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# Family Ownership Is No Bar To Creditworthiness In Europe


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# Family Ownership Is No Bar To Creditworthiness In Europe

Companies with family owners are common in Europe and the rest of the world and are a diverse group in terms of size, geographic footprint, and industry exposure. According to the European Central Bank (ECB), these businesses make up more than 60% of all European companies. Standard & Poor's Ratings Services rates only a fraction of these: rated family owned companies make up just 12% (92 in total) of our nonfinancial corporate ratings in Europe, the Middle East, and Africa (EMEA).

There have been numerous studies commenting on the effect of family ownership on a company's performance and in this report, we analyze whether there is a link between this type of ownership and creditworthiness. Based on the sample of companies that we've analyzed (which excludes utilities, project finance entities, financial services companies, and corporate securitizations), we make three observations: First, the credit factors for rated family owned companies seem to be on average marginally better than for rated corporates as a whole. Second, there is no systematic positive or negative bias on creditworthiness based purely on family ownership. Third, our sample of rated family owned companies shows a wide disparity in terms of credit characteristics.

**Overview**

- The median rating of a family owned company in our public portfolio is marginally higher, at 'BB+', than that of our overall nonfinancial corporate rated portfolio in EMEA ('BB'). That said, there are fewer family owned companies in the 'BBB' and 'B' categories compared with our rated issuer base as a whole.
- Our rating transition statistics show that family owned companies have displayed greater resilience over the past five years versus our entire rated portfolio. However, the number of family owned companies in this group is small compared to the overall issuer group, so we would need to confirm these trends over the next economic cycle as the universe of rated family owned companies expands.
- The management and governance (M&G) of family owned companies is marginally better than for rated issuers overall, with 18% of companies assigned a "strong" M&G score, compared with 13.1% for our rated issuer base in EMEA.
- On the credit negative side, family owned businesses are susceptible to succession planning issues and have less flexibility with regard to new equity issuance.
- Rated family owned companies are a diverse group in terms of size, industry, and country of incorporation, and there is no systematic positive or negative impact on creditworthiness from such ownership compared with our rated issuers as a whole.

On the credit positive side, we generally find that family owned companies have a longer-term investment horizon and more conservative business strategies than their publicly listed peers. Our rating transition data show that there is higher rating stability for family owned companies compared with our overall credit portfolio in EMEA. And when assessing management and governance (M&G)-–which is a broad range of oversight and direction conducted by an enterprise's owners, board representatives, executives, and functional managers-–we find that there is a higher percentage of family owned companies in the top category compared with the total rated portfolio. Family owned companies also have slightly less leverage, particularly in the broad 'B' category, which is typically dominated by private equity-owned companies.

However, family ownership can also carry credit negatives compared with listed public companies, including "key man" risk, succession planning, and less flexibility with regard to issuance of new equity. In terms of financial policy, our view is very dependent on the company situation, as there is a wide variation in family owned companies' views on leverage and dividend policies.

## Marginally Better Credit Quality, But Some Meaningful Disparities

For the purpose of this article we use the definition of family ownership set out by the ECB (see Note), namely that a firm, of any size, listed or unlisted, is a family business, if:

