The Family Business on the SSE
Family Ownership’s Impact on a Valuation Process

Bachelor’s Thesis within Business Administration
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**Abstract**

The main purpose of this thesis is to investigate the differences between family and non-family businesses that are listed on the stock exchange, more specifically which factors that is being used in the valuation process and why family businesses as a rule seem to be undervalued. We also look at if family ownership is a factor in this process.

By conducting interviews with analysts and journalists working with valuation we hope to be able to not only find out what factors differ but also why family businesses are undervalued.

Our conclusion is that while the two forms of ownership has several negative factors that differ between them that are more common among family businesses, such as conservative dividend policy, this is not connected to the family business as a form but is rather an individual factor differing from company to company. Family ownership as such was however not in any way a factor in the valuation since the valuations instead looks at the individual company and does not generalize.
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1 Introduction

This chapter is an introduction to the concept of family businesses on the stock exchange.

1.1 Background

The family business, in this thesis defined as a company where a family controls at least 20% of the votes and there are no other major share holders in the company, is one of the most commonly occurring forms of business. The family businesses are according to Astrachan and Shank (1996, cited in Lee 2006) responsible for 12% of the U.S. GDP and family owned or controlled businesses account for over 80% of all U.S. firms. On the stock exchange however the number is much lower but family businesses still represent a large percentage of the total number of firms on the world’s stock exchanges, Anderson and Reeb (2003) mentions that over 35% of the Standards & Poors (S&P) 500 Industrials list are family businesses. The situation in Sweden is that on the OMX Large Cap index (see appendix 1) Swedish family businesses account for 34% of the companies listed (Affärsdata, 2006). OMX data shows that the Swedish stock exchange’s A-list consisted of 26% family businesses on the 31st of December 2005 while the O-list had a staggering 48% (OMX, 2006a). The Medium Cap on the Stockholm Stock Exchange (SSE) consists of almost 40% family businesses of the total, while the Small Cap on the SSE has roughly 45% (Affärsdata, 2006).

Many experts believe that getting listed is the only way to raise the necessary capital for growth or even hinder bankruptcy for family-owned small businesses. Two causes are given as an explanation, the first one is internal obstacles caused by an information gap between inside and outside shareholders, and the second one is the financial market itself that is reluctant to invest in small firms that are not listed (Mahéralult, 2000).

Research into this field has established that family businesses on the stock exchange, in general, perform better than the mean on the exchange. Poutzioris (2006) even showed a 40% difference in performance between the family businesses listed in the Financial Times Stock Exchange (FTSE) indices and the average of the FTSE indices, although he also remarks that there are quite few family businesses on the FTSE (6,2%). Further more Anderson and Reeb (2003) in their study on the S&P 500 noticed higher Return on Assets (ROA) ratios and Return on Equity (ROE) ratios in family businesses compared to the index norm. However this has yet to be confirmed on the Swedish market and Cronqvist & Nilsson (2003) has shown a negative correlation between family ownership and ROA.

Shares in family businesses on the SSE have been proved to be priced at a discount by Andersson and Nyberg (2005), and they theorized that this is the case since the investors are, in effect, ceding control of their money to the controlling family and are unwilling to do this unless the stocks trade at a discount. Villalonga and Amit (2004, p. 29) show in their report that “Despite this “control discount,” minority shareholders are likely to be better off in a family firm than they would have been in a non-family firm.” This implies that family business shares should be more expensive, not less so, but obviously this is not the case. This phenomenon could be associated with lack of information on the side of the investor as seen in the Behavioral Finance Theory.

1 In this thesis the authors use the terms family business, family firm and family company interchangeably.
Lang, Li and Miller (2003) show that the number of analysts, in this thesis defined as a person who is employed by a bank, a brokerage firm or similar whose job is to analyze the market, following a specific share has an impact on that individual share’s price. Further on they state that family businesses are less likely to be followed due to lack of information made available by the companies. Lidén (2004) show us that buy/sell recommendations from journalists, in this thesis defined as any person employed by a newspaper, business magazine or internet based business sites to write articles to be journalists, have a distinct impact on the individual stocks performance on the stock exchange. Combine this with a lower amount of analysts following family businesses, and thereby making fewer recommendations in regards to family controlled businesses. Since the objective of stock recommendations is to influence potential investors this possible lack of insight into family businesses could create an information shortage among investors.

1.2 Problem
As mentioned in the background, earlier research suggests that family businesses worldwide outperform their indices in terms of ROA (Anderson & Reeb, 2003, Poutziouris, 2006, Tran, Romano & Smyrnios, 1999) while recent research in Sweden claim that Swedish family firms has lower ROA (Cronqvist & Nilsson, 2003).

A theory that instead seems to be well proven in Sweden is that family-firms are undervalued (Anderssson & Nyberg, 2005); a phenomenon that appears to be true for foreign family firms as well (Villalonga & Amit, 2004). There are diverse theories about why family businesses are undervalued, possible sources for the differences in valuation between family firms and non-family firms is suggested by previous researchers. Examples are investor discounts due to low minority owner influence or control held tightly by owning family with the help of different control mechanisms (Anderssson & Nyberg, 2005). Empirical evidence by Holmén & Högfeldt (2005) shows that family businesses are more prone to over-investments through a high retention rate, this would theoretically imply lower dividends. As dividends are a relevant part of many stock-valuation models this would have a direct impact on stock value, however the economic journalist Wilke (2003) claims that there are no analyst-models that directly focuses on listed family businesses.

