The Long-Term Survival of Family Business

Clarkson Centre for Board Effectiveness

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Rotman

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Introduction

The Clarkson Centre for Board Effectiveness (CCBE) at the Rotman School of Management has a mission to study corporate governance and provide practical insights for companies about what good governance means. For more than a decade, we, like many of our peers, embraced the widely-held and publicly-listed model as the paradigm of good governance. Every new crisis in the 1990s and early 2000s seemed to reinforce the importance of director and committee independence, shareholder democracy and an ever-increasing burden of disclosure to the public. To be sure, most of the recent evolutions in good governance have had a net beneficial effect for most companies. For example, the separation of the Chair and CEO roles is related to the adoption of other effective governance behaviours (Spizzirri, 2014). Our *Board Shareholder Confidence Index* board ratings (BSCI) have also tracked a steady increase in adoption of valuable practices such as board evaluations over the past 17 years.

However, the ongoing emphasis on widely-held and publicly-listed corporations as a model of governance effectiveness means that corporations with different ownership models are often viewed as second class citizens in conversations about good governance. For instance, a family-controlled corporation with a dual-class share structure and combined CEO and Chair positions is disqualified from a top-tier rating in our BSCI, regardless of any other effective governance practices it might adopt.

In 2013, the Clarkson Centre for Board Effectiveness (CCBE) published *The Impact of Family Control on the Share Price Performance of Large Canadian Publicly-Listed Firms (1998-2012)*, which launched what has become an ongoing examination of the governance of Canadian family businesses. In that study, we found that family-controlled and publicly-listed corporations in Canada had generated significantly higher returns to shareholders over a 15-year period than the rest of the S&P/TSX Composite Index (Spizzirri & Fullbrook, 2013). These results inspired us to take a deeper look at what good governance means to family-controlled companies.

Our interest in the governance of family enterprises is further driven by the fact that most formal studies of family businesses focus on identifying and managing their unique risks – succession planning, protecting the founder's vision, managing internal conflicts – but not their strengths. This has led, for example, to the development of tools such as the "Three Circle Model" (Davis, 2018). However, since family businesses generate more wealth for shareholders over time, perhaps claims about the outsize risk of family control are somewhat exaggerated.

Purpose

The life cycle of every company is entirely unique from founding to growth, from growth to prosperity and from prosperity to, in nearly all cases, death. Because each company's experience is so varied and nuanced, there is no perfect dataset with which to study precisely what causes some companies to thrive and others to falter. Our previous work on family businesses, however, emphasizes their potential for long-term value creation. Meanwhile, influential thinkers and investors have sounded the alarm on short-termism in capital markets, arguing that it had a primary role in the Great Recession, and potentially poses a threat to capitalism as a whole (Barton, 2011).[1]

[1] Yvan Allaire explains that "corporate short-termism is the conscious decision (under external pressures or not) by management/boards to take actions that will bring benefits in the immediate future, knowing full well that these actions may prove eventually detrimental to the welfare of the company." (Allaire, 2014)

Our previous work on family businesses hints that their excellent long-term results may be driven, at least in part, by the long-term perspectives of family owners. There is an oft-cited stat that 70% of family businesses do not make it to the second generation (Aileron, 2013). In the CCBE's interaction with family businesses, this stat is often shared as a caution to family businesses that they are not long for this world. However, the Small Business Association, using data from the U.S. Bureau of Labor Statistics, showed that between 1995 and 2010 fewer than 40% of businesses, family or not, survive past the 10-year mark (Small Business Association, 2012). In other words, perhaps when compared to other businesses, the 30% survival rate of first-generation family businesses is a more impressive feat than it seems.

The primary goal of this study was to take a close look at the survival of family businesses compared to non-controlled companies. Furthermore, we wanted to understand other factors that could potentially be linked to long-term vision. With these goals in mind, we tested three hypotheses:

1. Publicly-listed family businesses are more likely to survive in the long-term than non-family issuers.
2. Publicly-listed family businesses experience less frequent turnover in the CEO position than non-family issuers.
3. Publicly-listed family businesses experience lower share price volatility than non-family issuers.

To test these hypotheses, we gathered historical data on public issuers in Canada over a nearly 50-year time horizon and compared outcomes for family businesses against non-controlled companies. For the purposes of comparison, we also studied smaller samples of companies in the US and UK over the same time period. The outcome? Canadian publicly-listed family businesses show significantly higher likelihood of long-term survival, more stability in the CEO position and lower stock price volatility compared to non-controlled companies. While it is certainly true in some cases that the second and third generations destroy what the founder created, the risk of premature death appears to be even higher when a family is not at the helm.

Methodology

How We Selected Our Sample

Because of the nearly 50-year look-back horizon of this project, appropriate sampling was the biggest challenge in gathering valid data. It was difficult to find comprehensive listings of historical issuers, and a further challenge to identify reliable sources of historical data on those issuers. In addition, over such a long horizon there is inevitable attrition due to companies being acquired, de-listing or going out of business. We chose to supplement our dataset with issuers that became listed after 1969 in order to ensure that we have meaningful sample sizes throughout our entire observation period of 1969 to 2017. Finally, we relied on several different data sources, which sometimes did not all have data available on every variable for every company in our sample. These factors caused fluctuations in the sample sizes used throughout the report. We have attempted to explain our sampling and calculations as clearly as possible. Ultimately, we acknowledge that our sampling approach is not perfect, but believe that the size of the sample is sufficient to balance any biases that may be inherent in our methodology.

Canada

With a timeframe that goes back to 1969, the availability of historical data played a significant role in our sample selection. To build our Canadian dataset, we began with a listing of public issuers on the Toronto Stock Exchange published in the Globe & Mail in January 1969. We looked through historical issues of Moody's Industrial Manuals for information on CEOs, incorporation dates, major transactions, controlling shareholders and revenue. In some cases, issuers in the Globe & Mail list were not covered in the Moody's manuals and as a result were excluded from our dataset. Ultimately, these efforts resulted a sample of 185 Canadian issuers from 1969 which we tracked, subject to the availability of data, through to 2017 or until the companies became de-listed due to acquisition, privatization or going out of business.

