

The «strategic value» of family firms' governance: The Italian example

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- I. Why governance is important (also) in (private) family firms
- II. The Italian example: evidence from the Bocconi AUB Observatory
 - The governance success models
 - Governance and strategy
 - Governance and generational transitions
- III. Conclusions

Why governance is important in family firms

- In family firms, especially if private, corporate governance is considered - alternatively:
 - A burden that only listed companies should follow due to their access to a regulated market;
 - Hence, the «hidden cost» of listing;
 - A set of rules slowing down the decision-making process.
- But...corporate governance is the «architecture» of all firms. Without clear governance is impossible to make operations such as:
 - Changes in organizational structures
 - Generational transitions
 - Hire of external managers
- Also, a balance governance structure helps to reflect on the long-term vision of the company
- Finally, there is still scarce culture of governance in private family firms' context.

The Italian example: Evidence from the AUB Observatory



1. The governance «success» models



The AUB population of the 8° edition

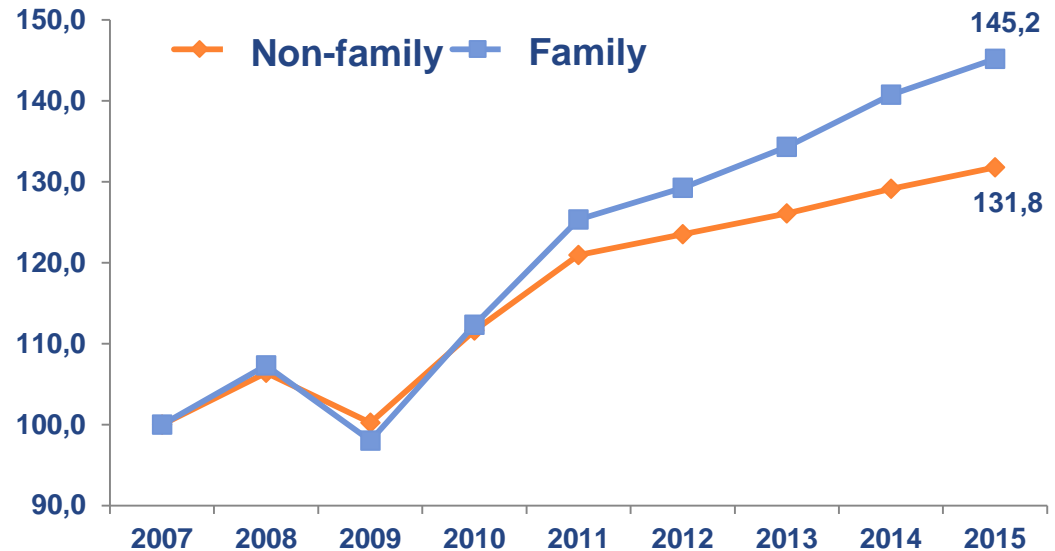
Ownership structure	Small *		Medium-Large **		Total	
	N	%	N	%	N	%
Family firms	6.149	70,5%	4.242	59,2%	10.391	65,4%
Branches of foreign companies	1.181	13,5%	1.494	20,9%	2.675	16,8%
Coalitions	450	5,2%	476	6,6%	926	5,8%
Cooperatives and Consortia	533	6,1%	382	5,3%	915	5,8%
State/Local authorities	255	2,9%	347	4,8%	602	3,8%
Controlled by Investment Funds/ PE	91	1,0%	158	2,2%	249	1,6%
Controlled by Banks/Insurance	47	0,5%	61	0,9%	108	0,7%
Controlled by Foundations	11	0,1%	1	0,0%	12	0,1%
Public companies	0	0,0%	2	0,0%	2	0,0%
<i>Total</i>	8.717	100,0%	7.163	100,0%	15.880	100,0%

(*) Small: firms with revenues between 20 e 50 mln at the end of 2014 (source: Aida).

(**) Medium-Large: firms with revenues exceeding 50 mln at the end of 2014 (source: Aida).

The growth trend in medium and large firms

The medium-large family firms have grown more than non-family firms

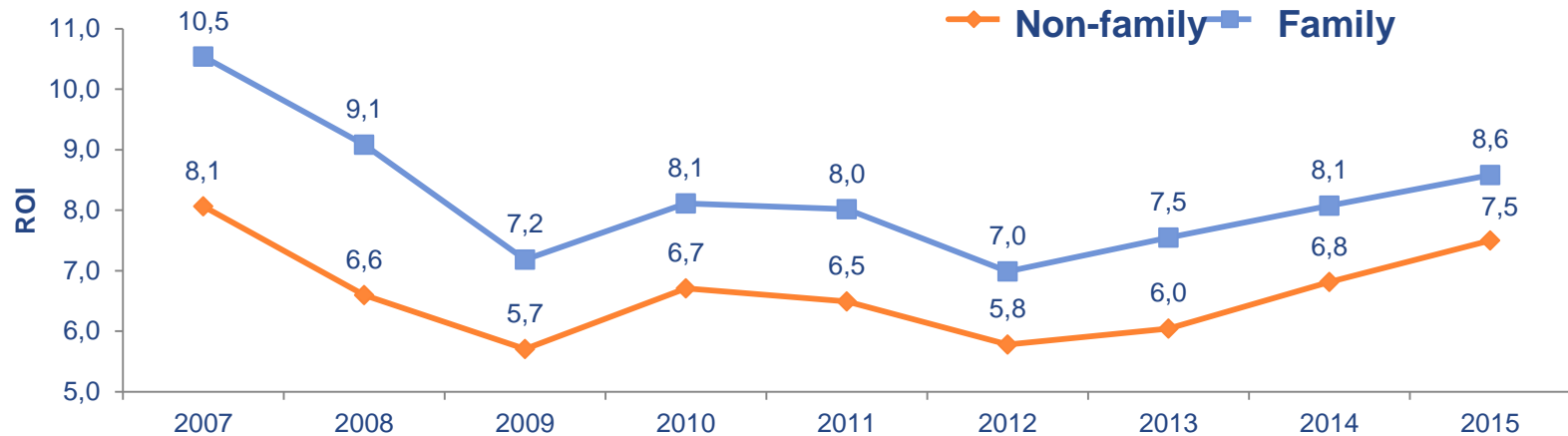


Non-Family (>50)	2007	2008	2009	2010	2011	2012	2013	2014	2015
Coalitions	100	110	105	120	132	137	140	144	146
Cooperatives and Consortia	100	112	112	121	129	134	138	138	140
Controlled by Investment Funds/PE	100	101	96	107	119	122	123	129	134
State or Local Authorities	100	109	114	122	127	130	135	130	126
Branches of foreign companies	100	104	95	106	116	117	118	122	125

(*) Cumulative growth (100 in base year 2007), calculated on the basis of sales revenues growth rates (source: Aida). Cumulative growth for non-family firms has been calculated as the weighted average of sales revenue growth rates of non-family firms with different ownership structures.