Earlier research by Olbert (1993) has stated that the most commonly used tools by journalists and analysts are those included in the fundamental valuation models. By doing a qualitative research through interviewing analysts and journalists, we hope to find out if family businesses have special characteristics that are reflected in the analysts and journalists valuation process, leading to the undervaluation. This is a problem that could be of great concern for the family firms, since undervaluation that is not explained by differences in the valuation process could mean an opportunity for potential investors.

1.3 Purpose
This thesis aims to examine what factors journalists and analysts take into consideration when valuing listed family businesses and if the valuation process differs compared to non-family firms.
1.4 Research Questions

- Among journalists and analysts, what are the main factors leading to different valuation results for family businesses compared to non-family businesses?

- What are the main reasons behind the acknowledging/neglecting of family ownership as a valuation factor?
2 Frame of Reference

This chapter presents theories and earlier research, forming the basis for the thesis.

2.1 Explanation of Definitions

In the sections below we explain more thoroughly the definitions of Family business and Analysts and Journalists used in this thesis.

2.1.1 Family Business

How to define a family business is a tough question. Astrachan and Shanker (2003) lists a number of criteria commonly used for the purpose of defining the family business. These criteria are the percentage of ownership the family has in the business, if the family has strategic control over the company, the involvement of multiple generations in the company and the intention of the family to keep the business within the family. They claim the different characteristics can all be important depending on where the family business is in its life cycle.

Tran, Romano and Smyrnios (1999) list different definitions mentioned in earlier research. Westhead & Cowling (1996, cited in Tran et al. 1999) used 50% voting rights; Moores & Mula (1993, cited in Tran et al. 1999) used 50% of directors or 25% of senior management under family control while Smyrnios, Romano and Tanewski (1997, cited in Tran et al. 1999) have the criteria that a single family group is controlling the business.

Poutzioris (2006) defines the Public Limited Company (PLC) as being family controlled when at least 25% of shares belong to family shareholders given no other major stockholder exist in the other 75%. Please note that Poutzioris research takes place in the U.K. where the common Swedish practice of dual-class shares is rare (Henrekzen & Jakobsson, 2006). Poutzioris (2006) points out that many recent studies have used lower thresholds in terms of shareholding when defining the family firm and points out that Anderson and Reeb (2003) used 10-20%.

When researching this subject it was evident that there seems to be as many definitions of a family business as there are articles and books and that they are sometimes quite diverse.

We have decided to use a minimum ownership of 20% voting rights provided no other major holders of votes exist in order for it to be recognized as a family business, which is at the upper level of Anderson and Reeb’s study. This thesis use voting rights since the Swedish dual-class share system makes it more relevant in terms of company control than actual shareholding in the company (Henrekzen & Jakobsson, 2006). We chose to base our definition on Anderson and Reeb’s since we base a large part of our empirical evidence on their study and that many reports we have read make references to their study.

2.1.2 Analysts & Journalists

- A journalist is a person employed by a newspaper or business magazine to write articles (Lidén, 2004).

- An analyst is defined as a person who is employed by a bank, a brokerage firm or similar (Lidén, 2004).
Given these definitions, the two categories got different approaches to the presentation of the analysis and recommendations. The major difference between analysts and journalists is that analysts got first class and more precise information about the firms, while the journalists lack this detailed information and they are also just working with the firms for a certain time period (Lidén, 2004). An important aspect that separates journalists from analysts is time. Previous research shows that an economic journalist spends about 30% of the working week analyzing equities, while an analyst spends about 70% (Olbert, 1993). Furthermore, Olbert’s research shows that the analyst on average splits this time between only 13 companies while the typical journalist divides his/her time between 23 companies. Another difference is that the analysts also often have more staff working for them, analyzing all the information, while the journalists work by themselves most of the time (Lidén, 2004).

There is also a darker side to the different approaches. The journalists are often doing the recommendations on behalf of an objective magazine, while the analysts got an employer who might gain from making buy recommendations. It could for example be that the bank or brokerage firms are having, or hoping to have, deals with the specific firms. Another possibility is that there could be gains to be made from creating higher sales volumes on their own brokerage firms or banks (Lidén, 2004).

Evidence for unbalanced recommendations in favor of the banks own clients are presented in a thesis by Hagelin and Larsson. Their report investigated 33 companies introduced on the Swedish stock exchange between 1996 and 2000; they present findings that in 2 cases out of 3 the bank analysts gave strong buy recommendations on companies underwritten by the corporate finance department of the same bank (Huldschiner, 2001).

2.2 Theory

In this section we explain theories relevant to this thesis, focusing on how a valuation is being conducted and with additional information regarding investment behavior, the Efficient Market Hypothesis versus the more recent Behavioral Finance theory.

2.2.1 Conducting a Valuation

When investigating if a company is profitable to invest in, there are different ways to conduct these analyses. Three generally accepted techniques are Beta analysis, technical analysis and fundamental analysis. Since both technical analysis and Beta analysis are more concerned with prior stock price charts and stock price volatility, we have focused on the most common technique used, fundamental analysis. Fundamental analysis deals with facts in terms of numbers and ratios and also includes other non-figure aspects such as which market the company is acting upon. This is the most commonly used valuation approach (Olbert, 1993) and the one that possibly could include ownership related factors such as family ownership. Therefore we will only mention the other valuation techniques briefly for the sake of completion, due to the fact that these techniques often are used after the fundamental analysis to determine the stock price volatility and the right time to purchase the security (Malmer & Pettersson, 1999). The Stock Valuation Process Model (Fig 2.1) by Malmer & Pettersson shows how the different aspects of valuation fit together.
2.2.1.1 Technical Analysis & Beta Analysis

