The family is the foundation of the company

Among all the stupid communist slogans I used to hear when I was a kid, there was one I liked then and I still like it now: The family is the foundation of the state.

I always believed that families were the basic building blocks of any society, the foundations of education and mutual care. It makes me sorry to see that in the current post-modern society of sharing everything with everyone and unclear gender definitions family is being forgotten. The importance and strength of family can be seen also in the corporate world. Many of history's most successful companies can be called family businesses.

If we define a family business as one where the founders or their direct descendants own at least 20% of the shares or have at least 20% of the votes, then among the best-known publicly traded companies are included, for example, Alphabet, Facebook, Alibaba, Berkshire Hathaway, Samsung, Walmart, BMW, Oracle, Inditex, Heineken, and many others. All of these are very successful companies.

What is more important, however, is that over the long term family businesses fare better than do other companies. Two years ago, Credit Suisse put together data about shareholder returns for approximately 1,000 top companies in the world and determined that over the long term stock returns of family businesses surpass those from the shares of other companies. The difference for 2006–2015 was 4.5% per year. In ten years, that difference compounds to 55%.

The performance difference is the largest in family companies managed by the first or second generation. In such cases, the difference is about 9% per year. The gap diminishes with each successive generation. The better performance of family businesses is visible in various countries and on various continents as well as in all industries, and it is independent of company size. Moreover, the shares of these companies are not more expensive on average than those of other companies.

Why do family businesses fare better? I would say there may be two reasons. The first one is the thesis that company founders are on average more capable than hired managers. This is quite possible. Establishing a company requires courage, vision, the ability to undertake risk, and certain managerial abilities. Because we only see the ones that succeeded, this sample of people can have really above-average characteristics.

But I think the second reason will be more probable. Family companies as a whole differ from others in their longer-term view, emphasis on financial strength, and their conservative methods of financing and of motivating managers that are closer to shareholders' long-term goals. All this means that allocating capital – one of the two main tasks of management – is usually more efficient, and in the long view this means faster accumulation of capital and faster growth in company value.

Our own investment experience supports this view. In companies which may be characterized as family businesses we see a truly long-term view and an effort for efficient capital allocation. On the other hand, we have seen the most serious managerial errors in companies with highly dispersed ownership, hired management, and excessive pressure for short-term results.

Today, we have 23 stocks in our portfolio. Twelve of these are companies managed by their founders or their direct descendants. In percentage terms, these account for 52% of our assets. The equities market allows everyone to be a co-shareholder and partner of a family in the diverse offer of family businesses traded on stock exchanges. In this way, an investor can put one's own property into the care of the world's most capable businesspeople and benefit from their abilities over the long term. That is the most beautiful thing about shares.

Invest with care!

Daniel Gladiš, 14 November 2017

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