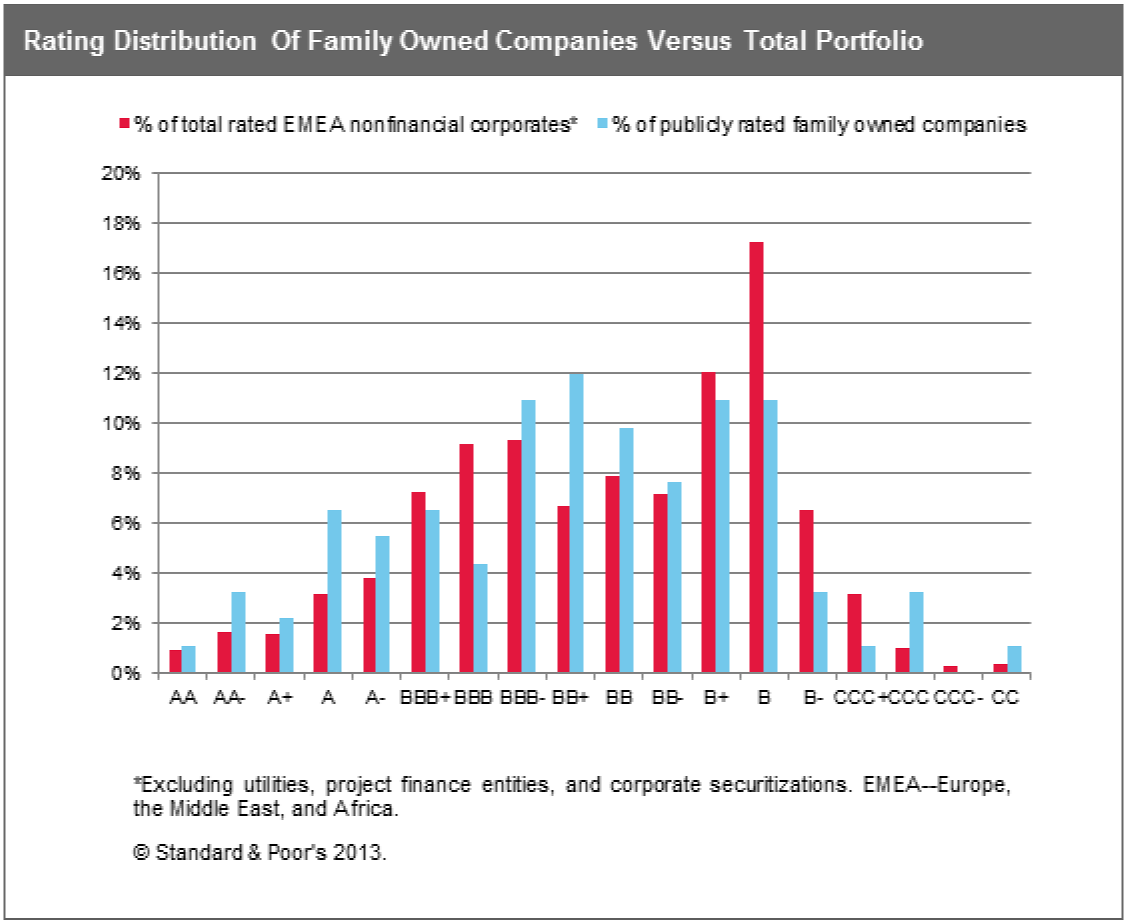
- The majority of decision-making rights (indirect or direct) is in the possession of the natural person(s) who established the firm, or in the possession of their spouses, parents, child, or children's direct heirs.
- At least one representative of the family or kin is formally involved in the governance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

Of the 784 companies to which we assign ratings (excluding utilities, project finance entities, financial services companies, and corporate securitizations) in EMEA, only 92 fall within this definition of family ownership. This group is diverse in terms of size, geographic footprint, and industry exposure. Contrary to the perception that family businesses must be small, almost 50% of the 92 companies are large multinational businesses with revenues of greater than €5 billion-equivalent and 36% have outstanding total debt of greater than €3 billion-equivalent.

There is a slightly higher median rating within the family owned companies' group compared with our control group of all the companies that we rate in EMEA. For firms with family ownership, the median rating is 'BB+', compared with 'BB' for the rated issuer base. There are also meaningful deviations within the broad distribution when comparing the two groups, in both specific rating categories and within industry groups.

As regards to specific rating categories, the first difference is that there is a lower percentage of companies with family ownership in the broad 'B' category (see chart 1 and table 1). We believe this is due to the high and increasing number of private equity-owned leveraged buyout companies (LBOs) that we rate.