To ensure a sufficiently significant representation of family businesses, we also examined a list of the 40 largest family-controlled public issuers that are currently listed on the TSX and gathered data from Moody's manuals back to 1969 or as far back as data was available. We further supplemented our sample with a list of Canadian issuers from S&P Capital IQ that had a first trade date later than 1969, excluding operating corporate subsidiaries. Between these two lists, we gathered a total of 1306 company-year observations on 300 Canadian issuers.

U.S.

We began crafting our U.S. sample by going through the 1969 Forbes 500 list beginning with the highest revenue and working down until we had a sample of 50 companies with coverage in the Moody's manuals. We further supplemented this sample by including any of the 36 large U.S. family issuers compiled in the Family Business Index at St. Gallen University. Some of these companies were already included in the Forbes 500 list and others were not covered in the Moody's manuals. In total, we covered 67 issuers and 518 company-years in our U.S. observations.

UK

The basis of our UK sample was the same Globe & Mail list used for the Canadian sample above. We added issuers that were listed on the defunct FT30 Index on or after 1969, and further included family businesses in the St. Gallen Family Business Index. In total, we covered 71 issuers and 393 company-year observations.

Definitions of Ownership Structures

Family-Controlled

We defined a company as family-controlled if it met one or both of the following criteria at any point during our observation period.

1. The company was described in Moody's Industrial Manuals as being "controlled" by a family or a non-public family-owned entity (e.g. holding company).

2. The company has been an issuer on the S&P/TSX Composite Index at any point between 2002 and 2017 and the CCBE's governance database shows that a family exercised 30% or more voting control at any point.

Family Subsidiary

At any point during our observation period, Moody's Industrial Manuals indicated that the company was "controlled" by a family-controlled company as defined above, or CCBE's database indicates 30% or more control by a family company.

Corporate Subsidiary

Moody's Industrial Manuals indicated that the company was "controlled" by a non-family-controlled public issuer as defined above, or CCBE's database indicates 30% or more control by a non-family company.

Non-Controlled (NC)

We found no evidence during our observation period that the company was controlled by any external entity.

Data Sources

We gathered historical data about dates of incorporation, CEO and board chair information, industry/sector and major transaction events from historical issues of Moody's Industry Reports. Additional information about the fate of companies was gathered from the International Directory of Company Histories and the Financial Post Survey of Defunct and Predecessor Companies. Historical share price information was from Thomson Reuters Datastream and historical shareholder information was from S&P Capital IQ.

How We Tracked Company Histories

The result of our company selection methodology above is a time series dataset with observations at five-year intervals beginning in 1969. Each five-year snapshot includes whether or not a change occurred in the CEO position and whether or not a major transaction occurred (e.g. a new listing, acquisition). For a company that existed for the entire observation period of 1969 to 2017, this approach yielded 10 snapshots. If data was not available in the first year of a 5-year window, then we would gather data whenever possible from the closest year within the same window. For example, if we were unable to find data for 1969, then we would gather data from 1970, 1971, 1972 or 1973. If we were unable to find data in any of those years, then the company would have null values for that 5-year observation.

We used daily share price histories for volatility calculations.

Company incorporations and first-trade dates were gathered by year, not by a specific date. Similarly, if a company became defunct, we captured the year of the associated event.

Terminology

NC = Widely-held (Non-Controlled) public company

Family business = Publicly-Listed and Family-Controlled at some point since 1969

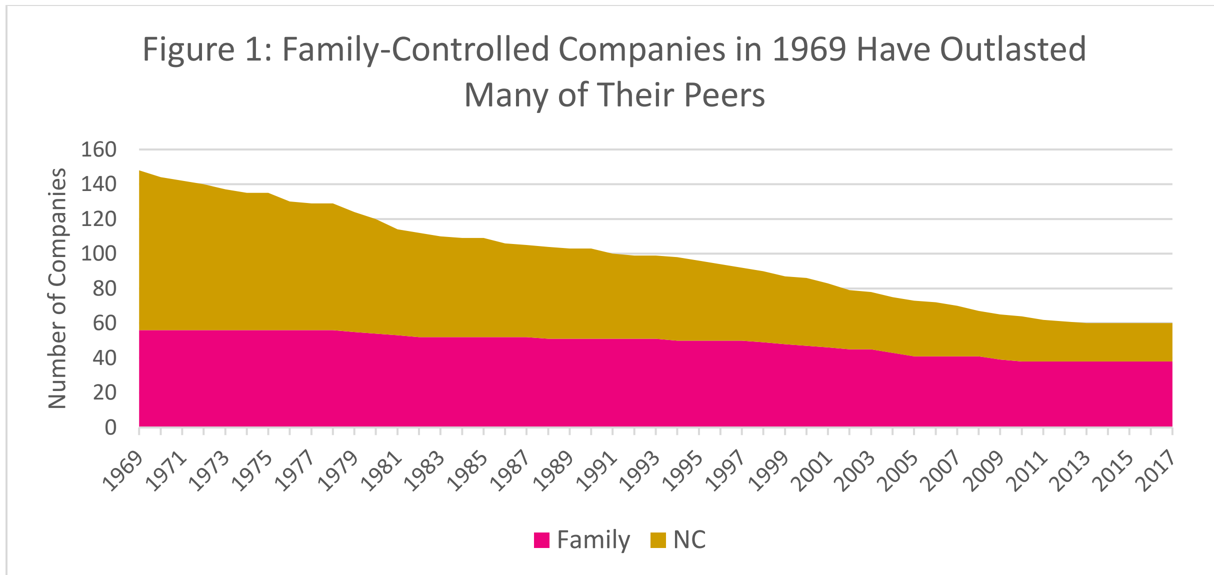
Family Sub = Public subsidiary of a publicly-listed and family-controlled company at some point since 1969