Operating profitability in medium-large firms

Medium and large family firms continue to maintain a positive gap of operating profitability...

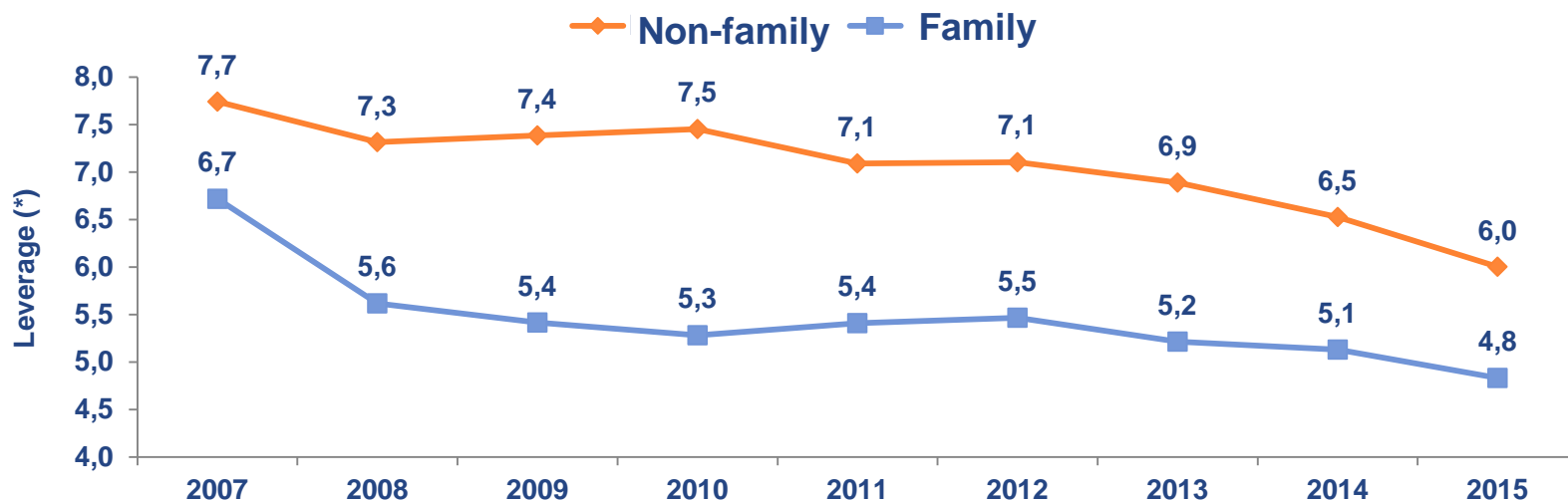


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Non-Family (>50)	2007	2008	2009	2010	2011	2012	2013	2014	2015
Branches of foreign companies	9,1	7,0	5,8	7,5	7,3	6,8	6,9	7,9	9,0
Coalitions	8,9	8,0	6,6	7,9	7,0	6,1	6,1	6,9	7,5
Controlled by Investment Funds/ PE	6,6	7,1	4,7	4,9	4,6	4,2	5,0	6,0	6,6
State or Local Authorities	5,3	4,7	6,1	6,3	5,6	4,3	5,7	6,8	5,2
Cooperatives and Consortia	5,6	4,7	4,2	3,7	3,8	3,0	3,1	3,5	3,3

Debt ratio in medium and large firms

Even in 2015 there is a decreasing debt trend both in family and in non-family firms