**Chart 1**




## Rating Distribution Of Family Owned Companies Versus Remainder Of EMEA Nonfinancial Corporate Portfolio*

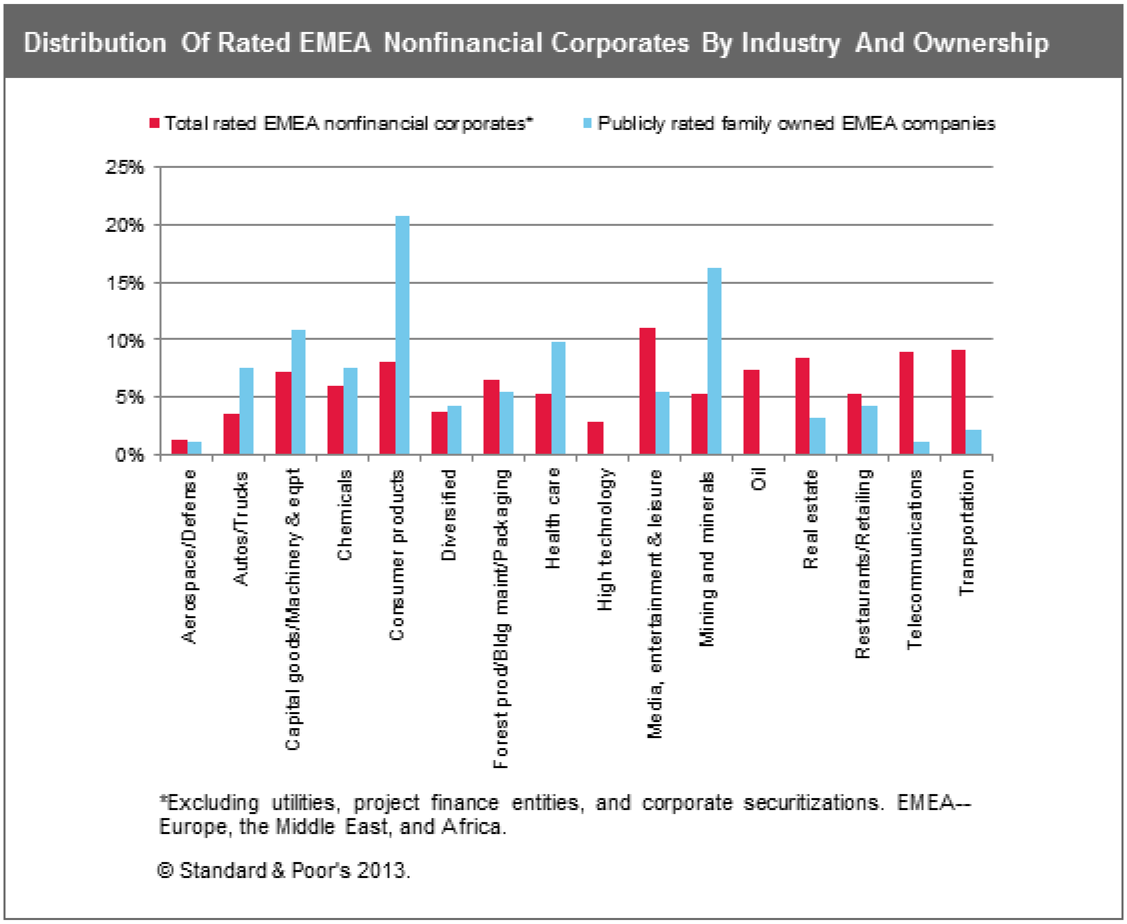
**Table 1**

| Rating category | No. of family owned companies | Percentage distribution | No. of corporates* excluding family owned | Percentage distribution |
|---|---|---|---|---|
| Investment grade | 37 | 40% | 252 | 42% |
| Speculative grade | 55 | 60% | 440 | 58% |
| AAA/AA | 4 | 4% | 16 | 2% |
| A | 13 | 14% | 54 | 8% |
| BBB | 20 | 22% | 182 | 26% |
| BB | 27 | 29% | 143 | 21% |
| B | 23 | 25% | 257 | 37% |
| CCC/CC | 5 | 6% | 33 | 5% |
| Total | 92 | | 692§ | |

*Excluding utilities, project finance entities, and corporate securitizations. EMEA--Europe, the Middle East, and Africa. §Total includes those entities that have 'D' (Default) and 'SD' (Selective Default) ratings.

The second difference between our family owned rated dataset and the wider issuer base is that there is a lower proportion of 'BBB' rated companies, but a higher number of those rated 'BB'. In our view, this is because family ownership is more prevalent in some industries than others. For example, rated family businesses are rare in industries with a high proportion of 'BBB' rated companies, such as media and entertainment, telecommunications, and transportation (see chart 2).

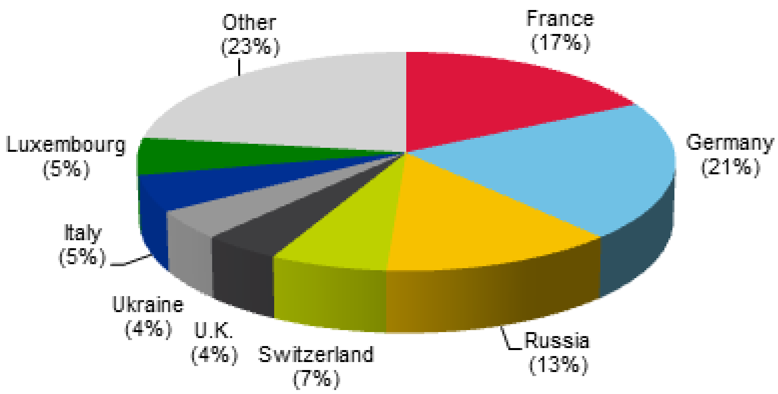
**Chart 2**




Geographically, we observe that in our dataset of family owned companies, the highest percentages by country are located in Germany, France, and Russia (see chart 3). In our total publicly rated issuer base, by contrast, the highest concentration by country is in the U.K., followed by France and Germany (see chart 4). One of the reasons for the higher concentration of 'BB' category credits is because the family owned dataset has more exposure to countries like Russia and the Ukraine and the attendant higher country risk of operating in these countries.