Corporate Sub = Public subsidiary of a non-family corporation

Hypothesis #1: Canadian Family Businesses are more likely to Survive

Status: Confirmed

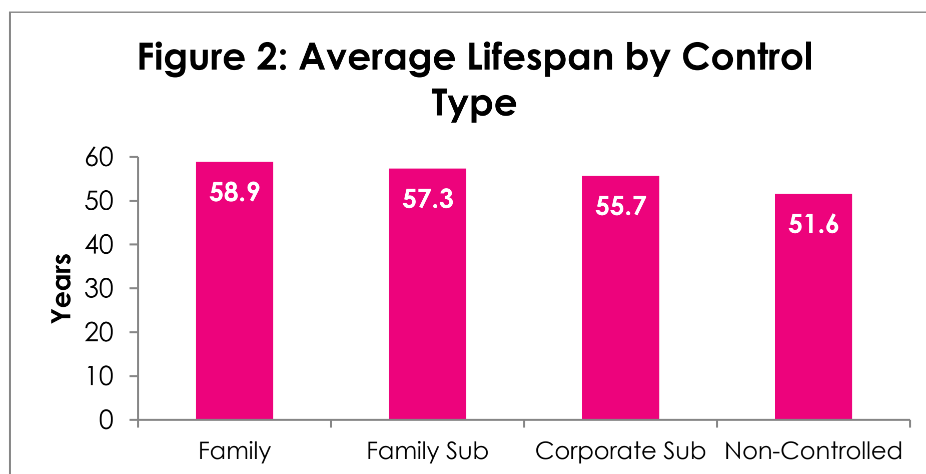
Our first hypothesis, that family businesses survive longer than non-controlled companies, is the most fundamental to the purpose of our study. Beginning with our full sample of companies listed in 1969, we first tracked the attrition of that group between 1969 and 2017 (Figure 1). Nearly 70% of family businesses survived through the entire 48-year observation, while all but 24% of NCs were de-listed, out of business or acquired.



When we consider the entire sample, including companies listed after 1969, family businesses have a longer average lifespan than any other control structure, and longer than NCs by 14% (Figure 2).

HOW WE DEFINED SURVIVAL

We tracked companies from the point of their incorporation to the point when they were de-listed, out of business or fully acquired. For the purposes of this study, the period between these two dates represented the total lifespan of a company. This approach means that many companies' lifespans are much longer than the observation period of the study.



NOTE: Our total sample of Canadian Companies included 78 family companies, 14 family subsidiaries, 73 corporate subsidiaries and 135 NCs.

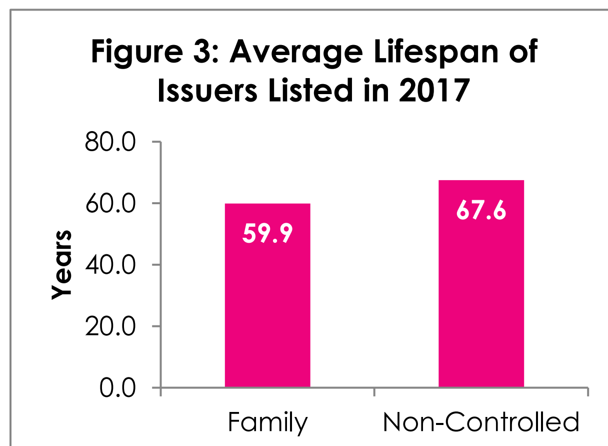
Isolating the Survivors

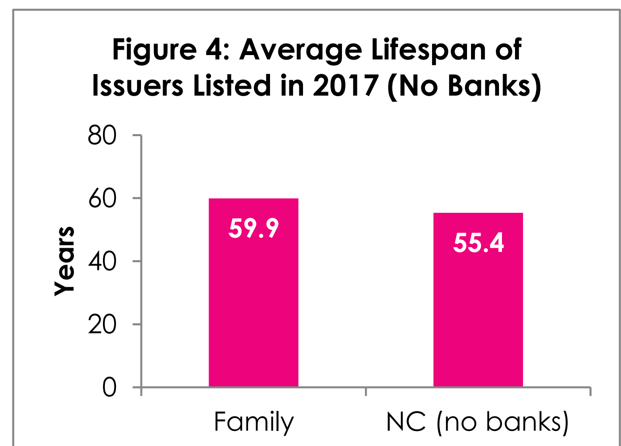
Canada's long-lived banks
Bank of Montreal est. 1817
Bank of Nova Scotia ext. 1832
CIBC est. 1858
RBC est. 1864
TD Bank est. 1955

Another way to consider survival is to look only at the companies that still survive today and compare the lifespan of family businesses to that of NCs. Using this approach, we found something different. Among companies that are currently operating, NCs have a longer average lifespan by approximately 8 years, or 13% (Figure 3). In this smaller sample of 56 family businesses and 40 NCs, the average lifespan of NCs is heavily influenced by the survival of Canada's big banks. In a sense, the big banks occupy an ownership class all their own. Since 1967, it is prohibited for any one person or entity to own more than 10% of a large Canadian bank. Prior to that, large transactions still required Ministerial Approval – a rule that did not apply in the same way to other organizations. As such, for the entire duration of our observation period, large Canadian banks have been protected from takeovers.

While similar rules now apply to large insurance companies, they were not included in our sample until after their demutualization in 1999.

As such, we might choose to consider the big banks as embodying a unique and protected ownership structure when compared to other NCs. If we remove them from our lifespan calculations we get the results in Figure 4, showing that today's family businesses have longer lifespans than NCs by 8%.