Technical analysis is a practice that is mainly concerned with discovering recurring and predictable patterns in stock prices. By doing this the analyst hopes to be able to predict stock price and thereby generate abnormal trading profits (Bodie et al, 2003). Analysts working with technical analysis do not necessarily deny the importance of fundamental information but believe that there is a possible to discover patterns in stock movements before any shift in market fundamentals has occurred, making it possible to get abnormal profits. This view is of course on a direct collision course with the efficient market hypothesis explained further down (Bodie et al, 2003). Beta analysis can be seen as a tool to determine how strongly a stock cooperates with the stock-market (Malmer & Pettersson, 1999). A risk-free investment has the Beta value zero while the stock market average is one.
Stocks with a Beta value less than one can thereby be seen as less volatile and more stable than the stock market on average (Fischer & Jordan, 1995, cited in Malmer & Pettersson, 1999). However, in order for financial analysts to be able to use a specific Beta value, the value needs to have been stable for some time, a criteria not always fulfilled by individual firms (Levy 1971, cited in Malmer & Pettersson, 1999) and this may be one of the reasons for analysts to be more focused on fundamental analysis.

2.2.1.2 Fundamental Analysis

Malmer & Petterson’s (1999) model (fig 2.1) focuses on four different methods of fundamental valuation, Cash-flow analysis, P/E ratios, Net worth analysis and Gordon’s growth model.

Cash-flow analysis, or discounted cash-flows as it is also known, assigns a value to the company equal to the discounted sum of expected future cash-flows in the company. Shareholder wealth increases if the company’s cash-flow increases or if the discount representing dividend demands\(^2\) diminishes (Gärtner & Olbert, 1995).

The P/E ratio assigns a value where the market price per share divided by the earnings per share in order to give a profitability value per share. Damodaran (1999) names it as the most widely used and also most widely misused of all key ratios while Gärtner & Olbert (1995) found that among the Swedish financial analyst community an analysis consisting of comparing the estimated P/E ratio of the next 1-2 years with a reasonable P/E ratio was the most common. However, this massive endorsement to the model is explained by Gärtner & Olbert (1995) as a consequence of the ease of use of the model rather than it being extremely relevant.

Asset Based Valuation looks at the capital invested in the company valued under the assumption that the company will stay in business and, simply put, values the company by taking the adjusted book value of assets and splitting the value evenly over the issued shares Malmer & Petterson (1995).

Gordon’s growth model takes into account company growth, dividend policy and demands on dividend payback from the shareholders when trying to establish an accurate price on the share. The biggest weakness of the model being that you must be able to accurately predict company growth in order to get a correct value as the model is very sensitive (Damodaran, 2002).

Damodaran (2002) lists four ways in which firms can be valued. These methods are Asset-Based Valuation, Discounted Cash-flow Models, Relative valuation and Contingent Claim Models. The choice of valuation method depends on several factors including the time horizon of the investment with asset based valuation estimating the value of a company as if it were to cease operations on the day of the valuation and discounted cash-flow being on the other end of the spectrum with an end date of infinity. Another factor impacting the choice of method is the reason for doing the valuation, if you are examining if a company is over-valued within the industry relative valuation would be useful while if you are thinking about investing as a private investor discounted cash-flow models might be more appropriate. The third aspect affecting valuation is the investor’s beliefs regarding the market as can be seen in fig 2.2. The different methods of valuation and how they are linked are shown in fig 2.3.

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\(^2\) Dividend demand is the yield the shareholders demand in order to invest at the current risk.
Figure 2.2 Views on Market and Valuation Approaches (Damodaran, 2002)

The main thing to note in fig 2.3 is that there are four major approaches to making a valuation, the main approaches will be presented in this section, but the different valuation models will only be discussed in more general terms.

Asset-Based Valuation is when you’re valuing the business by looking at the value of the firm’s current assets. This is most easily done in cases where the assets are separable and marketable in their own right, such as real estate, but more difficult when marketing several products under the same brand name, selling of a brand name for shaving cream while retaining the brand name for razors for example. The two major lines of thought in this area is the Liquidation Value model, where the value is what you would get paid if you sold all the assets in the company, and the Replacement cost model where the value is calculated from the basis of what it would cost the company to replace the assets it already is in possession of (Damodaran, 2002).
Valuations based on Discounted Cash-flows can be divided into two groups dealing with Equity Valuation Models\(^3\) and Firm Valuation Models\(^4\). These models are also dependant on the view taken in regards to growth and current/normalized earnings, dependant on if the company has a cyclical fiscal year (Damodaran, 2002).

The third way of valuation, the Relative Valuation model, aims to assign a value to the company based on how other companies in the same business sector are valued and does this comparison by looking at, among other things, earnings, book value, revenue and sector specific aspects. Valuation can be difficult to perform with this method since it is difficult to find several companies that are similar since even if the companies are of similar size and in the same industry they might still differ in terms of risk, growth and cash-flows (Damodaran, 2002).

Contingent Claim valuation essentially uses option valuation applied on assets. This can be useful if the asset may be valued at a higher price than the present value of expected cash-flows, if the cash-flows are dependant on the occurrence or non-occurrence of a future event. The Contingent Claim models can be used because of the uncertainty related to for instance, undeveloped natural resource reserves owned by a company or in a situation where a company has a patent but has not decided to go through with production yet (Damodaran, 2002).

\subsection{2.2.2 Control Mechanisms}

Control mechanisms are usually employed by company owners in order to maintain control over their company and at the same time reduce their shareholding. These practices are frequently used by family companies where capital needs to be attracted while the owner still demands control. The most common control mechanisms are; dual class share systems, pyramidal structures & cross holdings which all have a significant impact on firm value (Cronqvist & Nilsson, 2003).

