolio has risen in value faster than the IPD index over the past five years. This is partly due to market conditions and also due to the fact that property stock selection is much more focused. According to Edward Ziff, "the family formula for success is to have a long-term strategic horizon and never tune operations to achieve short term improvement in share price. We bring a sense of care, stability and planning for the future. Not just inflating the share price today so some senior executives can get the benefit of a share option". In addition, the family has, over the years, developed dynamic capabilities across the generations to deal with ups and downs of the property market whilst at the same time building an extremely competent corporate team to manage the long-term growth strategy of the business. "We believe one of the reasons we have done so well (ranking 3rd-4th in the Real Estate Sector in Shareholder return over the last five years) is because we are not primarily interested in short term share price performance, but interested in running the business for the medium to long term benefit of all its shareholders", said Mr. Ziff.

The stewardship of the family as dominant shareholders has "paid dividends" in terms of adding value for all stakeholders. Another example cited by Mr. Ziff, which illustrates that the board of TCS (which includes 2 family members and another 7 non-family Directors) looks after the interests of all shareholders, is the decision to distribute TCS's large (approximately 15%) stake in Stylo PLC. Many of the Ziff family shareholders would have preferred it if TCS had retained the shares in Stylo (where Michael Ziff is Chairman and CEO) mainly for sentimental reasons, although it made sense financially to sell the Stylo shares. The board decided to distribute TCS's Stylo stake to its shareholders so that they could decide for themselves whether to keep or to sell the shares. The board saw this as a way of returning value to shareholders. According to E. Ziff, this action sent the message that, although it is a family-controlled business, TCS considers the return of value to all shareholders is a vitally important part of its core strategic aim to improve shareholder value.

Relations with the City

Mr. Ziff thinks that in the most part the City is transaction fee driven and therefore unlikely to derive significant fees from a stock such as TCS which tend to grow organically rather than through acquisition: “We are a suspicious group of people and question what people’s motives are, and the City doesn’t like that. The City has a very interesting opinion of itself, which is fine for the City. We see our role, as a board, to iron out the peaks and troughs of the property market, and are well placed to take a view so as to deliver that objective. In a family controlled business, the City does not expect directors to be independent. They like directors to speak their speak, we like to look after the people who look after the company and have long term loyalty to the company, a luxury the City is not always allowed to take”.

E. Ziff clearly stated that he values directors who are independent in their outlook on the market and the general economy and welcomes a code of behaviour of what is right. However, he strongly feels that “the City does not like controlling, independently wealthy groups of shareholders, whether they are family or not, because the City then loses its control”.

His view on combining the role of Chairman and CEO is that: “TCS has three truly independent non-executive directors and my brother as well. If the four of them came to the view that it is inappropriate for me to keep both positions I would reconsider. Frankly, what the company needs its stability, particularly critical when my father passed away in 2004, and a management team that drives the business forward, cares for it and is prepared to nurture it”.

When prompted to comment on where the family tradition may not be in accord with the business agenda, he said: “Sometimes, families get emotionally attached to certain assets.

Moreover, conflicting views between family owner-managers and non-family directors could emerge. Everyone ought to respect and listen to each other so that you can move forward together. It is vital that we keep talking and communicating with each group, no matter if they are family, non family, independent or non independent”.

Will “Keep it in the Family Tradition” Continue?

Now its time for the Ziffs to plan for the future and nurture the 3rd generation of the family – Mr. Edward Ziff, has a 19 year old son who, hopefully, will join the business. There are 13 grand children (male and female) descending from the founder so there should be no shortage of future managers of the business. The second issue is that, at Stylo PLC, today only Edward and Michael Ziff are meaningful family shareholders. Gradually, ownership has gone back to the people that are involved in running the business. Furthermore, A Ziff had put a lot of his shareholdings in charitable trusts, which are large shareholders of TCS and Stylo. What he firmly believed is that: “you should enjoy a great lifestyle if you are successful, but you only need so much. Beyond that level you need to understand that there are people that are less fortunate and in need”.

Edward is a big shareholder in Stylo and his brother Michael is a big shareholder in TCS and thus their fortunes are interlinked. Their sister also remains a large, but passive shareholder in both businesses. He acknowledges that with the next generation, managing the succession issue will become an emerging issue.