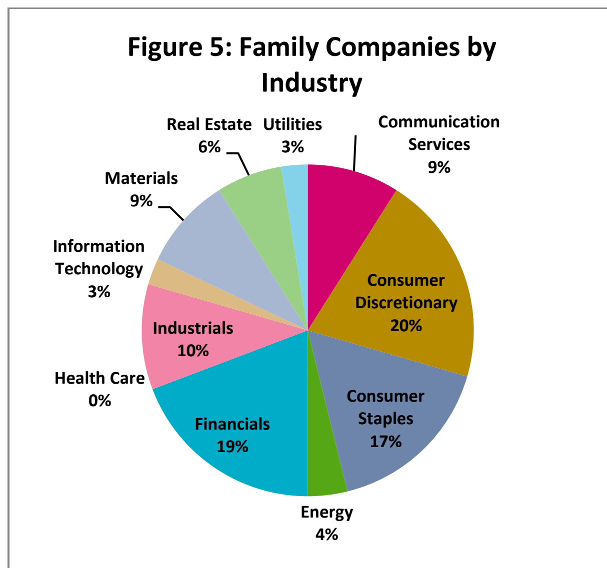


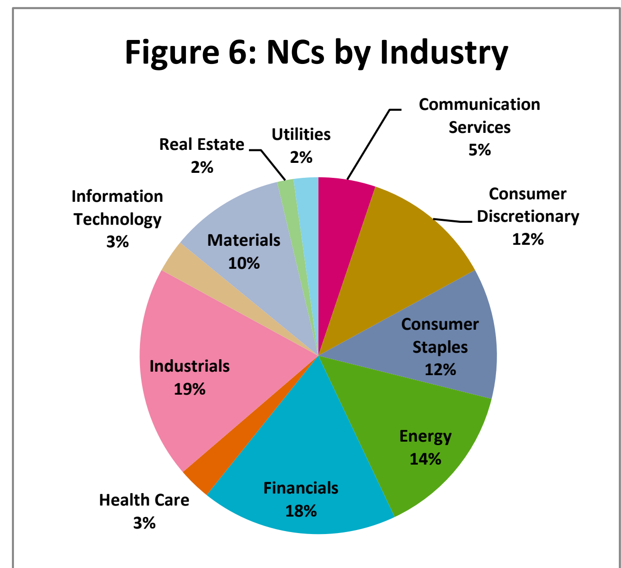


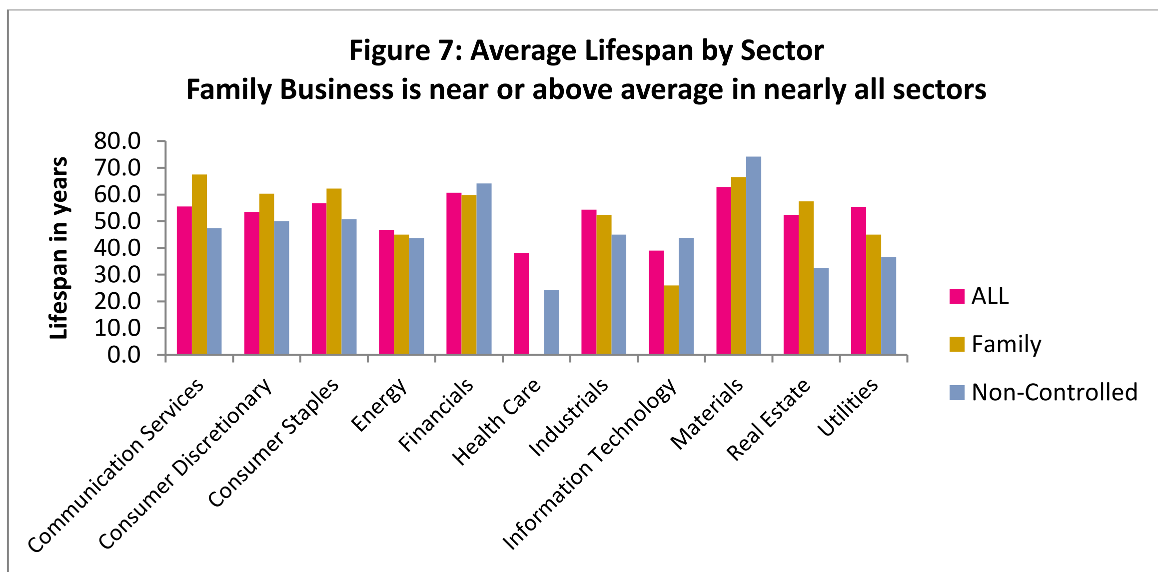
Industry Comparisons

Our sample of family businesses included companies in every sector except for Health Care. Compared to NCs, the balance of family companies in our sample over-represents Consumer Discretionary and Consumer Staples, and under-represents Energy and Industrials. Otherwise, the balance is relatively similar for both samples (Figures 5 and 6).

In nearly all sectors, the average lifespan of Family businesses is at or above the average lifespan for the entire sample, while NCs are at or below the average for the entire sample in most sectors (Figure 7). These comparisons provide us with further confidence that the overall survival of family businesses is not influenced in any significant way by industry trends.