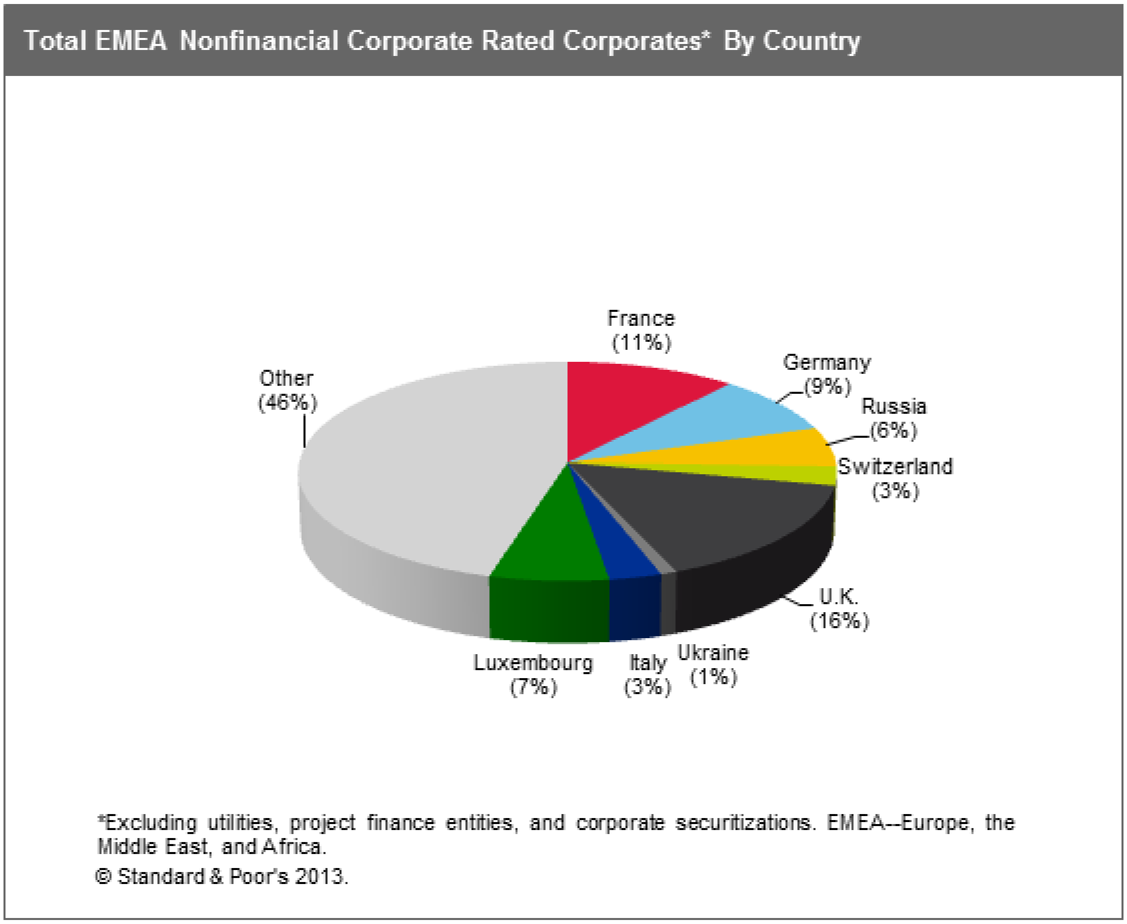
**Chart 3**

EMEA Publicly Rated Family Owned Companies By Country




EMEA--Europe, the Middle East, and Africa.

**Chart 4**




## Ratings Resilience Shows Relative Performance

We often hear that family owned businesses take a longer-term view because owner families want to transmit the business to the next generation. This often translates into more defensive business strategies: During more difficult economic downturns, these firms tend not to react with large-scale layoffs and drastic investment cutbacks. Similarly, during upswings in the business cycle, these firms seldom initiate rapid expansion, expensive hires, and large capital outlays.

There have been various studies trying to understand the effect of this behavior on performance. Standard & Poor's contribution to this debate is to measure the potential effect of the aforementioned characteristics through rating transitions. We've looked at the rating transition of family owned companies over the past five years and compared this to our total rated nonfinancial corporate portfolio in EMEA. There were 49 family owned companies we were able to include that were consistently rated throughout the past five years, versus 365 credits in the total study during the same time period. Companies where ratings were withdrawn have been excluded. The results of our transition study should be viewed in the context that the dataset of family owned companies is small in comparison to the total portfolio.

In each broad rating category, the ratings on family owned companies were more stable, apart from those at the 'BBB' level (see tables 2 and 3). We believe the reason this latter group had less stability is due to the larger percentage of "fallen angels"--that is, companies downgraded to speculative grade ('BB+' or lower) from investment grade ('BBB-' or higher). For the total portfolio, 18% of 'BBB' credits were downgraded to either the 'BB' or 'B' broad categories, compared with 24% of family-owned businesses. Based on anecdotal evidence, we believe this this could be because family companies can take on more aggressive financial policies (through an acquisition, for instance) and then do not have the flexibility to issue equity. However, this is not something we believe is systematic. More often it's external economic and industry factors causing the downgrades–-factors that could also affect public listed companies.

