Large family holding companies: undefined objects?

By

Jean Estin

Chairman & CEO, Estin & Co

After forty years of strong growth of the world economy and stock markets, the acquisitions and disposals resulting from industry restructurings have generated a significant number of large family holding companies, whose ambitions go beyond the mere risk diversification of their wealth.

Today in the United States, there are more than 900 family holding companies with more than 500 million dollars of assets, including 400 with more than 1 billion dollars of assets and 25 with more than 5 billion dollars (on average, the stake in the historical company represents less than 50% of the total). Globally, the number of these holding companies is growing by 18% per year.

Some of these holding companies, especially when they are newly created, have difficulty defining their positioning, their strategy, and therefore their organization.

What role?

Family holding companies often mix three investment categories within the same structure–the logic of each category is different; they need to be managed differently and their weighting should be regularly challenged:

- The rallying of family shareholders around the ownership of historic industrial stakes;
- A family office with classic wealth diversification assets (cash, real estate, equity shares, investments in external private equity funds);
- The direct investment category, organized as a private equity fund with internal and external capital, or as an evergreen fund.

The main challenge of those family holding companies is that they are created by entrepreneurs who must become financiers, with difficult changes in perspective and approach that it requires:

- Managing a diversified business portfolio, as opposed to developing a company generally specialized in one business;
- Developing expertise in a replicable value creation model, as opposed to the intimate knowledge of a business;
- Using the asset holding period and turnover as a value creation lever, as opposed to only developing one activity over time;
- Managing a holding company where the leaders of businesses in the portfolio have a high degree of autonomy, as opposed to being the CEO of one company, even it may be multi-business.

What positioning and what competitiveness?

Those family holding companies are therefore often less successful in terms of value creation than the historical companies from which they originated, at least in the first few years, because their leaders have difficulty recognizing that they are in a world just as competitive as the one

of "industrial" companies, but different. Because of that, their positioning and competitiveness are uncertain:

- Versus their more established competitors (private equity funds, other established investors);
- Versus industrial buyers chasing the same targets;
- Versus investment targets (increasingly sophisticated in their understanding of the investment world and their own needs);
- Versus their recruitment needs of small, high-caliber internal teams expecting competitive salaries compared to the market.

Their performance is often average and not consistent over time. Some successful holding companies have a TSR (Total Shareholder Return) of 25% per year or more; however the average of very diversified holding companies generates a TSR of 5%:

- The value creation thesis is uncertain or not applied systematically with all its implications;
- There is an inconsistency between the value creation plan, the optimal asset holding period and the anticipated TSR;
- The investments are made slowly, with many poorly focused internal analyses which are not followed up with decisions; with a lack of discipline in the criteria and the selection process;
- The investments are too small compared with the size of assets under management;
- It seems difficult to pay market prices for companies with high potential, narrowing investments to turnover or transformation theses;
- The generation of a systematic deal flow is too weak or the family holding company's presence is not credible enough;
- It is difficult to identify key value creation factors for portfolio companies and help the companies' management position themselves on those factors rather than merely providing an operational challenge;
- The expertise of internal teams is not consistent with the investment thesis;
- It is difficult to take into account major market and macroeconomic cycles in the management of the portfolio; there is great difficulty in letting go of investments once they have been made.

The investment world which they are facing is increasingly professional and competitive. Private equity alone represents 2% of the world economy (5% in the United States)[1]. It continues to grow strongly. Over the 2010-2019 period[2] it generated an average return of 15% per year.

Large private equity funds are clearly focused by sector and/or investment thesis. Funds specializing on one specific growth trend (a particularly well-adapted thesis in the 2000s and the 2010s), for example Vista in the US (technologies, software, digitalization), Waterland in Europe (aging population, leisure and luxury, outsourcing and performance improvement, sustainable development), or Advent worldwide (emerging countries in Asia and South America) generated average net TSRs of 23 to 30% per year for their investors over the 2000-2015 period.

Large family holding companies face a benchmark which is hard to match.

[1] Value of commissions, carried interest…

[2] Return to the investor net of fund commissions; 2007-2016.

What strategy?

The strategies of large holding companies that succeed in the long run are always based on three pillars:

- Strong knowledge of two or three businesses in the broader sense (consumer goods, retail, B2B services, high tech and telcos, health, capital intensive sectors…) and their success factors;
- A unique value creation thesis, reproduceable, professionally rolled out, and adapted to the long macroeconomic cycle of the moment (long-term growth, build up, transition and rebound, restructuring / turnaround, cyclical management…);
- Strong consistency between the value creation thesis, the management type and the asset holding period.