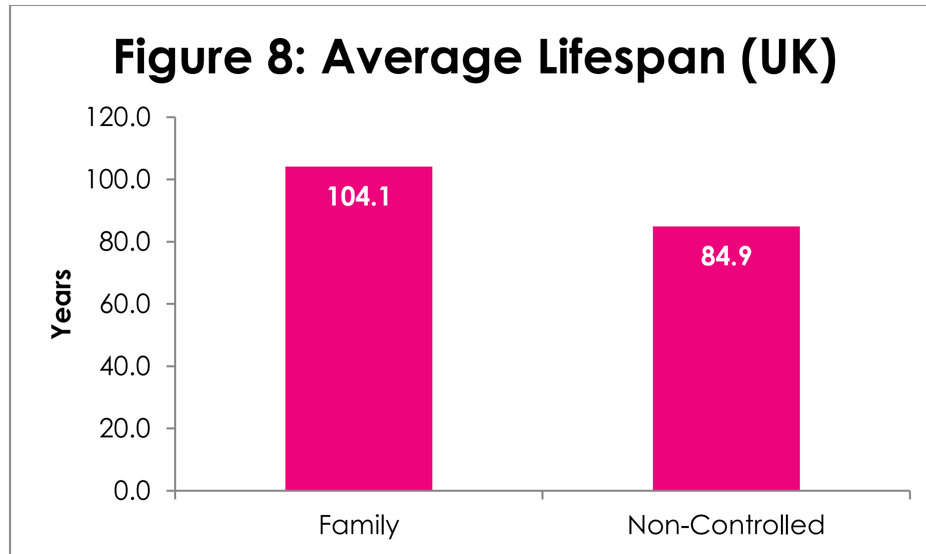




International Comparisons

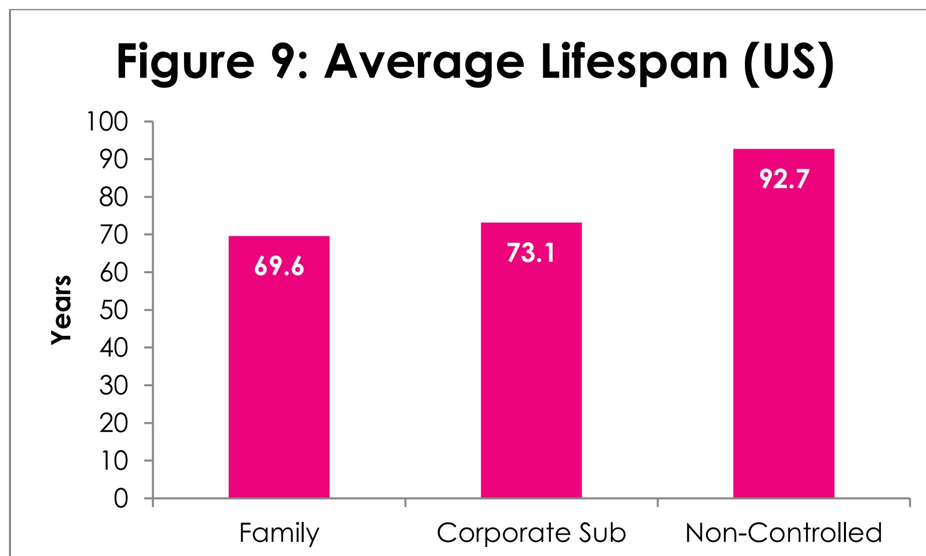
UK

Our sample of UK issuers included 14 family businesses and 45 NCs. Perhaps unsurprisingly, given Canada's relative youth as a nation, issuers in the UK have significantly longer lifespans overall than Canadian companies. Nonetheless, we still found that family businesses, with average lifespans of over 100 years, survive longer than NCs by nearly 20 years or 23% (Figure 8).



US

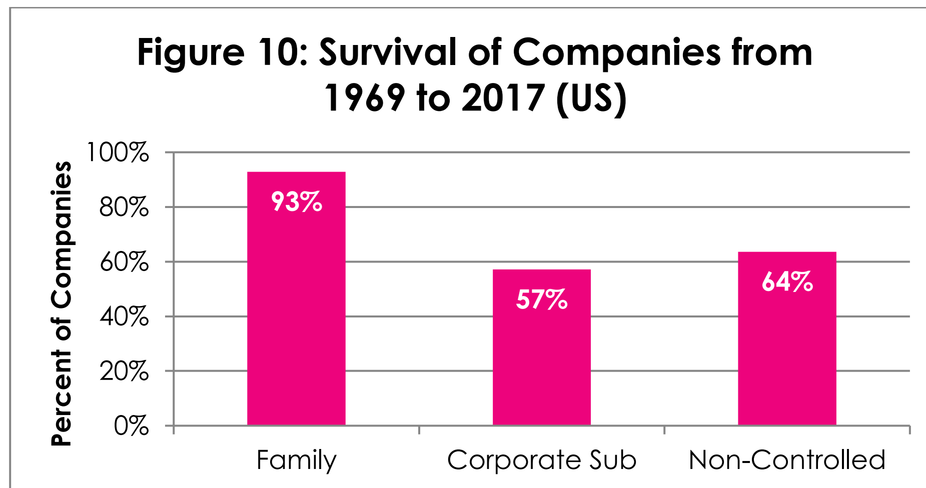
Our findings from our US sample of 67 companies are somewhat different. Included are 22 family businesses and 38 NCs, as well as seven corporate subsidiaries. Recall that we define a company as family-controlled only if they were controlled by a family at some point within our observation period (1969-2017). There are storied and long-lived US corporations that, while perhaps family controlled at some point in their history, were NCs by the time our observation began in 1969 (e.g. Procter & Gamble, BF Goodrich). These NCs have a significant influence on the average lifespan of NCs in the US, which is much higher than other structures unlike the Canadian and UK samples.



Isolating the Survivors (US)

Isolating the companies that survived our entire observation period of 1969 to 2017, like we did with the Canadian sample above, presents a different picture. Nearly all of the family businesses from our 1969 US sample survived all the way to 2017 (Figure 10), a figure much higher than the NCs and

corporate subsidiaries. This illustrates that many family businesses have weathered the traumatic market events of the past 50 years while NCs have not.