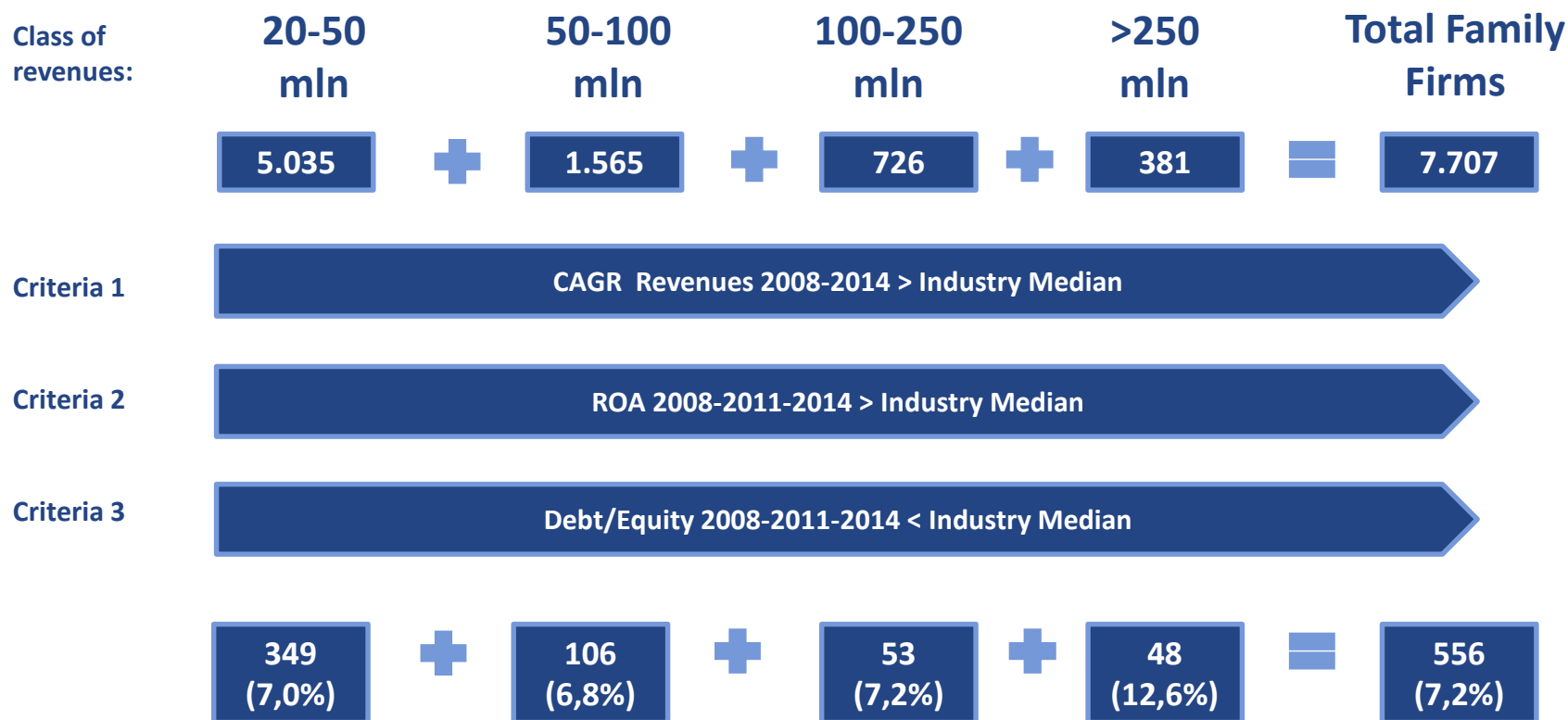


Non-Family (>50)	2007	2008	2009	2010	2011	2012	2013	2014	2015
Cooperatives and Consortia	11,3	10,0	10,9	10,8	10,1	10,5	10,5	11,1	9,8
Coalitions	8,4	7,0	7,0	7,0	7,0	6,4	6,4	5,9	6,2
Controlled by Investment Funds/PE	8,3	7,9	7,8	7,3	6,0	6,7	6,4	7,1	6,1
State or Local Authorities	8,1	8,5	8,0	7,5	7,4	7,5	7,9	7,3	5,9
Branches of foreign companies	6,8	6,7	6,7	6,8	6,5	6,6	6,3	5,7	5,3

(*) Leverage= Total Assets/Equity (source: Aida). The ratio for non-family firms is a weighted average of the ratios of all firms with a non-family ownership structure.

The selection criteria

Starting from **more than 7,700 family firms** of the AUB Observatory with revenues exceeding € 20 million, we identified **556 companies** that show financial performance higher than their industry median with respect to three indicators*:



(*) For more information about the selection criteria of 7,707 family firms out of 10,391, see the methodological note.

«Successful» family models

According to “FsQCA“ method of analysis, family firms of the AUB Observatory were analyzed to understand whether and to what extent the 556 companies identified have adopted different models of governance*.

The variables considered for identification of successful governance models are as follows:

- **Leadership:** family *versus* non-family manager;
- **Openness towards non-family members :** 100% family directors *versus* at least 1 non-family director;
- **Leader’s generation:** first *versus* following ones;
- **Leader’s age:** young (< 50 anni) *versus* non-young (> 50 anni);
- **Business size :** small (revenues < 50 mln €) *versus* medium-large (revenues > 50 mln €).

(*) FsQCA (Fuzzy Set Qualitative Comparative Analysis): comparative qualitative analysis technique that uses algebra to implement comparative standards used in qualitative studies of macro-social phenomena.

«Successful» family models

Combining the previous governance variables according to the "FsQCA" methodology, **three main "successful" models** have been identified:

	Good Founder	Close	For the growth
Leader's age	NOT YOUNG	-	YOUNG
Business size	-	SMALL	MEDIUM-LARGE
Founder	YES	-	NO
BoD	CLOSE / OPEN	CLOSE	OPEN
Leadership	F	F	F / NF

- In the first generation companies, the founder fosters the company's success with any model of governance.
- In subsequent generations, the openness towards both Board and leadership positions as well as the younger leaders are able to favor growth.
- Success is also possible with a "closed" model towards non-family members, but only in business contexts of limited size.

First implication.

Family firms can be very successful. But their governance should be carefully designed («tailor made» process)



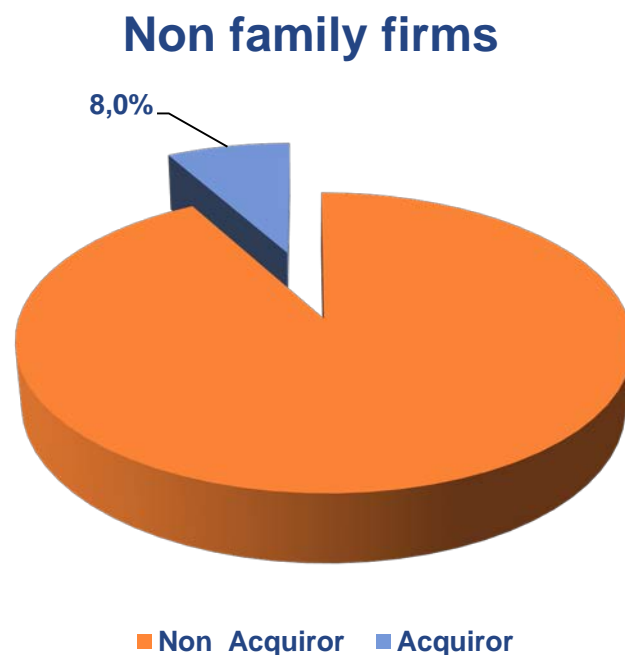
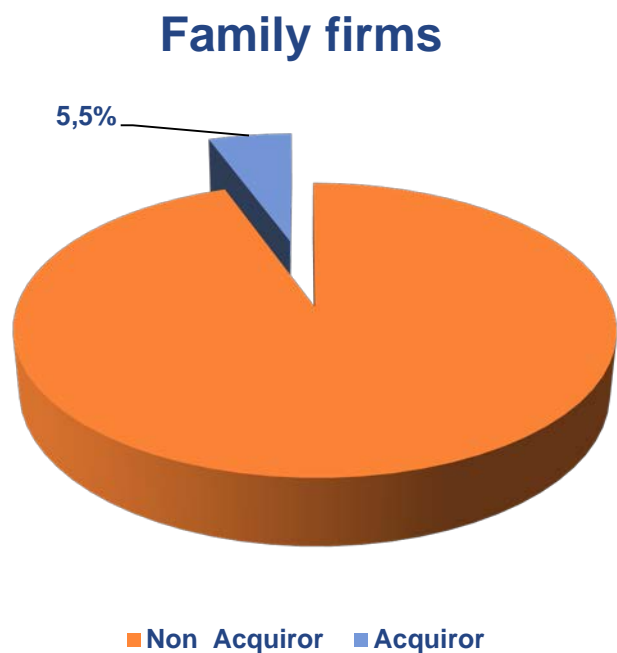
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Acquirors

The analysis concerns acquisitions and JV carried out by both family and non-family firms with revenues exceeding € 20 million in the period 2000 – 2015.