**Table 2**

**Five-Year Rating Transition for EMEA Corporates***

| Rating | No. of issuers | AA | A | BBB | BB | B | CCC | CC | C | D |
|---|---|---|---|---|---|---|---|---|---|---|
| AA | 25 | 0.60 | 0.40 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| A | 72 | 0.03 | 0.63 | 0.33 | 0.00 | 0.01 | 0.00 | 0.00 | 0.00 | 0.00 |
| BBB | 134 | 0.00 | 0.10 | 0.70 | 0.17 | 0.01 | 0.00 | 0.00 | 0.00 | 0.01 |
| BB | 74 | 0.00 | 0.00 | 0.28 | 0.45 | 0.18 | 0.01 | 0.01 | 0.00 | 0.05 |
| B | 60 | 0.00 | 0.00 | 0.08 | 0.13 | 0.48 | 0.03 | 0.02 | 0.00 | 0.25 |
| Total | 365 | | | | | | | | | |

*Excluding utilities, project finance entities, and corporate securitizations. EMEA--Europe, the Middle East, and Africa Source: Standard & Poor's CreditPro©.

**Table 3**

**Five-Year Rating Transition For EMEA Family Owned Companies**

| Rating | No. of issuers | A | BBB | BB | B | CCC | CC |
|---|---|---|---|---|---|---|---|
| A | 11 | 0.73 | 0.18 | 0.09 | 0.00 | 0.00 | 0.00 |
| BBB | 17 | 0.18 | 0.59 | 0.18 | 0.06 | 0.00 | 0.00 |
| BB | 14 | 0.00 | 0.29 | 0.64 | 0.07 | 0.00 | 0.00 |
| B | 7 | 0.00 | 0.00 | 0.00 | 0.71 | 0.14 | 0.14 |
| Total | 49 | | | | | | |

EMEA--Europe, the Middle East, and Africa.

## Management And Governance Is A Strength

In addition to more stable rating performance, our analysis indicates that family controlled businesses exhibit slightly stronger M&G scores as a group, with 18% assigned a "strong" score, versus 13.1% for our rated issuer base (see charts 5 and 6). We define M&G as the broad range of oversight and direction conducted by the owners of an enterprise, covering board representatives, executives, and functional managers. We look at their strategic competence, operational effectiveness, and ability to manage risks, all of which shape a company's competitiveness in the marketplace and credit profile.

Of our 662 EMEA-based publicly rated issuers, 87 (13.1%) scored "strong," 287 (43.4%) "satisfactory," 271 (40.9%) "fair," and 17 (2.6%) "weak." This data is drawn from our published report on M&G scores for EMEA issuers, which includes utilities. For more information, see "Standard & Poor's Assigns Management And Governance Scores To

More Than 600 Nonfinancial Corporates In EMEA," published May 13, 2013, on RatingsDirect.

