EFB response to
the public consultation on building a proportionate regulatory environment to support SME listing

EFB
EUROPEAN FAMILY BUSINESSES

Family Business: Ownership, Business, Family

The vast majority of SMEs are family businesses. The common feature of these companies is that of the ownership dimension, where business and family are intertwined. Indeed, taking the ownership perspective as opposed to the company size perspective is how best to understand this form of company.

The first principle of the common European definition of a family business states, 'the majority of decision-making rights are in the possession of the natural person(s) who established the firm, or in the possession of the natural person(s) who has/have acquired the share capital of the firm, or in the possession of their spouses, parents, child or children's direct heirs[1].' Indeed, the exercise of decision-making rights, through ownership, is fundamental to the strategy that underpins family businesses.

In the context of supporting the listing of SMEs, the introduction of external equity can be contentious and must be promoted with caution. 'Enduring family businesses regulate ownership issues for example, how shares can (and cannot) be traded inside and outside the family through carefully designed shareholders' agreements that usually last for 15 to 20 years.[2]' Listing can be a useful tool for funding growth or even remunerating value built over generations, but it should not be considered as a tool that can be applied across the board. Ownership, and its management across the family, is highly complex, and introducing external influences on that ownership, adds another layer of complexity.

EFB concedes that capital markets are not as effectively utilised in Europe as they should be, and we maintain that listing can entail risks and opportunities for family businesses. But, there are various other less costly, less risky, less burdensome capital raising options that are available (e.g., private equity, private borrowing and government funding) which can be more suitable.

EFB would also raise caution on the notion that listed companies outperform their privately-owned counterparts. Various other studies, which look at returns and value creation over a longer period, would argue that privately owned companies outperform their listed counterparts. Privately owned companies, the vast majority being family owned, will fare better during downturns and have better staff retention[3].

Why do certain family businesses avoid listing?

A recent study by London Business School, argued that 'family firms in general appear to prefer remaining privately held, rather than publicly listed for the following reasons: (1) listing rules and requirements are perceived as onerous and a burden to the firms; (2) the perceived short-termism of the market, which is not consistent with their long-term strategic objectives, including long term value creation and (3) fear that they will lose control of the business; and (4) concerns that confidential information becomes available to private competitors.[4]'

With this understanding of why certain Family SMEs do not list, the tools at the disposal of policy makers are limited. However, that is not to say that they can't help. Below EFB outlines three crucial areas that must be considered by the European Commission if and when it prepares any supportive regulatory measures.

---

[1] https://ec.europa.eu/growth/smes/promoting-entrepreneurship/we-work-for/family-business_en
[2] The five attributes of enduring family businesses, McKinsey&Company, 2010, https://www.mckinsey.com/business-functions/organization/our-insights/the-five-attributes-of-enduring-family-businesses
[3] http://www.famcap.com/articles/2016/2/4/spanish-family-businesses-saved-the-economy
[4] 'Causes and Consequences of The Decline of The Public Corporation' (Economides et al, lbs, 2016)

Supporting Family SME Listing

1. Two-tier share system

Using a two-tier system of share ownership has proven to be an effective tool for family companies to inject paid-in-capital into the business, choosing to list using two classes of shares usually one with super-voting power, the other without. Under the structure, one class of share, often called class B, is worth more than the class A stock, because of the enhanced voting rights it carries. The dual-share system has sometimes come under criticism but, EFB argues that such structures allow the family or those with in-depth knowledge of the company to steer the business in the right direction, taking long-term decisions rather than responding to short-term market pressures.

2. Admin burden reductions

As noted above, family SMEs are sometimes put off by the arduous regulatory requirements that come with listings. Given that IPOs come with significant public scrutiny and regulatory oversight, and other capital-raising mechanisms might not, it is important that family SMEs have the right information to take on the right investments that best fit their needs. But, certainly a reduction in the complexity and the reporting requirements that come with listing, might encourage more family businesses to seek out this form of capital injection.

3. More information needed

After consultation with our members, it is clear that family businesses, especially the smaller ones, are not fully aware of the potential benefits of seeking external capital. For example, certain family businesses are not aware that they could list only a small percentage of their shares to keep control. Dedicated markets for family SMEs, which take into account the family element and all the complications that might entail, could improve the take up of these companies (for example: Euronext Family Business Index).

Conclusions

EFB understands that IPOs can be a vehicle for growth and expansion. If properly thought out and implemented it can help turn our family SMEs into bigger enterprises; something that EFB fully endorses. However, there is big caveat, taking on external equity can force a change in strategy that certain family businesses are not prepared for.

In sum, one must remember that behind SMEs, there are human beings and family, underpinned often by strong values which are not purely market driven or profit seeking. 'One of the biggest mistakes a company can make is to approach an IPO purely as a capital event (PwC)[5].' As a result, the promotion of SME listing must be done with caution, where the risks, as well as benefits, are clearly laid out.

European Family Businesses is the EU Federation of 14 national associations representing family owned companies. Our members represent a turnover of more than one trillion Euros, over 9% of the European GDP. We strive to raise awareness about the crucial role of family businesses in the European economy by pressing for policies that put family owned companies on a level playing field with other companies, and policies that favour and promote long-term responsible ownership.

[5] http://www.ey.com/uk/en/services/strategic-growth-markets/ey-ipo-leaders-insights-anil-menon