FAMILY BUSINESS - BLOG

Are You Sure You Want to Go Public?

Morten Bennedsen, The André and Rosalie Hoffmann Chaired Professor of Family Enterprise at INSEAD | May 8, 2015

Many family owners are tempted to float their company on the stock exchange, lured by the idea of raising significant amounts of cash. But going public is not always what it's cracked up to be.

There are numerous benefits to going public: obtaining finance for future growth, giving capital to family owners so they can invest elsewhere, providing private owners with clear valuations and even exiting, if that's what the owners want to do. But listing may not be the ultimate solution for all family businesses for three main reasons.

Firstly, corporate legal requirements are much stricter for publicly traded firms. The need to hold shareholder meetings, appoint a board, deal with minority owners – all in a highly regulated fashion – can be tiresome. If you, as a founder, are used to running the firm though board meetings over Sunday lunch, it can be a real shock to have to deal with the board of your newly publicly traded company in more formal settings.

Secondly, the new owners have a voice and will want a say in how you run the business. They may start to contest the leadership: are you working for your own interests or in the interests of the owners as a whole? Are you able to create shareholder value or could others do better? Also, it is worth keeping in mind that since publicly traded firms are more visible, unhappy minority owners may use the media to criticise you.

Thirdly, your control of the company may ultimately be challenged. Even when ownership is carefully designed, going public may create long-term dynamics (not foreseen at the time of the IPO) that threaten your control – either in the immediate aftermath or years later.

How can it all go wrong?

Two well-known family firms which ran into well publicised problems are Cadbury's and Hermès. The fall of the iconic British chocolate firm is a powerful example of how ownership is a dynamic concept and how going public can, in time, set in train unforeseen changes in ownership and control. Essentially over the course of 50 years since 1962, the Cadbury family's ownership stake had been diluted sufficiently for it to lose control of the company.

In the early 1960s the number of family members who held shares increased to several hundred – of which only 10 were actively involved in the business. With non-managing family members keen to have access to their capital, pressure to take the firm public grew, and the Cadbury board floated the company.

The firm's ambitious growth plans to expand into new geographies was facilitated by a merger with Schweppes at the end of the 1960s. Over the following decades of rapid global expansion there was a sharp reduction in the family's ownership stakes as their charitable trusts and foundations sold shares to reduce the risk of being over-dependent on one company. After Dominic Cadbury, the last family member involved in the company, retired in 2000 speculative investors recognised the value in demerging Schweppes and Cadbury and moved in.

Hedge fund investors subsequently saw Cadbury as an enticing takeover target due to its return to a mere confectioner, and their actions led the way for Kraft to launch a successful takeover in 2010, thus ending 180 years of a family-owned business.

Could the Cadbury family have held on to the company if their ownership stake had not been diluted over time? Probably, but even a big family stake may barely be enough to protect family ownership of a publicly traded company.

Luxury company Hermès learned this lesson just in time. It was pressure from heirs to liquidate their shares that led the company to go public in 1993.

Luxury wars

Hermès listed all its shares but over 70 percent remained family-owned. However, unbeknown to CEO Patrick Thomas, its rival, LVMH, had acquired a 17 percent stake in Hermès through undeclared financial derivatives in 2010 and it wanted more.

LVMH CEO Bernard Arnault intended to approach the 70 Hermès family members who still had shares to ask them individually if they would be interested in selling. He was given encouragement when one branch of the Hermès family publicly advocated collaborating with him.

Hermès had two options: either the family could buy up all the outstanding shares and de-list the company, or they could make Arnault a counter-offer and pay him a premium to leave the company alone. Neither option was attractive.

In response to the threat, the family created a holding company that had first right to buy any family shares. Through this mechanism they could prevent at least 51 percent of the shares of family members being transferred to LVMH for the next 20 years.

Though LVMH appealed against the measure, arguing that it was not in the interests of shareholders, a court upheld the legality of the arrangement.

The Hermès family had stood down their rival, but they learned a hard lesson. And although the holding company was legal in France, it may not have been in countries such as the U.K. or the U.S. Re-designing the tradability of publicly traded shares has a significant cost for minority shareholders who originally invested under a different set of rules. In this case, they were not compensated. Would the French courts have come to the same conclusion if Hermès had not been an icon in the luxury industry of France? We will never know the answer. What is clear, however, is that the family's control of Hermès would have come under severe pressure if the courts had reached a different conclusion.

It is worth pointing out that the family could easily have protected itself in 1993 when the company first went public. If the holding company or other control-protecting mechanisms had been in place at the IPO stage, new investors would have known this when they invested, and the price of the shares would have incorporated the lack of a potential takeover premium.

The Cadbury and Hermès stories are dramatic illustrations of how going public can have long-term implications for a family's ability to control the business. If done correctly, it can be the first step towards a full exit, if that is what's best for your family firm. Exiting will be the subject of my final blog to complete the road map for the future governance of your family company.

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