A dual class share system is a practice which is very rare in the large financial markets in UK and USA, but relatively common outside these nations. Sweden can in some regards be considered as an extreme case when it comes to this practice (Henreksen & Jakobsson, 2006). A dual class share system is present when there is more than one type of shares within a company, with different voting rights. The most common practice is a system with A & B shares but in some cases there may also be C & D shares. A-shares hold a higher voting power than B-shares; however, A-shares may not have more than ten times the voting rights of B-shares according to Swedish law. Exceptions are companies founded before 1944, in which one can find larger differences (Andersson, 2002).

In a dual class share system all shares are required to have the same nominal value and thereby dividend rights are the same for all shares regardless of type, preference shares excluded. The dual class share system has been an excellent way for Swedish families and individuals to maintain control in their companies with a relatively small capital base (Henreksen & Jakobsson). The practice makes it possible for a founding family to conduct an initial public offering (IPO) of their company and maintain total control with as little as 10 % of the total shares. Since dividend rights are equal for different share classes there might

\(^3\) Includes dividends or free cash flows to equity.

\(^4\) Includes Cost of Capital, APV and Excess return models.
be an incentive for controlling families to maintain retained earnings within the company through a high retention rate since most dividends would end up outside the family.

Outside the Anglo-Saxon countries the most common approach to maintain control in a number of listed firms with a narrow capital base is pyramidal structures (La Porta, 1999, cited in Holmén & Höglund, 2005). A pyramidal structure consist of a company at the top of the pyramid that controls a holding company that in turn controls other firms that possibly can control other firms etc. This structure combined with a dual class share structure leads to that the ultimate controlling owner's own capital investment becomes smaller and smaller, further down the pyramid (Holmén & Höglund, 2005). An excellent example in Sweden is the Wallenberg family that has employed an extensive pyramidal structure.

Cross holdings in Swedish companies became common during the 1980's as an attempt to make takeovers, and especially hostile takeovers, harder to perform (Henrekson & Jakobsson, 2006). Another control mechanism that can be found today is Shareholder agreements. These agreements are often about how to vote in certain matters and may also regulate the right to sell shares to a third party (Cronqvist & Nilsson, 2003).

Control mechanisms are very common in family firms and research shows that these control mechanisms employed leads to a discount in firm value in terms of Tobin’s Q\(^5\) (Cronqvist & Nilsson, 2003).

### 2.2.3 Efficient Market Hypothesis (EMH)

Fama (1970, cited in Shleifer, 2000) defined an efficient financial market as a market where the prices of securities always reflect the information available.

All markets are not equally efficient as the amount of information being analyzed differs from market to market (Bodie et al 2003). There are three forms of the efficient market, the weak-form, where the current price reflect the information of past trading (prices, volume etc), the semi strong-form in which stock prices reflect all publicly available information and the strong-form EMH where the price reflects all information including insider information (Bodie et al 2003).

The EMH means that in both a semi strong-form and a strong-form of EMH any recommendation from the press will be instantly recognized in the stocks price since it is publicly available, this means that stock tips are useless since the recommendations from the analysts should not be able to outperform the market (Shleifer, 2000). This is confirmed by Lidén’s (2004) research showing that recommendations have an impact on the market (see chapter 2.3.3) in the short term but not in the long term perspective.

Shleifer (2000) says that EMH has three assumptions; investors are rational and values securities rationally, some investors not behaving rationally all the time will trade in a more random way and cancel each other out without changing the market price and the third assumption is that irrational investors will be met by rational traders who will eliminate their influence on prices. As a consequence of this prices on stocks and other securities reflect all information available to the market. Another factor needed for efficient markets is arbitrage. Sharpe and Alexander (1990, cited in Shleifer, 2000) explains that arbitrage is when an investor simultaneously buy and sell a specific security, at different prices in different

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\(^5\) Tobin’s Q = market value / asset value
markets and thereby normalizing the price of the overpriced security to the fundamental value of the security.

Criticism of EMH includes the difficulty of proving that investors are fully rational since many investors react to irrelevant information when they make their valuations of securities (Shleifer, 2000). Fischer Black (1986, cited in Shleifer, 2000) claimed that some investors react to noise, i.e. non-information, contained in news rather than information, calling those investors who aren’t acting rationally noise traders. Another point of criticism is EMH’s assumption that irrational investors trade randomly and this was heavily criticized by Kahneman and Tversky (1979, cited in Shleifer, 2000) who had found that the irrational traders in fact do not trade randomly but rather tend to digress from the market by making the same mistake at the same time. This is done by trying to buy or trying to sell the same security at the same time. The requirement of efficient arbitrage has also come under attack as securities such as shares may not have perfect substitutes, the argument being that a share of a company is not the exact substitute for another, this naturally increases the risk that the investor must endure and reduces the willingness to invest (Shleifer, 2000).

2.2.4 Behavioral Finance

The Behavioral Finance theory aims to predict how investors gather information and how they predict price changes as a consequence of this (Damodaran, 2002). Shleifer (2000, p.23) writes that “At the most general level, behavioral finance is the study of human fallibility in competitive markets”. One of the main points of behavioral finance is that the financial markets of the world should not be expected to be efficient and that market efficiency should only appear in extremely special cases.

