THINKING**ahead**

FAMILY-CONTROLLED BUSINESS:
A Model for Long-Term Investing

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Investors who partner with families must possess a special mindset, one that values a willingness to develop relationships over long periods of time.

CPP Investments

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Faced with a global pandemic that is pushing the world's economies into recession, now more than ever it is critical that long-term investors stay the course. One of the challenges long-term investors face, however, is finding partners who share a similar long-term time horizon. We have often found family-controlled businesses to be strong partners.

By joining forces with a family business, investors can benefit from that family business' market knowledge, proven track-record, and investment discipline. And the businesses can benefit from partnerships with long-term investors that bring strong governance, decades of investment expertise, and a global business perspective.

We have learned from past financial disruptions that — as tempting as it may be to react quickly — it is the long-term perspective that leads to lasting returns. For many family-controlled companies, with their multigenerational perspective, this approach is already in their DNA.

In markets around the world, family-controlled companies are dominant in key sectors. Whether they are retail and technology firms in the United States, car manufacturing in Germany, telecom in India, fashion in Italy, banking in Spain, or luxury goods in France, all these markets are led by companies with a strong founder or family control, and with a long-term perspective on shareholder returns.

IN LATIN AMERICA

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In Latin America, 43%[1] of the largest companies are either controlled by a family or a group linked to the founders, according to our own analysis. This holds for several sectors that have been able to outperform their competitors, especially in moments of volatility and stress when other companies were focused on cutting costs or divestments.

A good example is the Votorantim Group. Founded in 1918, today it is one of Latin America's biggest conglomerates. The family has controlled the business for five generations with plans for many more to come; clearly the company has a long-term perspective. The company exhibits traits that are common among family-controlled businesses: an appetite for smart risk-taking, a strong business focus, determination, and sound organizational governance.

Family business: *A company that is majority owned or controlled by a family, usually a founding family with experience managing and operating a business across generations.*

FROM 2003-18
companies controlled by their founders listed on the equity market
PERFORMED ALMOST
2x
as well as the annualized performance of the market

Family businesses tend to pursue long-term strategies that benefit from alignment between performance and management incentives. Greater fixed investment and higher R&D expenditures are also common behaviours of these enterprises.

As a result, these companies tend to outperform their peers. Over the 15 years to the end of 2018, companies controlled by their founders listed on the equity market performed almost twice as well as the annualized performance of the market (17.8% returns vs 9.1% for the MSCI). The companies were also more profitable, with a 16.6% ROE versus 11.3% over a 10-year period, according to a study from UBS and PwC.

The study[2] found that the strong governance, stable shareholders and long-term value creation strategies associated with family-controlled businesses correlate with companies that outperform their indices. In particular, the study cites transparency, succession planning, shareholder rights, and remuneration targets — all bellwethers of good governance — as drivers of performance.

A Commitment to Good Governance

We have found that family-owned partners can bring a great deal to the table for long-term investors. In the best cases, they are first-in-class operators with deep knowledge of their business and their markets, have long track records that can be evaluated, and — whether private or public — resist short-termism. Critically, these companies are deeply committed to good corporate governance.

Take Itaú Unibanco, as an example. The largest private bank in Latin America has a model of corporate governance that assures the Souza Aranha and Moreira Salles families have strategic controlling positions on the executive board, although Itaú Unibanco has non-family professionals at the forefront of the business. Through a holding company, the families ensure a long-term focus and alignment between shareholders.

Thanks to its disciplined approach and long-term perspective, Itaú Unibanco has thrived through several economic cycles. And so, the bank was able to increase its market cap by over 126 times between 1995 and 2019, yielding a 21% yearly return versus 14% for the Bovespa Index, in Brazilian reais.

Such long-term thinking is a winning strategy. Long-term oriented companies outperformed their peers in revenue growth by a factor of 1.7 and in earnings growth by a factor of 2.3 between 2003 to 2017, according to a KPMG study.[3]

Building a True Partnership

Partnering with families does require a special mindset, however — one that values a willingness to develop relationships over a long period of time. Most families are looking for partners who can bring more to the relationship than just money, including a shared emphasis on governance, strategic advice, investment expertise, and long-term commitment.

Since these relationships can last decades, it is essential to focus on the people you will be partnering with rather than on the individual transaction. It is an approach that requires patience and a deep commitment to a long-term philosophy. In our experience, investors considering long-term family-owned partners should consider the following:

- Select and prioritize key regional groups and potential partners rigorously.
- Make sure your values and standards are aligned with those of your potential partner.
- Commit to developing the relationship over years.
- Approach these relationships as equal partnerships, unlike more transactional arrangements.
- Be clear on what value you bring to the business: perhaps some combination of governance, investment and industry expertise, global perspective, and specific global experience in the relevant sectors.
- Take the time to be certain about compatibility, as these relationships can be hard to unwind.

Needless to say, it is essential to invest significant time before making such an investment. Build the relationship slowly, as both sides gain confidence in the other. Over time, a simple investment can scale into an entire investment platform that leverages the partner's operational excellence across a portfolio of investments with your complementary expertise.

Partnering with families requires a special mindset, one that values a willingness to develop relationships over a long period of time.

CPP Investments, for example, began a relationship with Cyrela Brazil Realty, Brazil's largest homebuilder and real estate company, in 2009. Our first transaction came in 2010, with Cyrela Commercial Properties. We now have roughly C$1 billion committed with the group.

In Mexico, we started our relationship with infrastructure company IDEAL in 2015. In 2016 we invested in Arco Norte, a toll road in the central valley of Mexico. In 2018, we increased our commitment to the group with another toll road, Pacifico Sur, and in 2019, we became shareholders of the group, with exposure to 16 different roads and other assets across the country, committing over C$2.2 billion.

Partnering with family-controlled business can be an effective strategy for the deployment of long-term assets. To get it right, however, investors must stop thinking about short-term transactions and start thinking about building relationships that last generations — like the family itself.

Sources

1. CPP Investments Analysis.
2. "The billionaire effect," UBS and PWC, Nov 2019.
3. https://assets.kpmg/content/dam/kpmg/nl/pdf/2019/advisory/winning-strategies-for-the-long-term.pdf

About the Author

RODOLFO SPIELMANN

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Rodolfo is responsible for leading our operations in Latin America, overseeing all aspects of our mandate, including our investments and partner relationships in Latin America. He leads our activities in these markets.

Prior to joining CPP Investments in 2014, Rodolfo spent 21 years with Bain & Company, the past 14 in Brazil and prior to that, in Germany. Most recently he was Practice Leader, South America Financial Services, at Bain & Company. Prior experience includes Deutsche Bank Commercial and Corporate Banking in Spain and Germany.

Rodolfo holds a BA in Economics from the University of Buenos Aires and an MBA from the Wharton School at the University of Pennsylvania.