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% Acquirors*

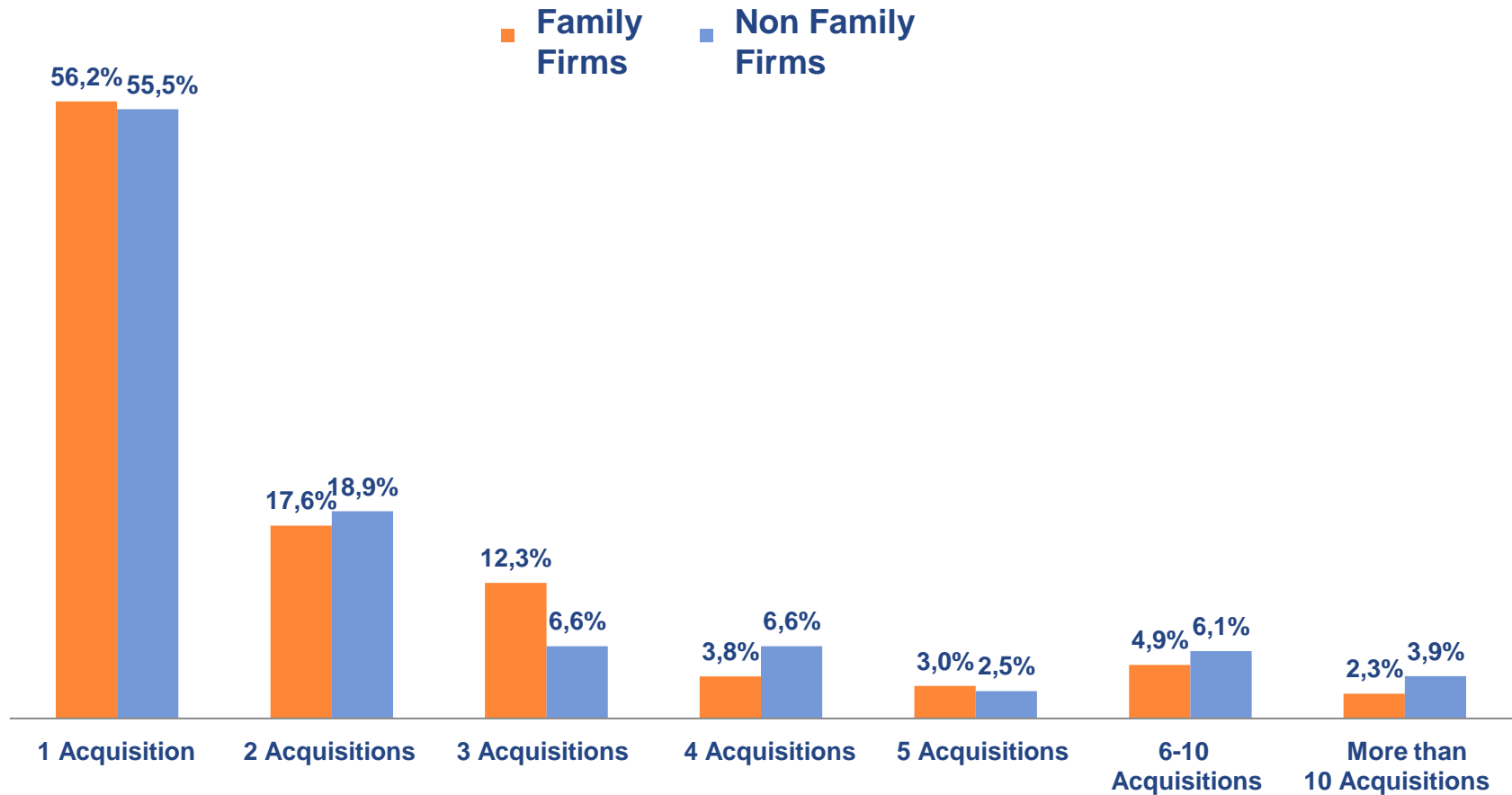


* The analysis is based on all operations of control acquisition (at least 50% of the target company or 100% in case of Joint Venture).