Hanson Trust, for example, generated an average TSR of 20% per year for 20 years in the 70s and 80s by focusing on the restructuring of diversified groups in semi-commodities (cement, building materials…) and in consumer staples (cigarettes…), with a focus on a few select levers: refocusing of activities, massive asset disposals, cash generation, cost restructuring, change of the management; average holding period of 2.5 to 3 years and quick asset turnover in the portfolio, in a context of high interest rates and low financial leverage.

Berkshire Hathaway has generated an average TSR of 20% over 55 years through three different investment theses, the most recent being less clear and with lower returns:

- *1964-1990*: "value" investments in restructuring, transformation and rebound in traditional industries: textile, utilities, publishing, food, financial services… The strategy was well-adapted to the business cycle (high inflation rates; sectors undergoing restructurings; value to short-term profit). The TSR was 27% per year (vs. 10% for the US stock market); the holding period was 5 years with exceptions. The only failure was the investment in textile, showing the risk of investing in sectors undergoing heavy restructuring: whatever the quality of the management and the investor, there can be no value creation.
- *1990-2008*: investments in long-term growth strategies adapted to a cycle of declining interest rates with strong valuations for companies with profitable long-term growth: internationalization of major leaders in consumer goods (Coca-Cola, McDonald's, Anheuser-Busch, Procter & Gamble…) and investments in financial services with strong growth over the period (going from 5.7% to 7.1% of US GDP between 1990 and 2007). The TSR was 14% per year (vs. 10% for the US stock market). The holding period rose to between 10 and 20 years.
- *2008-2020*: continuation of the investment strategy in long-term growth companies (Apple, Amazon…) combined with investments in cyclical or low-growth sectors (airlines, automotive…). The TSR fell to 12% per year (vs. 15% for the US stock market). *Berkshire Hathaway* did not believe in the previous period's growth strategy, or failed to remain focused on it, while the continuation of the economic cycle made it even more attractive.

Artal, the holding company of two Belgian families, has generated an average TSR of 15% per year since the sale of the Tirlemont sugar factories to Südzucker in 1989 with contrasted performance:

- Two investments made most of the value creation. They were in two growth trends within the agri-food industry, related to the original business: Weight Watchers (the $224 million invested 1999 had generated $4 billion to $5 billion in capital gains and accumulated dividends in 2012); to a lesser extent, Blue Buffalo (pet food) with around $2 billion of capital gains between 2006 and 2018;

- Weight Watchers after 2012, other investments in agri-food and investments in other sectors and investment theses (restructuring and rebound in textile; growth in biotechnologies or IT) have had a performance below the stock market average;
- Apart from two major exceptions (which largely offset the rest), the investment team of some 40 people has not managed to generate systematic and resilient value creation, due to a lack of a consistent investment thesis or sector focus.

For large evergreen family holding companies, the absence of constraints on the holding period is, at first glance, an advantage over traditional private equity funds. It makes it possible to invest in long-term growth strategies or in strong transformation theses followed by a rebound. In addition, family businesses are preferred targets (families talk to families).

But it is often a weakness as well. This lack of constraint gives the illusion that time is widely available to wake up sleeping beauties which were bought cheap. This thesis also requires expertise of a different nature (operational and strategic) and is complex to implement. A lag of a year or two in implementing the transformation levers or a poor assessment of the rebound potential in the company's strategic context irretrievably ruins the expected TSR.

Similarly, in long-term growth investments, a misunderstanding of the realistic duration of the growth and the levers to make it happen often mean that the high entry multiples cannot be maintained.

Time on hand does not replace the necessary expertise in identifying and accurately implementing value creation levers and in understanding the strategic context of the business.

What future?

Competitiveness and performance apply for investors and companies alike. The large "long-term shareholder" industrial equity funds of the 1970s and 1980s quickly gave way to the more adapted and efficient private equity model.

Are large family holding companies, which are currently experiencing strong growth, a competitive alternative model? Which ones will remain defining players in the industry landscape? And which ones will only be a transition between the ownership of high performing industrial companies for two to three generations to ultimately a diluted shareholding on the stock market?

Jean Estin

February 2021

Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists the management of major European, North American and Asian groups in their long-term growth strategies, as well as private equity funds in the analysis and valuation of their investments.

PARIS – LONDON – ZURICH – NEW YORK - SHANGHAI
3, RUE DU DOCTEUR LANCEREAUX - 75008 PARIS
TEL.: +33 1 56 59 87 87 – FAX: +33 1 56 59 87 88 – https://estin.com