Behavioral Finance rests on two fundamental assumptions, limited arbitrage in the market and investor sentiment. Limited arbitrage is important since the effect of arbitrage is to equalize prices over different areas, keeping markets efficient. Limited arbitrage assumes that trade in securities markets is far from perfect, lack of good substitutes’ makes arbitrage trading riskier and the limited trade creates a situation where prices might not react to new information in a correct way or where new so-called non-information changes the price when it shouldn’t. Investor sentiment has less to do with prices but instead deals with how real world investors values companies and what demands they make on securities in order to invest in them. In order for behavioral finance to work there must be limited arbitrage or prices will gravitate towards the “real” value quickly and efficiently even if there are many irrational investors. Investor sentiment is also required for the model to work since without it there would be no irrational trading decisions and the prices would reflect the actual value of the security (Shleifer, 2000).

2.2.5 Investor Behavior and Investment Risk

Investors, as a group, are interested in two things when deciding where to invest their capital: Return On Capital (ROC) invested and the risk connected to the venture (Wickham, 2001). The Investor acceptance of risk is called their risk tolerance and varies from person to person (Bodie, Kane & Marcus, 2003). The decision to invest is made on the basis of in-

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6 The security is overpriced in one market and not in the other.

7 The only substitute for a share is another share with the same cash flow.
formation available to you at the time; this can include prior performance, relevant ratios and expected performance for the company based on what the investor knows about that company and its management. The information flow regarding companies on the SSE has got rules and regulation to avoid insider trade and distorted competition, leading to an unstable environment on the stock exchange. The most important one is the general clause saying that if a matter of importance for the company or for the view of the company is occurring it should immediately be published (Hägglund, 2001).

There are also several constraints to investment, the major five are: the liquidity of the investment\(^8\), the investment horizon\(^9\), laws and other regulations in regards to investing, the effect of tax on the investment compared to another and lastly the unique needs of the investor, such as a need to secure money in order to fund children’s tuition or pay into a pension fund (Bodie et al, 2003). Another factor to consider is that ROC of an investment should be compared to the opportunity cost for the investment in order to locate the optimal choice for the investor (Wickham, 2001).

When dealing with investments one must realize that the general rule is that there are no “free lunches”, investments that are so under priced that they are obvious bargains. Investments are connected to risk, high profitability usually brings along high risk, and this is called the Risk-Return Trade-Off. Low risk, high return investments will be considered good deals and many investors will spend their capital, driving the price up and making the investment ROC lower. Shares associated with high risk will on the other hand drop in price until the risk is acceptable when compared with the possible return (Bodie et al, 2003).

2.3 Empirical Evidence from Related Fields of Research

There has been a lot of research conducted within the field of family businesses and since the foundation of this thesis rests on results from earlier research we present some previous findings that we find relevant for the credibility of our purpose and our problem discussion.

2.3.1 Family Business Performance

Anderson and Reeb (2003) found, when investigating the performance of family businesses on the S&P 500, that they could not confirm the hypothesis that family businesses were performing worse than the norm. Family firms were in fact performing similarly to non-family firms in most respects; however the ROA based on net income of the companies was higher than that of the non-family run businesses. In fact their conclusion was that “Using profitability-based measures of firm performance (ROA) we find that family firms are significantly better performers than non-family firms. This result is robust to the measurement of ROA and is inconsistent with the hypothesis that family ownership is inherently less efficient in U.S. firms.” (Anderson & Reeb, 2003, p. 1324). They also found a correlation between high performance and the presence of a family Chief Executive Officer (CEO) and suggest that this may be a result of the family CEOs seeing themselves as stewards of the firm. The conclusions of Anderson and Reeb (2003) do however note that just

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\(^8\) How fast the investment can be converted to cash.

\(^9\) The planned time between investment and liquidation.
because you are a family firm, it is no guarantee for good performance as the relation between family ownership levels and firm performance is not always consistent but rather the performance is rising at lower levels of ownership and as the family’s ownership in the firm gets higher and higher, the risk of entrenchment and poor performance increases.

The best way to get rid of the problems commonly faced by family businesses situated on the stock exchange is to have a good way of monitoring the actions of the business in order to minimize the risk of having the family manipulating the company for their own benefit (Anderson & Reeb, 2003). Anderson and Reeb (2003, p.1324) claims that: “in well-regulated and transparent markets, family ownership in public firms reduces agency problems without leading to severe losses in decision-making efficiency.”

Jim Lee (2006) who was also researching the performance of the family firm on the S&P 500 confirmed Anderson’s and Reeb’s research stating that “Holding other things constant, family firms are likely to grow faster and be more profitable.” (Lee, 2006, p.112). Lee’s research also show that family businesses are more stable than non-family firms and that they are less likely to lay people off during recessions.

The Australian Stock Exchange provides further evidence as the listed family controlled businesses were shown to continually outperform the Australian market during the years 1995-1999 (Tran, Romano, Smyrnios, 1999).

Poutzioris (2006) saw three ways in which the family controlled Public Limited Companies differ from the normal FTSE-PLC. The first difference is that they have a lower, albeit not significant, growth rate when it comes to sales and assets. They are more profitable, having a higher ROA, ROE and ROC and they have a comparatively small amount of debt, both short and long-term, compared to equity.

### 2.3.2 Family Business Valuation

Anderson & Reeb (2003) found that the market value of family businesses on the S&P 500 was higher than the non-family firms by using Tobin’s Q. They found that family businesses enjoyed a roughly 10% higher Tobin’s Q value relative to non-family firms on the U.S. market. In comparison Cronqvist and Nilsson (2003) when looking at the Swedish market found a lower measure of Tobin’s Q among family businesses than among non-family businesses and drew the conclusion that this was associated with agency costs in companies where there is a controlling minority shareholder. The reason for this could be that the Swedish market is not sufficiently advanced and transparent as, in such a market, family businesses actually reduce agency problems “without leading to severe losses in decision-making efficiency” (Anderson & Reeb, 2003 p.1324).