Frequency of acquisitions

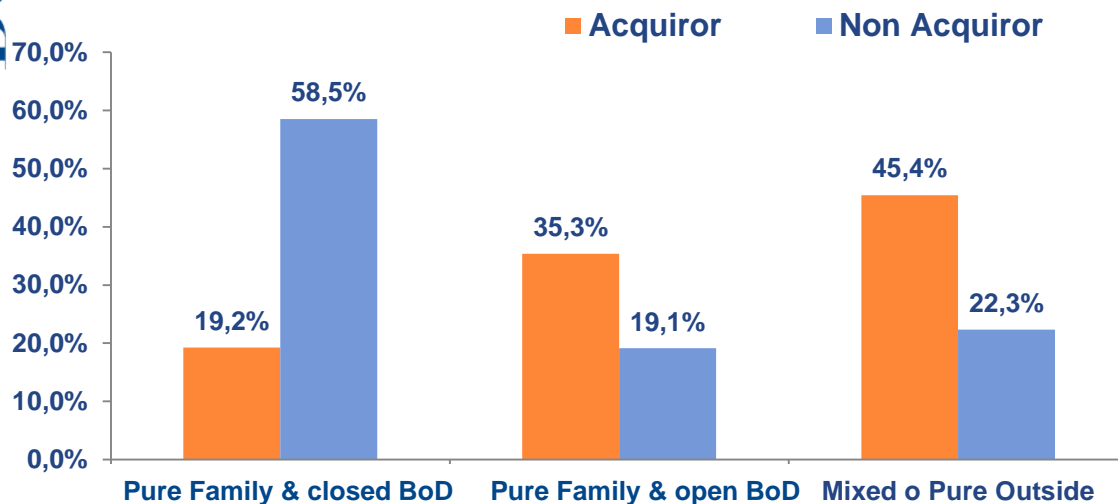
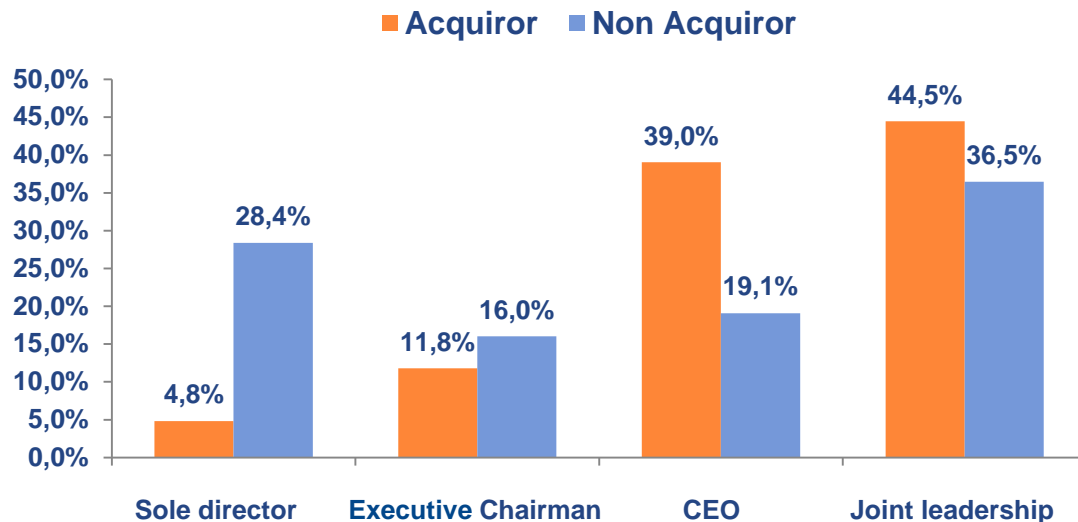
More than half of the firms made only one acquisition in the period 2000-2015

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Leadership models and openness of Acquirors

Structured leadership models are most common in companies that carry out acquisitions

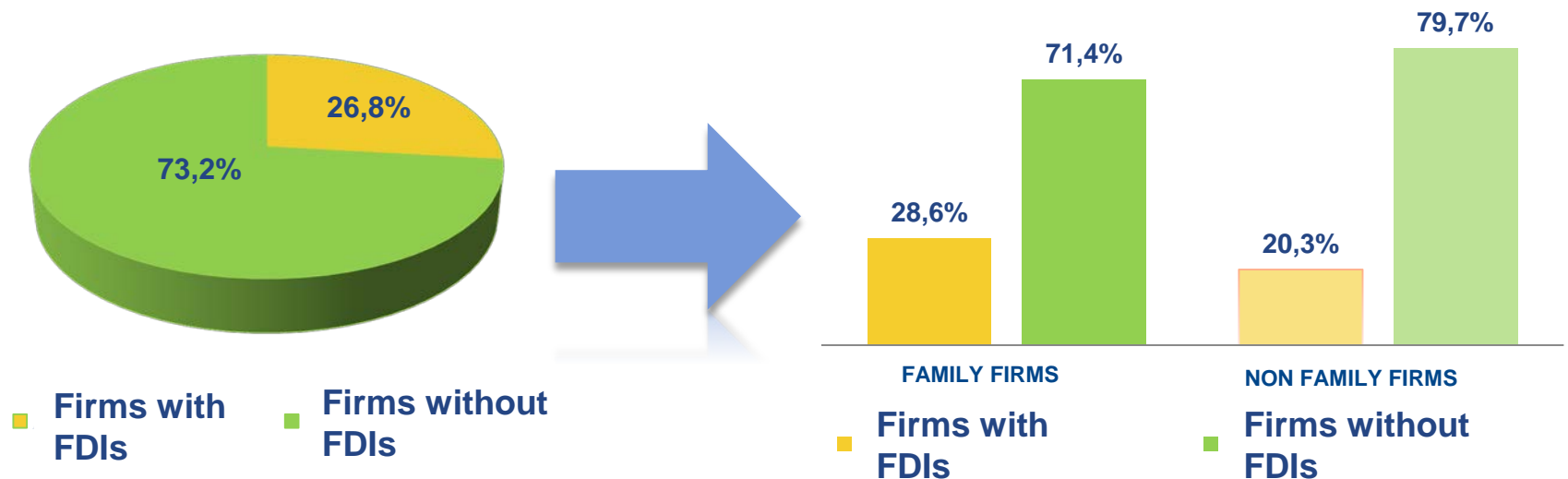


Models of governance open towards non-family members are more common in companies that carry out acquisitions

Foreign Direct Investments

- 28% of AUB companies has carried out at least one FDI*
- Family firms implement an internationalization strategy through FDIs to a greater extent than non family firms