**Chart 5**

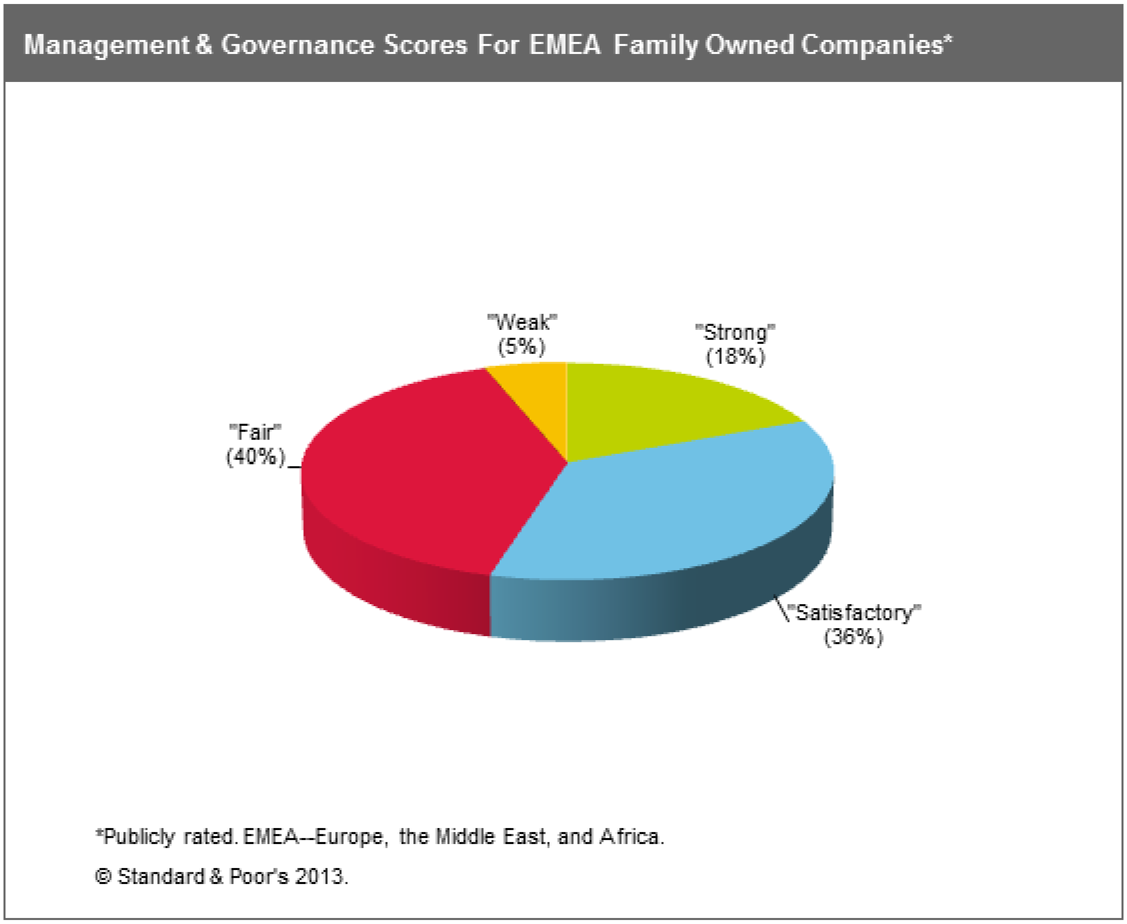
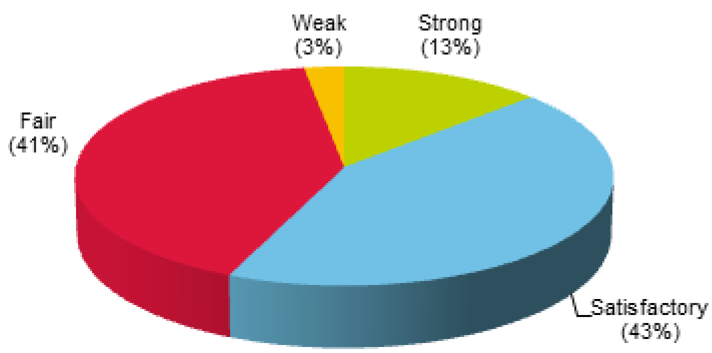


**Chart 6**

**Management & Governance Scores For Rated EMEA Nonfinancial Corporates**




EMEA--Europe, the Middle East, and Africa.



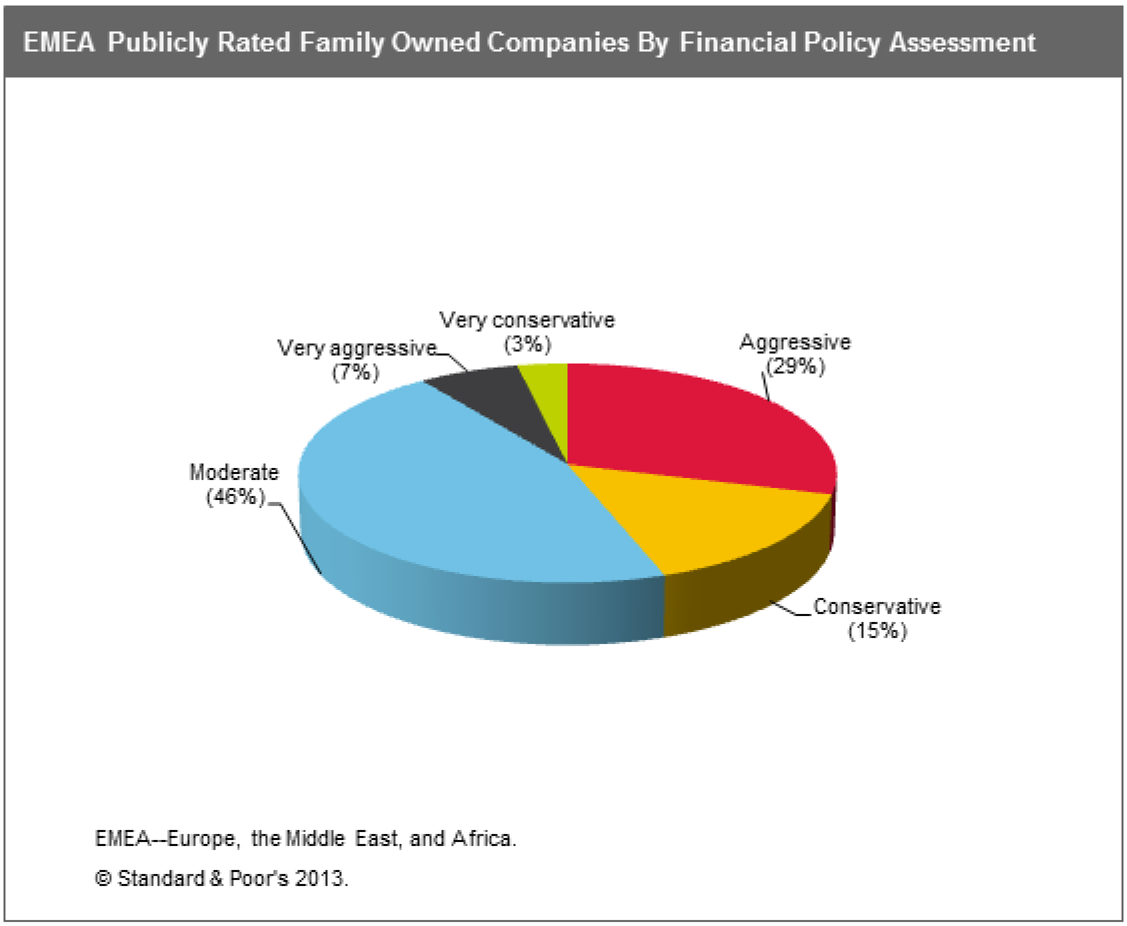
The specific factors that we consider when assessing M&G scores for family owned companies include whether or not ownership and management is separated, the level or formalization of oversight or corporate governance, and the stability of management. For example, closely held and family owned companies are generally less likely than widely held public corporations to appoint a majority of independent directors to the board. On the other hand, risks that can arise due to the separation of ownership and management may be less prominent where owners take an active part in management oversight, since family owners are less beholden to the short-term sentiments of the equity markets.