Andersson and Nyberg (2005) investigated if family control, family ownership and family management creates or destroys value for the family business. They found that while family ownership and management could not be conclusively associated with the creation or destruction of value, family control was clearly connected to destruction of value. Villalonga and Amit (2004) reflects this view, mentioning several control mechanisms of family firms such as dual class shares, pyramid holdings and cross holdings which reduce shareholder value. While both sets of authors found that shareholder value diminished in family business, Andersson and Nyberg noticed a greater negative effect on the Swedish market than was noticed on the U.S. market studied by Villalonga and Amit (Andersson & Nyberg 2005).
Cronqvist’s & Nilsson’s (2003) however show a clear connection between a family acting as a controlling minority shareholder (CMS) and undervaluation. They theorize that the reasons for this undervaluation are agency costs such as not putting value maximization of the company as priority one, but instead focusing on personal benefits. There appears to be a clear correlation between CMS structures and undervaluation. In a paper from the 2005, Holmen & Högfeldt investigates the reasons for stock price discount in pyramid structured company groups, another classic CMS form popular in family companies. Their research reveals significant empirical results that there is overinvestment within these family-held groups, investments that do not reach shareholders profit-expectations. This would then imply that the existing discounts are compensation to non-controlling shareholders (Holmén & Högfeldt, 2005). Both these theses reject the correlation between tunneling and undervaluation.

Lang, Li and Miller (2003) argue in their paper that the number of analysts following a firm has a clear correlation with firm valuation. Due to the fact that analysts tend to be less likely to follow firms with poor internal governance, such as when a family is the largest holder of voting rights, it in general leads to undervaluation of these firms. A reason for analysts’ unwillingness to follow these firms are the perceived risk that controlling managers within these companies may withhold information or at least try to reveal as little as possible. The low level of information available is a large factor for analysts’ lack of coverage (Lang et al, 2003).

Lang et al, (2003) find a clear, negative, relationship between analyst coverage and proportion of family ownership/management, the stronger the family’s position in the company, the less analyst coverage.

2.3.3 Recommendations Effect on the Market

There are two groups of regularities in a market called under reaction and over reaction. Under reaction means that the prices of shares and other securities tend to under react to news, current news regarding the prices of shares tends to under react to news, where the EMH makes this impossible since any information contained in the news should be taken into consideration when determining the price instantaneously. Contrastingly over longer time periods prices tend to overreact to news where the continuous pattern is in the same direction meaning the shares which are highly performing will in time become overvalued as analysts will keep on valuating them highly and as a result of the overvaluation will have a lower ROC than could be expected (Shleifer, 2000).

Lidén’s (2004) research shows that buy and sell recommendations have a distinct impact on the market and that they are both leading i.e. giving you returns in line with the market in regards to sell recommendations, and misleading i.e. leaving you worse off than if you had followed the market index regarding buy recommendations. Lidén’s paper shows no proof of a significant difference between the market reactions on stock recommendations from journalists and analysts. However, these results regarding recommendation results can be a matter of discussion since other research published the same year shows that the average returns on recommendations from both banks and economic journalists is greater compared to the general index (Gideskog, Heimonen & Nilsson, 2004).

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10 Three to five years.
The journalists' recommendations have a great impact on the market in the short term, since the market believes journalists have newer information. This has been confirmed separately, as the US TV-show Wall $treet Week recommendations have been shown to generate an increase in stock price, although this increase was usually reversed in the next four days (Ferreira & Smith, 2003). Analysts were shown to have a smaller impact on the market in the short run, but in the long run their recommendations outperform the journalists' (Lidén, 2004).

Scott, Stumpp and Xu (2003) found a link between news and increased price momentum that was unrelated to the volume of stocks traded and company growth. There was an increase in volume of shares traded after good news about the share had spread, but they saw the correlation between the news and the price momentum as more important since news actually creates an increase in volume.

### 2.4 Conclusive Theory

The efficient market hypothesis assumes that nearly all market actors on a market are rational and the few irrational actors cancel out each other with their trades. If there would exist a semi strong or strong market efficiency all information available would directly be absorbed in the stock prices. If this is the case why is there evidence that family businesses are undervalued? The answer must lie in that either the market is not efficient and that the behavioral finance theory is more accurate or that the family businesses are actually not undervalued and their value is accurate but we do not know the reasons for the valuation being what it is. As the more recent Behavioral Finance theory is the more accepted theory today worldwide implies that markets are not efficient, except for extreme cases. Behavioral economists are convinced that investors often act irrationally and react to new and even non-new information in unexpected ways. This approach justifies the existence of analysts and the different kinds of valuation methods.

Analysts tend to lean towards fundamental valuation methods (Olbert, 1993) when conducting a valuation. The Beta analysis is used primarily to determine the volatility of the share while technical analysis helps to determine a good time to invest. The Fundamental valuation models used by Malmer & Petterson (1999) in their model (Fig 2.1) is in our model (Fig 2.4) replaced by more general valuation methods suggested by Damodaran (2002) for conducting Valuations as we do not wish to exclude the possibility that the analysts and journalists use other models than the ones listed by Malmer and Petterson.

Earlier empirical findings suggest that due to factors such as control mechanisms within family firms that cause stock price discounts (Holmén & Högfeldt, 2005) and limited information access (Lang, Li & Miller, 2003) in family businesses there ought to be a difference in valuation on a family firm compared to the valuation of a non-family firm, something we illustrate in our working model presented below.