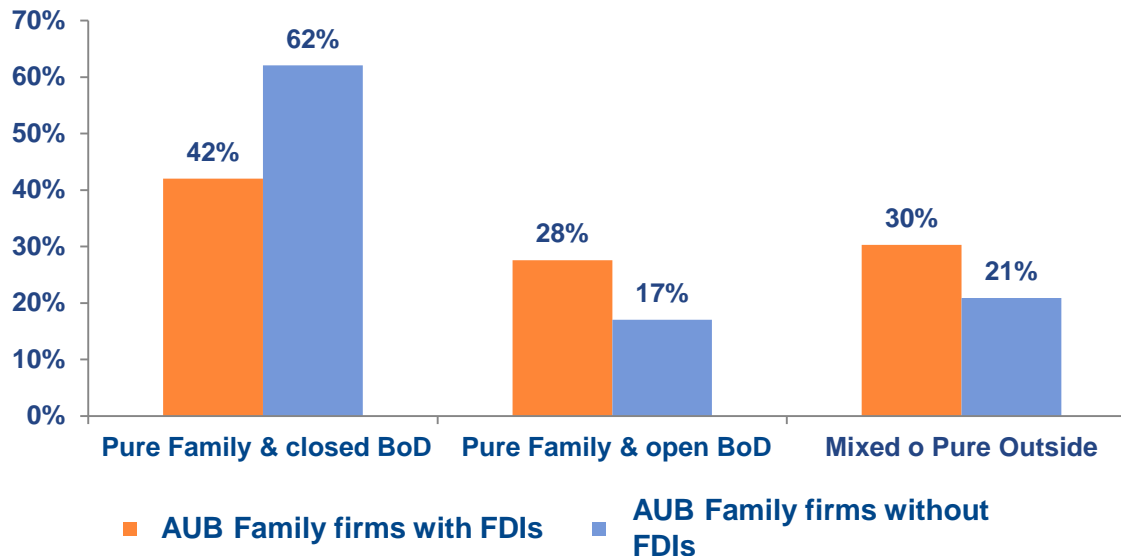
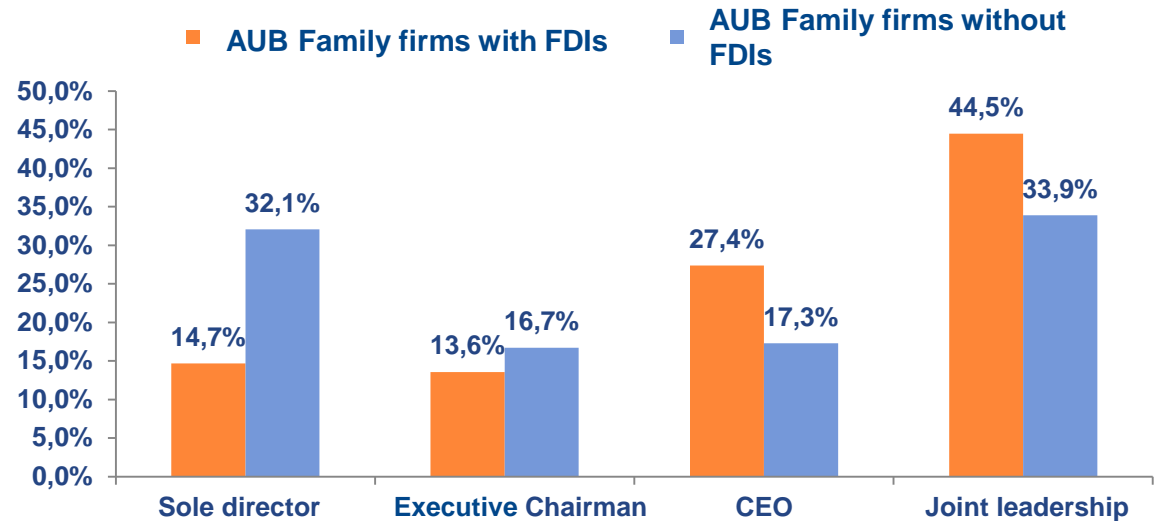
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(*). Foreign direct investments refer to all foreign investments in which Italian companies hold at least 10% of equity share. (source: Orbis). Holdings of mono-business groups and firms controlled by multi-business groups were excluded from the analysis.

Leadership models and degree of family influence

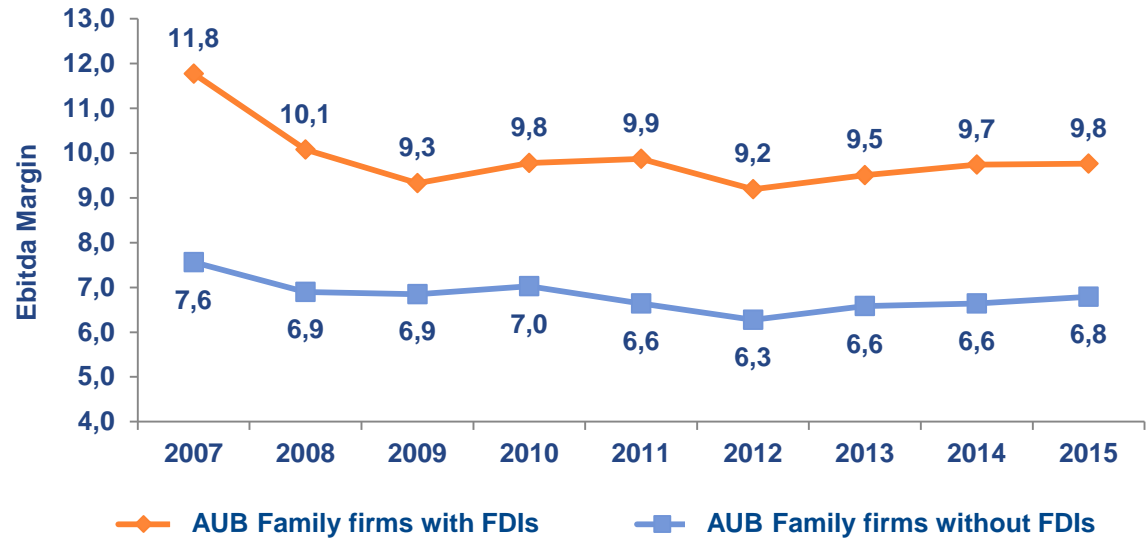
Structured leadership models are most common in internationalized companies through FDIs



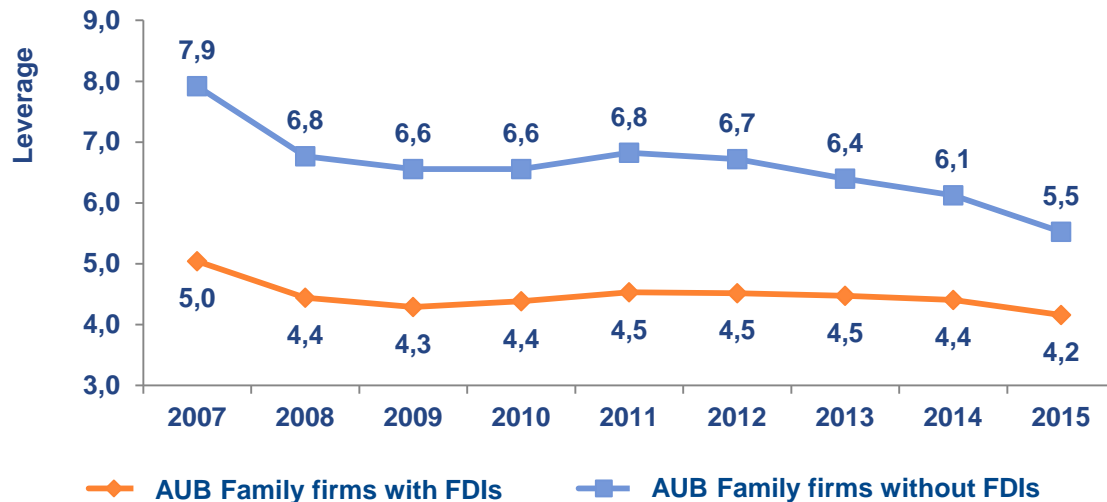
Governance models open towards non-family members are most common in internationalized firms through FDIs

Profitability and debt ratio of firms with FDIs

Firms with FDIs are those with the greatest rates of profitability ...