Hypothesis #2: Family Businesses Have Greater Stability in the CEO Position

Status: Confirmed

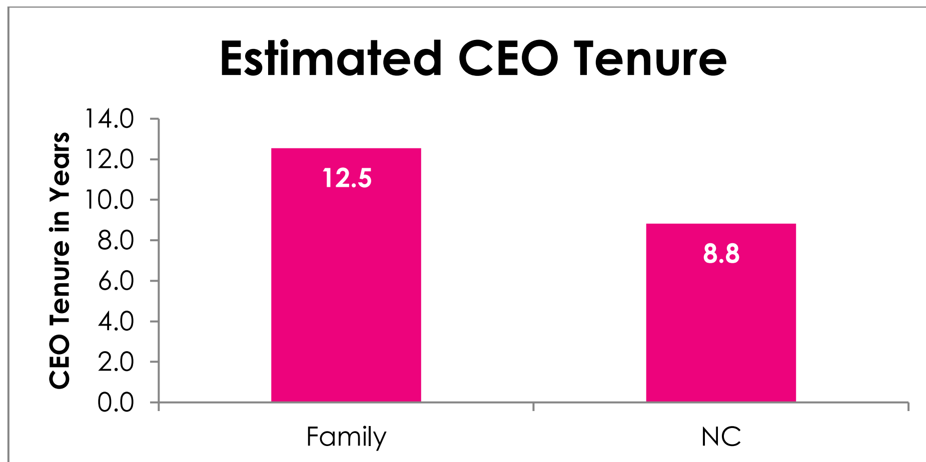
Changes in the CEO position are inevitable and sometimes hugely beneficial to corporate governance. Nonetheless, CEO turnover is one of the most disruptive events that can occur to a company. Up until the 1990s, the most common reason for CEO departure by far was voluntary retirement or death (Lucier, Spiegel, & Schuyt, 2002). This trend has shifted, with more CEOs than ever losing their jobs due to poor performance or other involuntary causes (Tayan, 2017). Consistent with our hypothesis that family businesses are more stable in the long term, we expected to find longer CEO tenure in family businesses than in their NC counterparts, reflecting overall strong performance and potentially reduced governance risk.

We monitored changes in the CEO position for our entire sample every five years. The result is a relatively course-grained time series. Consequently, we did not capture the exact start or end dates for CEOs. Moreover, it is possible that we were unable to observe short-tenured CEOs if their appointment and departure both occurred in between our observations. As a result, for any single observation, it is possible for our estimate of CEO tenure to be inaccurate by as much as five years at both the beginning and end of a CEO's appointment. We believe that the size of our sample, over 1300 company-year observations, helps to smooth out these potential inconsistencies. CCBE's dataset shows that the average S&P/TSX Composite Index CEO has had a tenure of less than 10 years since at least 2003, suggesting that our estimates are not far off base.

Ultimately, our findings showed that family businesses in Canada, the UK and the US all had longer average CEO tenure than NCs, confirming our hypothesis.

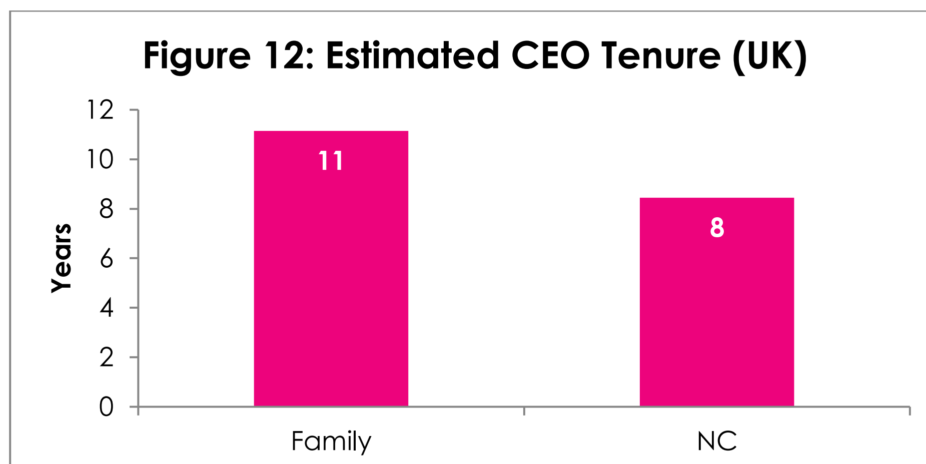
Canada

Looking at our entire sample of 300 Canadian issuers, a typical family business CEO is in the position for nearly four years longer than an NC CEO, a difference of more than 40%.



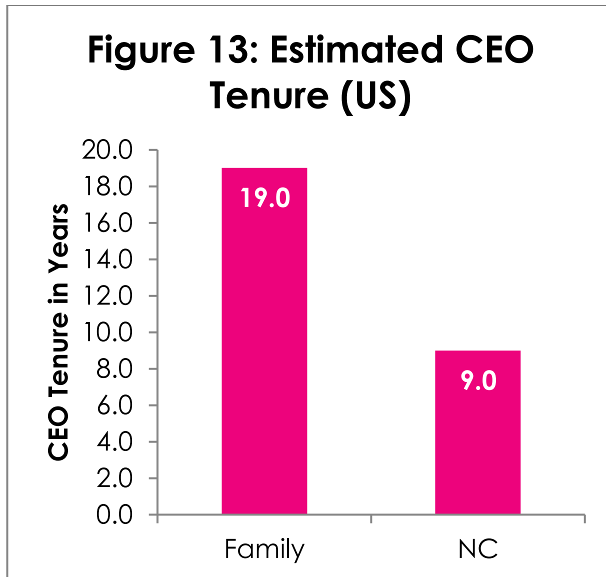
UK

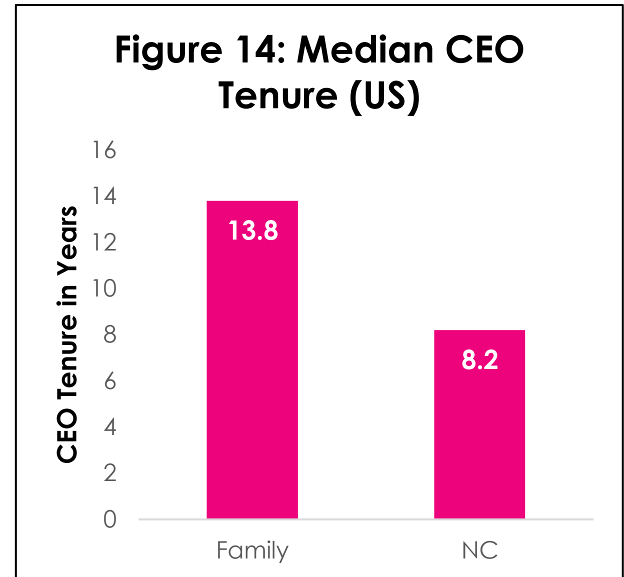
CEO tenure trends in the UK are largely in line with what we observed in Canada, with family business CEOs holding their positions for an average of approximately three years longer than NC CEOs.