A specific issue related to family businesses is that of "key man" risk, when there is dominant figure running the business. In that case, the presence of a clear succession plan would be a major aspect of our management and governance review. Family owned companies can also face succession issues. The loss of key personnel can significantly disrupt operations and cash flow; and tax burdens (in the form of death duties) can also arise when passing shares from one generation to another. (For more details on our criteria for mid-market family owned companies, see "Mid-Market Evaluation: Definition And Scale," published June 24, 2013.)

## Financial Policies Show The Biggest Area Of Variation

We attach great importance to management's financial policy, which forms part of our financial risk assessment. In our view, more sophisticated business managers have policies that recognize cash flow parameters and the interplay between business and financial risk (see "2008 Corporate Criteria: Analytical Methodology," published April 15, 2008). Although we can make generalizations regarding the financial policies of family owned companies, this group is heterogeneous. For example, there is a big variation in financial policy among our rated group of companies under family ownership (see chart 7).

**Chart 7**




Auto component supplier Robert Bosch GmbH, for instance, has a very conservative financial policy according to our analysis. The group has a track record of low leverage, exceptional liquidity, and credible commitment to maintaining a conservative financial structure. French starch and sweeteners manufacturer Roquette Freres similarly has a very conservative financial policy, in our opinion, with solid metrics and either a net cash position in recent years (2009-2011) or very low net debt (we projected only €100 million of net debt for 2012, and no significant change thereafter). And Fredrik Lundberg, who along with his family, controls L E Lundbergföretagen AB, is well-known in Sweden for his financial conservatism and aversion for debt. By contrast, other family owned companies have become more aggressive in their financial policies and as a consequence compromised their credit quality--as is evident in the large percentage of family-owned "fallen angels" now in the 'BB' rating category, which includes French investment company Wendel and German holding company Franz Haniel & Cie GmbH.

## Leverage Is Slightly More Measured, But Broadly Similar

There is a wide held believe that in general, family owned companies are less leveraged than publicly listed firms of similar size. Our data overall show a slightly less leveraged profile for family owned companies. But apart from the broad 'B' category, which is dominated by LBOs when we compared median debt-to-EBITDA Standard & Poor's-adjusted leverage ratios for our entire rated portfolio against the medians for family owned companies, we found that there was no significant difference (see table 2).

**Table 4**

**Median Debt-To-EBITDA Ratios Of Publicly Rated Family Owned Companies Versus All Rated EMEA Nonfinancial Corporates***

| | --Fiscal year-end 2012-- | | |
|---|---|---|---|
| **Rating category** | **Median debt-to-EBITDA of publicly rated family owned companies** | **Median debt-to-EBITDA ratios of all rated EMEA industrial corporates*** | **Median three-year averages (2009-2011) for all rated EMEA industrial corporates§** |
| **AA** | 0.6 | 1.0 | 1.0 |
| **A** | 1.1 | 1.7 | 1.6 |
| **BBB** | 2.3 | 2.4 | 2.4 |
| **BB** | 3.4 | 3.5 | 3.4 |
| **B** | 4.2 | 5.6 | 5.6 |

*Excludes utilities, project finance entities, and corporate securitizations. §According to Standard & Poor's CreditStats. EMEA--Europe, the Middle East, and Africa.