The model forms the basis upon which we construct our questions. It is intended to investigate the possible differences in the valuation processes between the family owned and non-family owned companies. The model throughout is intended to compare the analysis processes of the two and it starts out with listing some of the different information sources available when conducting the analysis. This information gathered is then filtered by looking at different valuing factors. This fundamental analysis looks at several valuing factors, where the individual family business might differ from the non-family one, such as dividend policy (Holmén & Högfeldt, 2005). Other factors to consider are if the technical and
Beta analysis are performed in the same manner or if they differ in some way when comparing the two forms of businesses.

As the intent of this thesis is to investigate the factors that differ between the family owned and the non-family business several possible differences have been listed, including less information (Lang, Li & Miller, 2003), smaller dividends (Holmén & Högfeldt, 2005) and several others. These possible dissimilarities are the foundation of our interview questions (see appendix 2).

Figure 2.4 Differences in Valuation Model (Own model, adapted from Malmer & Petterson 1999)
3 Methodology

This part of the thesis focuses on the methods chosen in order to conduct empirical research within the field of interest.

3.1 Research Methods

Most of the research conducted on family business valuation has used quantitative research methods and thereby managed to get a statistic correlation between undervaluation and family firms, but the reasons behind this undervaluation are not known and to examine if we can find out some of these underlying reasons we will conduct a qualitative study.

This chapter begins with explaining the qualitative approach to collecting the empirical data. Then this approach is compared versus the other major research method and then there is a discussion regarding validity and reliability and primary and secondary data.

3.1.1 Qualitative Research Methods

One of the basic assumptions that qualitative research methods rest on is that individuals construct reality in interaction with their respective social worlds (Merriam, 2002). A Qualitative interpretive research method focuses on learning how different individuals experience and also interact with their perceived social world (Merriam, 2002).

A few characteristics can be identified when analyzing different interpretive qualitative research designs: All researchers strive for understanding the meaning people have constructed about their view and experiences and the researcher is always the primary instrument for both analysis and collection of data (Merriam, 2002). This means that the researcher might be biased or has a subjective view. It is therefore of great importance to identify and monitor these “obstacles” in order to see how they influence the data handling.

3.1.2 Qualitative Research vs. Quantitative Research

There are several differences between qualitative and quantitative research methods. Qualitative research often tends to be more explorative and even unstructured while quantitative research often emphasizes descriptions more (Grønhaug & Pervez 2005).

When conducting qualitative research the data is often gathered and analyzed at the same time, for example in interviews where new questions arise and further data collection and clarification is made possible. In quantitative research the tendency is that data collection and data analysis are separated and follow a sequential pattern (Grønhaug et al, 2005). At the end of the process the product of a qualitative inquiry often differs from a quantitative one in several ways. Merriam (2002) defines the results of a qualitative research as “richly descriptive” with words and pictures instead of numbers and this leads to a larger need for interpretation and understanding of the data collected (Merriam 2002).

As this thesis intends to go into deeper and more detailed levels a qualitative method was chosen. Further on as the purpose of this thesis is to analyze the processes and thoughts of individuals the qualitative method was seen as more appropriate. Interviews will be our approach to solving the research questions, and will be discussed in chapter 3.2.
3.1.3 Analytical Procedures

There exists no single accepted approach when it comes to qualitative data analysis. Because of the often overwhelming amount of data (Gronhaug et al., 2005) it is often necessary to reduce the amount of information. According to Miles and Huberman (1994, cited in Gronhaug et al. 2005) there are 3 components in qualitative data analysis;

- Data reduction
- Data display
- Conclusion drawing/verification

Data reduction can be seen as the first step and it is about selecting, focusing, simplifying and transforming the data into more meaningful material. This is a sensitive stage where the researcher must balance between simplifying and reducing material but not losing relevant data, such as alternative explanations (Gronhaug et al., 2005). Data display can be seen as an organized and compressed assembly of information that permits the researchers to draw conclusions and also taking action (Gronhaug et al., 2005).

3.1.4 Validity, Reliability and Generalisability

The concept of validity refers to the researcher ability to get hold of participants’ knowledge and also interpretation and understanding of their answers/replies (Saunders et al., 2007). In order for a research’s collected data to be valid it is of great importance to use non-biased questions in order not to steer the participants answer towards your intended conclusions. It is also important to be sure that both researcher do not misinterpret answers from the data collection and equally important that interviewees do not misinterpret the questions from the researchers (Saunders et al., 2007).

Reliability in a research is about getting reliable results. If another researcher conducts new research with exactly the same purpose and methods the results should be identical with your results. A common method to check for reliability is the input-output model, which implies that two identical questionnaires distributed to two random samples should provide the same results. Same input, same output. If they do not, most likely reliability is low in one or both investigations (Svenning, 2003).

According to Svenning (2003) it is much harder for a quantitative research to be reliable than a qualitative one. The reason for this is that a quantitative research needs to have higher generalisability than a qualitative study, which in general has a smaller sample that is non-random. There are several ways of raising the reliability in a research. By using clear definitions in interview situations, interviewees are able to provide more exact answers than if they had to interpret every unclear definition as they consider it to be (Svenning, 2003).

Since this thesis uses a qualitative research method, interviews, we will set out to create easily understood questions that should be hard to misinterpret. The interviews were also recorded in order to reduce the possibility of the thesis misquoting any of the interviewees. Although it should be known that is almost impossible to get flawless results, but by having the knowledge about validity and reliability when conducting your research, you are more likely to raise the levels of both in your research.
3.1.5 Primary Data & Secondary Data

Our Primary Data collection will consist of performing telephone interviews with analysts and journalists working on a day to day basis with analyzing the stock market. Telephone interviews were used because it was assumed that the interviewees would be based in too far away for face-to-face interviews to be a viable option.