US

In the US, the gap between family businesses and NCs in CEO tenure is much wider. The figure for family businesses is driven significantly by very long-tenured CEOs at companies like Wal-Mart and Comcast. Overall, family business CEOs outlast NCs by more than 100% (Figure 13). If we control for the extremes by looking at median CEO tenure instead, US family business CEO tenure is still longer than NCs by more than 5 years or 68% (Figure 14).



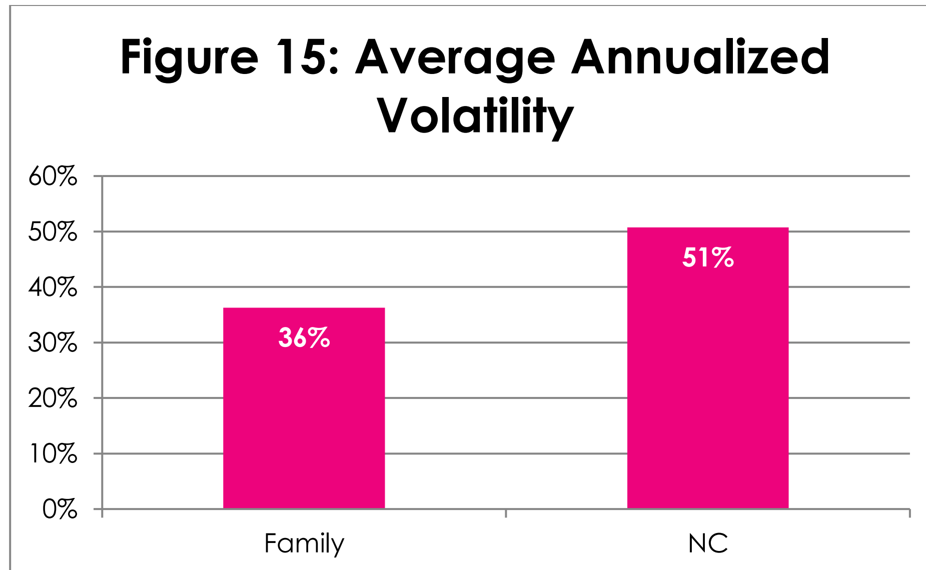


Hypothesis #3: Family Businesses Represent Lower Risk to Shareholders

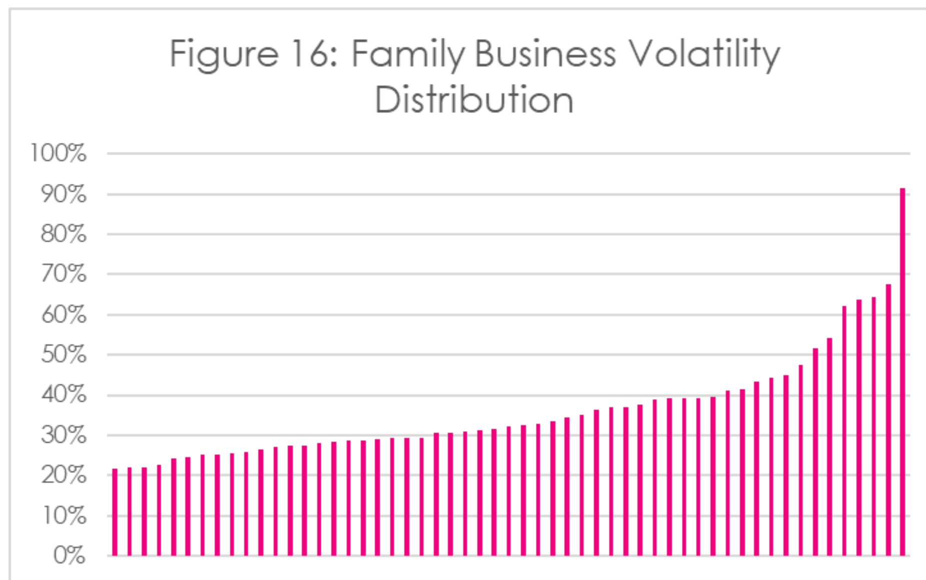
Status: Confirmed

In 2013, CCBE found that Canadian family businesses generate a greater return to shareholders over long investment horizons, demonstrating the potential upside of family control. For this study, we examined long-term stock price volatility of family businesses compared to NCs to test the hypothesis that an investment in a family business might carry less risk than an investment in an NC, in addition to the reward measured in 2013. We examined daily historical share prices for all of the Canadian issuers in our sample that are currently trading on the Toronto Stock Exchange. The resulting sample is rather different from those used in other parts of our study largely due to the attrition described in Hypothesis #1, which affected NCs more dramatically than family businesses. For more information about how we constructed our samples, please refer to How We Selected Our Sample on page 4 above. The calculations for this hypothesis include 56 family businesses and 30 NCs. We gathered data on each company as far back as when it was first traded up to a maximum of 45 years, which is the limit of our historical dataset. Average annual volatility for our family business sample is 36% over 33 years, compared to 51% for NCs over 35 years (Figure 15).