### Financial caution prevails

But the difference for companies within the broad 'B' category highlights the contrast between family owned companies in this category and the more typical 'B' rated companies, which are usually private equity-owned. Unlike private equity owners, a large concentration of a family's wealth may be tied up in a smaller family owned company, leading the family to be inherently more cautious than a financial sponsor would be. Also, family owners may be constrained when it comes to accessing finance, particularly if they depend on bank loans and do not have access to the debt capital markets (although this is not true of our sample of publicly rated family owned companies).

Many family owned companies in our study remain in the 'B' category because their ratings are constrained by their business risk profiles--the largest percentage (60%) of which we consider to be "weak." According to our ratings criteria, it is unlikely that we would assign a rating higher than 'BB' if a company has a "weak" business risk profile (see table 5). In addition, the ratings on family owned companies in the 'B' category are constrained by country risk. In our opinion, 42% of these 'B' category credits have high exposure to emerging market risk.

**Table 5**

Business And Financial Risk Profile Matrix

| Business Risk Profile | --Financial Risk Profile-- | | | | | |
|---|---|---|---|---|---|---|
| | **Minimal** | **Modest** | **Intermediate** | **Significant** | **Aggressive** | **Highly leveraged** |
| "Excellent" | AAA/AA+ | AA | A | A- | BBB | -- |
| "Strong" | AA | A | A- | BBB | BB | BB- |
| "Satisfactory" | A- | BBB+ | BBB | BB+ | BB- | B+ |
| "Fair" | -- | BBB- | BB+ | BB | BB- | B |
| "Weak" | -- | -- | BB | BB- | B+ | B- |
| "Vulnerable" | -- | -- | -- | B+ | B | B- or below |

These rating outcomes are shown for guidance purposes only. Actual rating should be within one notch of indicated rating outcomes.

### External funding sources can be limited

In general, family owned companies are more dependent on bank loans, and have limited access to the public equity markets compared with other corporates that we rate. Although most rated family owned companies have good access to the European capital markets, we cannot draw too many conclusions from that. Companies that choose to obtain a rating tend to have larger financing requirements than those that do not, and often make this choice with the intention of tapping the capital markets for liquidity.

Potential access to the equity markets can be a source of funding for listed companies and provides an element of financial flexibility. For family owned businesses, wider equity ownership can conflict with their goal of independence and control over the company because it means outside shareholders are likely to exert greater influence on decision-making. On the other hand, we find that family owned companies tend to nurture relationships with their lenders. For example, German holding company Franz Haniel communicates extensively on its financial health and strategic undertakings for the sole benefit of its debt investors because the company is unlisted.

### Dividend policies vary greatly

Overall, there is a wide variation in dividend policies between the family owned companies that we rate. For some, net profits generated tend to be redeployed in the business and the risk of sudden and material shareholder remuneration payouts can be relatively low, when compared to listed companies (particularly large listed firms). That said, dividend policy is clearly influenced by the controlling families' financial standings. For example, we understand that the Koç family (Koç Holding A.S.) has ancillary assets on top of the main family vehicle, and is not that dependent on dividend streams.

## No Systematic Positive Or Negative Bias On Ratings

Family owned companies in EMEA with a credit rating are heterogeneous with a large variation in size, a wide range of financial policy approaches and a broad spectrum of management and corporate governance practices. From our experience, ratings on family owned companies have proven to be relatively more stable than the rated nonfinancial corporate issuer base as a whole. At a given rating category, we observe that family owned companies have marginally less leverage, and on the whole, stronger-than-average M&G scores. However, comparing rated family owned companies with their publicly held counterparts, we conclude that family ownership structure does not have a systematic positive or negative bias on creditworthiness.

***The authors would like to acknowledge the contributions of Mona Kim, Holger Gromer, and Umberto Ciangherotti in the preparation of this article.***

## Note

More details on the ECB's definition of a family business can be found at http://ec.europa.eu/enterprise/policies/sme/promoting-entrepreneurship/family-business/index_en.htm

## Related Criteria And Research

The articles listed below are available on RatingsDirect.

- Mid-Market Funding: Q&A: How The Development Of Private Placement Financing Could Aid Mid-Market Companies In Europe, July 18, 2013
- Mid-Market Evaluation: Definition And Scale, June 24, 2013
- Standard & Poor's Assigns Management And Governance Scores To More Than 600 Nonfinancial Corporates In EMEA, May 13, 2013
- Underwriting The Recovery: Europe's Mid-Market Seeks New Ways To Fund Growth, April 22, 2013
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008