... and with greater capitalization



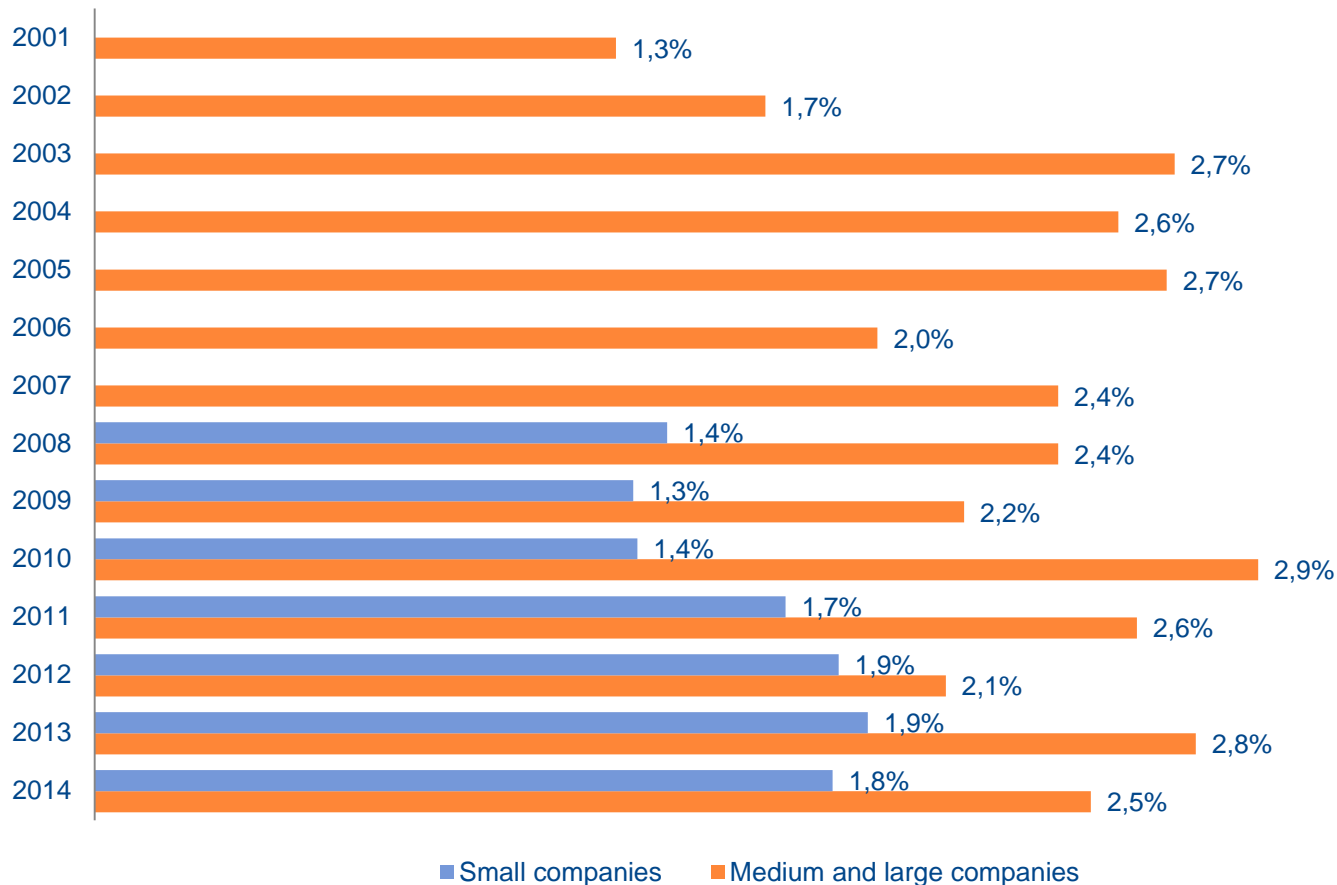
Second implication.

A good governance model is essential for modern, open, international companies, which are ready to acquire (instead of being acquired)

3. Governance and generational transitions

Generational change: trends

A generational change occurred in approximately 2,5% of medium and large Family-businesses (and in 1,6% of the small ones).*

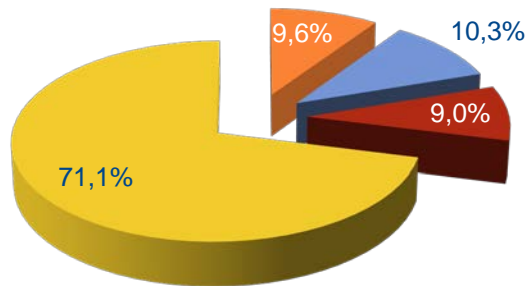


* A change is considered generational if a family-leader was replaced by a non-family leader or if there is at least a 15-years age difference between the outgoing and ingoing family-leaders.

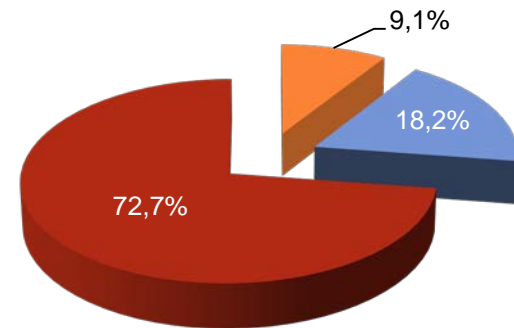
Generational change: comparison with ISTAT

A generational change occurred in 10.3% of AUB Observatory companies in the period 2006-2010. Whereas, the national average as of the ISTAT 2011 census is 9.1%.

AUB Observatory



ISTAT



- Generational change (2001-2005)
- Generational change (2006-2010)
- Generational change (2011-2014)
- No Generational change

- Generational change- last 5 years
- Generational change -planned for the next 5 years
- No Generational change

(*) Processing on 2011 Census of Industry and Services data (Source: Istat).

(**) Question designed to reveal any generational change occurring since 2006.