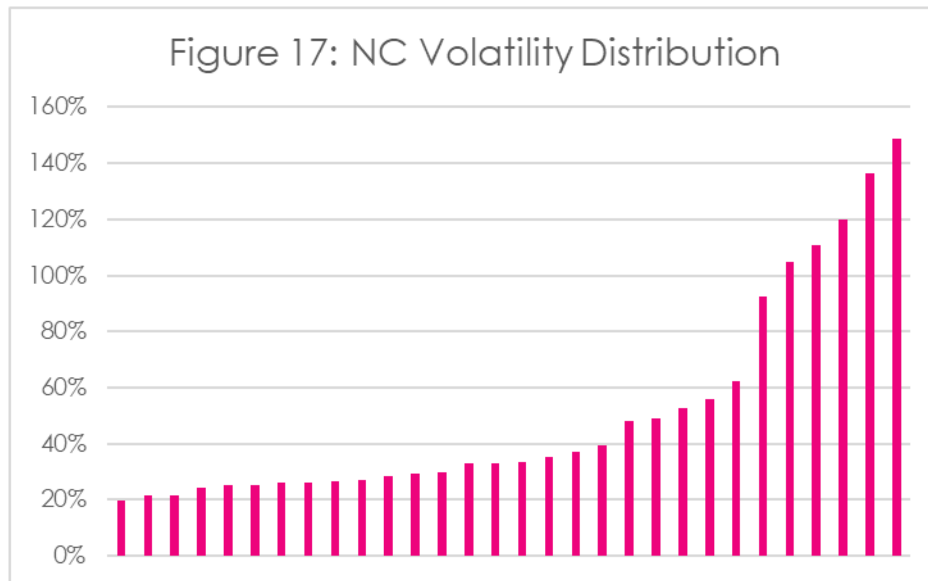
Please note that the reason for the relatively high overall volatility numbers is that we have used a very long observation period during which many of the companies in our sample have grown significantly in market capitalization. To illustrate, the average difference between the lowest and highest points in our sample for a family business is a multiple of 107, compared to a multiple of 635 for NCs.



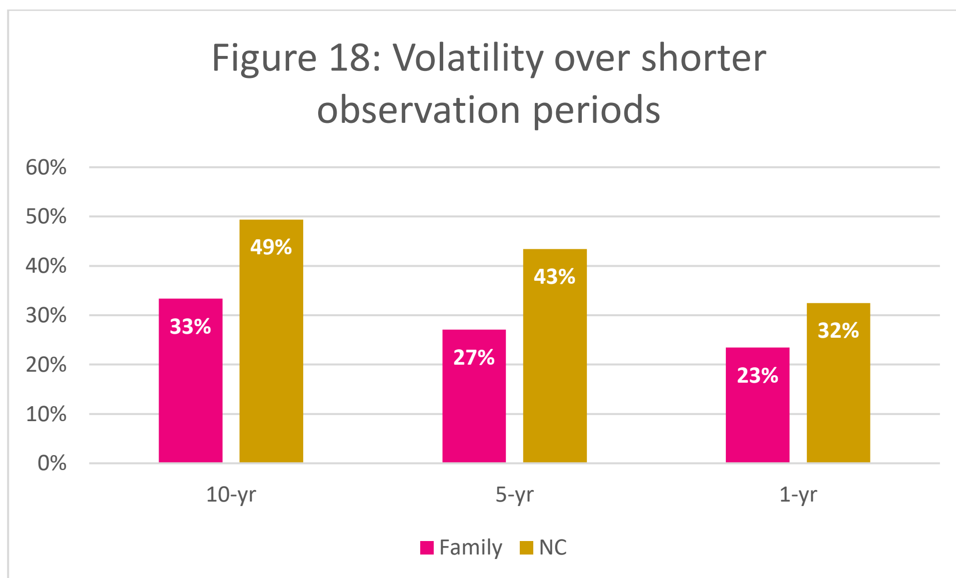
The distribution of family businesses in our sample shows that most issuers had annualized volatility below 50%, and none above 100% (See Figure 16). These findings show that there are no extreme outliers impacting the averages in Figure 15.



The sample of NCs has a larger number of high-volatility companies, with 5 out of 30 showing over 100% annualized volatility (Figure 17). Combined with the findings of our 2013 report on family business returns to shareholders, these figures suggest that family businesses represent a combination of low risk and high reward to investors.



For the figures and charts above, we used the longest time horizon possible to calculate volatility because of our hypothesis that family businesses represent lower risk over the long term, but the trend still holds over 10-year, 5-year and 1-year observations, suggesting that the lower risk of family business is not only a long-term phenomenon.



Conclusions and Next Steps

Each of our hypotheses was intended to highlight the potential stability and longevity of family business. We focused on simple questions with concrete answers:

- Do family businesses survive longer?
- Do CEOs of family businesses have longer tenure?
- Do family businesses represent a lower risk investment?

Although we have found compelling evidence that the answer to each of these questions is "yes" there is still more work to be done to better understand the implications of this study, and the importance of family enterprise to the Canadian economy.

What, if anything has changed now that we are 10 years removed from the Global Financial Crisis?
CCBE will conduct an updated review of the performance of family businesses now that more time has passed since the Financial Crisis. Do family firms still outperform their counterparts? In what ways do our findings about volatility enrich the understanding of long-term family firm performance?

To what extent do these findings extend to privately-owned businesses?
Private companies are often impossible to study due to a lack of publicly-available data. CCBE is building partnerships with external organizations that will provide us with direct access to private companies as well as meaningful datasets.

What lessons can NCs learn from family business?
If short-termism is in fact a significant threat to the health of NCs and potentially capital markets as a whole, what, if any, lessons from family business might help NCs to extend their perspectives farther into the future?

CCBE is committed to building a deeper understanding of family business in Canada, and will explore these and other questions in the months and years to come.

Acknowledgments

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- Canadian National Railway
- Colliers International
- Empire Company Ltd
- Haskayne & Partners
- OMERS
- Power Corporation of Canada
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- Riddell Family Charitable Foundation
- Shaw Communications Inc.
- Sun Life Financial Inc.
- Teck Resources Ltd.
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Conflict of Interest Statement

The Clarkson Centre is largely funded by private donations from corporations that wish to support research into corporate governance. Many of our projects, including this one, require us to perform analysis on one or more of the companies that sponsor our research. In some cases, including this project, our findings may reflect favourably our unfavourably on companies or groups of companies that may include our sponsors. All of our data gathering and analysis is conducted without influence from our donors, and we strive to be transparent in the descriptions of our methodology and motivations. If you have any questions or concerns about this report or any other work conducted by CCBE, please email ccbe@rotman.utoronto.ca.

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