In conclusion, Edward Ziff declared: “Family values and business ethos kept us united and on track. The future for TCS is to constantly be reviewed as well as progressing the strategic vision for the business. Property will always be central to what we are doing, and development might continue depending on the market. At the end of the day, it is the income and cash flow that allows the business to grow and to survive.”

For more information: www.tcs-plc.com

Evidence from the case studies

The interviews and case study research have highlighted a number of positive attributes that family controlled PLCs have. The following outlines the key findings:

- Devotion and commitment instilled from generation to generation, since family wealth and heritage is linked to the family business.
- Long-term strategic horizon – they are not in the business of adventurous growth to impress opportunistic investors with short-term returns.
- Financial prudence is symptomatic of their drive to sustain their financial health and autonomy, so that they can insulate the family wealth creation from outside interferences.
- Strategic focus in the core business; they have developed special capabilities to exploit (without excessive risk exposure) opportunities in each of their sectors.
- Stability and stewardship drawn from the dominant owning family
- Harmonious relations with loyal investors that respect and understand the family way of governing growth and development.
- Culture of trans-generational sustainable development; they are driven by duty of responsible ownership to steer their companies across business cycles.
- Defensive Ownership – they are administering control through various schemes e.g. trusts that will block hostile takeovers.
- Vision to keep the family at the helm of the business, as they are custodians of their heritage and guardians of their destiny.

Considering their views as to where family ownership could pose problems, a number of issues have been identified as follows:

- Family domination coupled with absence of governance scheme to regulate the role of family members could lead to damaging conflict.
- The chasm between family values versus business practices that professional non-family managers promote could erode goal alignment with owners.
- Nepotism could jeopardise the business performance but also strain the relations with outside investors and non-family executives.
- The failure of the family to evolve, adopt open thinking and be ready for change in areas such as corporate governance, financial strategies etc.
- The expropriation of special benefits for the family at the cost of other shareholders,
- The failure of family owner-directors to decide to divest or dispose of a business unit that is of sentimental value to the family (this relates to the “sacred cows” phenomenon).

The Future of Family-Controlled Companies in the Capital Market

Despite the out-performance of family-controlled quoted companies, evidence suggests that there is a diminishing role for Family Business PLCs in certain countries (for Germany; Klein and Blondel, 2002; and for Spain; Navarro and Ansón (2004). In the case of UK family business capitalism, Franks et al. (2003) explored the dynamics of the UK capital markets and provided historical evidence and sound arguments of the demise of the British Family Business PLC economy. This is evidently epitomized by the dilution of family ownership in the twentieth century.

The main driver for this trend has been the issuance of equity shares by the family-controlled PLCs in order to finance acquisitive growth. This financial practice occurred in the absence of minority investor protection and normally families were able to retain control by occupying a disproportionate number of seats on the boards of firms. Over time, with smaller stakeholding, rising hostile takeovers, demanding institutional shareholders, increased capital market regulation and takeover reforms, families found it very challenging to sustain control. Thus, while acquisitions facilitated the growth of family-controlled firms (in the first half of the 20th century) it has resulted in dilution of their ownership and ultimately led to a loss of control (in the second half of the century). Moreover, this period was marked by more capital market regulations geared to offer protection to minority shareholders.

This research study has shed light on the structure and performance of the UK Family Business PLCs, the constituents of the FTSE Index and those firms that are quoted on the main London stock market. It transpires that there is evidence to conclude that the family effect is stimulus to shareholders return – especially during the downturn. However, the proliferation of quoted family-controlled PLCs firms is on the decline.

It is the thesis of the research team that there is much scope to re-evaluate the profile of the UK Family Business PLC economy on a more longitudinal basis, and by extending the focus on the Fledgling. With the focus on the smaller cap sector and other secondary equity markets such as AIM and OFEX, this will enable us to better understand the progression of quoted firms across the equity markets. It will also help serve as a starting point in informing policy debate on what is the most optimal equity market route for growth-inspired family firms.

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Profiles

The Institute for Family Business (UK) is an independent, not-for-profit organisation supporting a dynamic family-owned business sector in the UK through education, research and advocacy. Our educational programmes offer family business owners, their families and directors the opportunity to exchange knowledge and best practice in an atmosphere of confidentiality. We are a voice for family firms and our aim is to highlight the vital contribution this sector makes to the UK economy and the issues that family firms face. Independent research commissioned by the Institute underpins IFB educational programmes and advocacy in support of family business.

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