Leader's age

Between 2007 and 2014, the proportion of older leaders has been rising

Leader's age	20-50		> 50		Totale	
	2007	2014	2007	2014	2007	2014
Less than 40 years old	11,1%	5,8%	9,1%	4,5%	10,4%	5,3%
40-50 years old	24,5%	19,5%	22,1%	18,2%	23,7%	19,0%
50- 60 years old	26,4%	28,2%	24,7%	28,8%	25,8%	28,4%
60-70 years old	24,4%	24,5%	27,5%	24,8%	25,5%	24,6%
More than 70 years old	13,7%	22,1%	16,6%	23,6%	14,7%	22,6%

Leader's age and performance

Older leaders show weaker performance

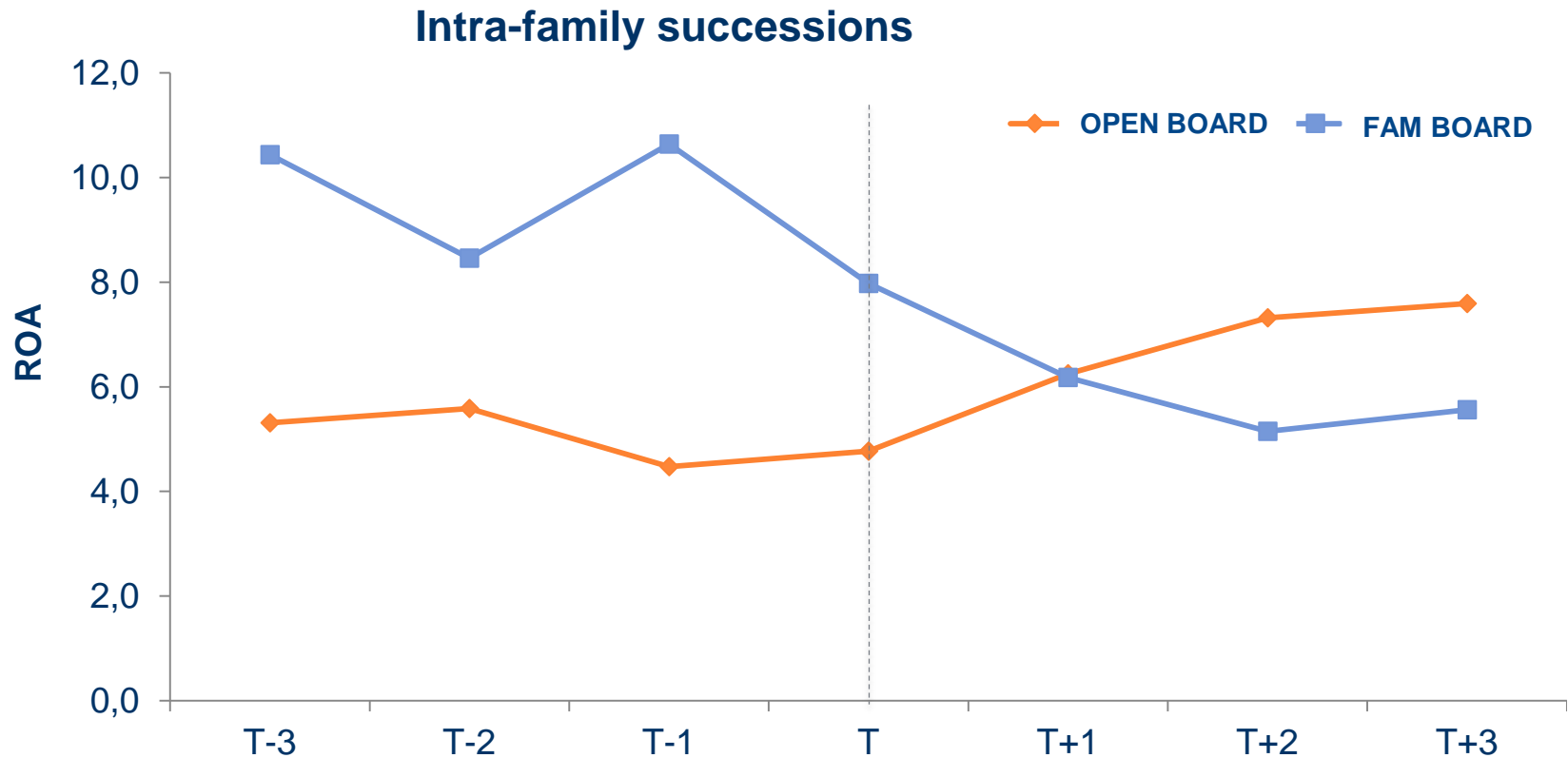
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Leader's age	▲ ROI		▲ ROE		▲ Revenue Growth	
	20-50	>50	20-50	>50	20-50	>50
Less than 40 years old	-0,2	0,0	1,9 ***	2,0***	3,0***	2,2***
40-50 years old	-0,3	0,2	-0,1	0,7*	0,5*	0,9***
50- 60 years old	0,2*	0,0	0,1	-0,7**	-0,6**	-0,5
60-70 years old	0,5***	0,2	0,1	-0,1	-0,7 **	-0,5
More than 70 years old	-0,5 ***	-0,4**	-1,2***	-0,8***	-0,5 **	-0,9***

The values indicate that companies with leaders belonging to a specific age group are characterized by a performance that is “x” points higher (+) or lower (-) than the population average. The difference is highly significant (***) if the p value is <.01, significant (** o **) if the p value is <.05, discreetly significant (* o *) if the p value is <.1). For the analysis 2004-2014 data were used for companies >50 mln € and 2007-2014 data for companies 20-50 mln € (source: Aida). An OLS regression has been run with the following controls: i) company's age; 2) company's size; 3) year (firm year dummies); 4) sector (firm year industry) using the first 2 digits of the Ateco 2007 code ; 5) standard errors clustered by company

Governance and succession

When the incoming leader is a family member, an open Board of directors with non-family members inside can be very helpful for a smooth leadership transitions.



Third implication.

**An open and balanced
governance is key to manage the
generational transition**

Conclusions

1

There is no «universal» governance model. The governance design depends on the type of company (and family) and is highly tailor made.

2

Governance is more than compliance. At the opposite, private firms can have considerable advantages through governance to be open, modern, efficient, and internationally present.

3

One of the key advantages of a good governance is to facilitate generational transitions, and to force its timing. Otherwise, risks of failure in those transitions are extremely high.