The Secondary Data in this thesis consists of scientific and news articles and books and was collected through searching databases such as Google scholar, DiVA and the JIBS library’s JULIA in order to collect the earlier research and theories deemed necessary for the thesis.

3.2 Interviews

A commonly used method in order to obtain data in qualitative research is interviews. An interview can simply be defined as by Kahn and Cannel (1957, cited in Saunders, Lewis & Thornhill, 2007): “A purposeful discussion between two or more people”. Interviews can be conducted in different ways; the most common definitions are discussed further down. An interview is built up around questions of different nature, often referred to as open or closed questions. Closed questions are questions which can be answered with a confirming or a denying answer, yes or no. Open-ended questions often starts with words as; What, Why, and How? (Häger 2001, Saunders et al 2007) By using open-ended questions the interviewer often gets longer, more explorative answers from the respondent.

3.2.1 Unstructured Interviews

The characteristics of unstructured interviews include the fact that the interviewer does not enter the interview situation with a predetermined set of questions. The reason for this is that he/she does not know what specific information is wanted from the interview setting. An unstructured interview is usually conducted with the help of broad, unstructured questions which enables the interviewees to elaborate on those subjects that is found relevant to them. The main objective of an unstructured interview is to bring up some preliminary issues in order to determine which of them that needs further attention in structured follow-up interviews (Sekeran, 2003).

3.2.2 Structured Interviews

Once the information need is known, structured interviews come into play. The information need may be established from earlier unstructured interviews and the objective with the structured interviews should be to go more in depth with issues that are considered relevant to the problem investigated. In order to gain this information the interviewer has a list of pre-determined questions that is the same to all interviewees, even though new follow-up questions may arise depending on the interviewees (Sekeran, 2003). Since structured interviews are used to collect quantifiable data they are often referred to as Quantitative research interviews (Saunders et al, 2007). Once a sufficient number of structured interviews have been conducted and enough relevant information gathered in order to understand and describe the different factors involved in the problem, it is time to halt the interviewing. Thereafter the information should be tabulated and analyzed in order to accomplish the task set out to investigate (Sekeran, 2003).
3.2.3 Semi-structured Interviews

In a semi-structured interview the interviewer usually has a list of themes and questions that are to be covered but these questions may be different from interview to interview. Additional questions will also often arise during the interview (Saunders et al, 2007). This approach is a mix between the unstructured and the structured interview, which gives the advantage of the flexibility that occurs in the unstructured interview and the more detailed information that is obtained in a structured interview.

3.2.4 Different Types of Interviews

3.2.4.1 Face-to-face

In most unstructured interview situations, face-to-face interviews are often used. A large advantage with face-to-face interviews over different types of interviews is the flexibility. The interviewer can easily modify and adapt questions to suit the respondent better and may also pick up nonverbal clues such as hesitation, stress or uncertainty (Sekaran, 2003). According to Saunders et al (2007), people are in general more willingly to be interviewed than filling in a questionnaire. Saunders also stresses the significance of establishing personal contact since the research will be seen as more important and interviewees will be more obliged to participate in follow-up interviews and clarifications by telephone once they met the researcher in person.

3.2.4.2 Telephone

Even though face-to-face interviews seem to have an absolute advantage over other interview forms, this is not the case. When conducting a highly structured interview with precise, pre-set questions a telephone interview might work equally well. A large advantage with telephone interviews is that they are far less time consuming. Telephone interviews also enable the researchers to expand their respondent base to a wider geographical area. A few disadvantages concerning telephone interviews are that the interviewee is able to, at any time, ending the interview by hanging up the phone. Another possible flaw of this interview form is the question of caller ID (Sekaran, 2003). Telephone interviews normally do not last as long as face-to-face interviews because of the inconvenience connected to using a phone compared to a free discussion. Therefore it is often recommended to use rather standardized interviewing, in other words semi-structured and structured interviews (Saunders et al, 2007)

3.3 Our Approach

Since we are aware of what area we are interested in when gathering information and we have relevant background information, we can eliminate the unstructured interviews. However, we do not know exactly the answers we are looking for and will therefore conduct semi-structured interviews with some preset questions and possible follow-up questions, which will be different for journalists compared to analysts. Due to geographical distances all interviews will be telephone interviews. The reason for this is that most Swedish business papers editorial staffs are located in Stockholm. Analysts exist in all banks but due to central governing in the Swedish bank sector most analysts are constrained to follow directions from headquarters, once again situated in Stockholm.
3.3.1 Translation Bias and Ethical Issues

Since all of our interviews are conducted in Swedish the information received will be translated to English. This could pose a problem seen to the fact that specific information that interviewees focuses on can be misinterpreted and further distorted in the translation that will be carried out by the authors. In order to minimize this problem all interviews will be recorded and all information extracted from interviewees will also sent back to them for further clarifications and a final approval on request. Even though we are not seeking sensitive information about any specific companies or any of the interviewees’ employers, we have implemented some common ethical interview standards such as; Explain why this interview is being conducted, tell interviewee if conversation is recorded and no lies (Häger, 2001). Since all information collected will be sent back to the respondents for approval, we believe the risk of perceived unethical behavior to be rather low.

3.3.2 Chosen Interviewees

When deciding to include interviews in your research, it is important to know that qualitative interviews traditionally have not had the intention to produce statistical generalisable knowledge as is the case with quantitative analyses. Therefore there is no distinct need for a random sample, which’s purpose is to mirror the whole population. In qualitative studies the sample of interviewees is chosen by the researchers themselves (Ryen, 2004). Even though the researcher is free to make the sample selection, Trost (1989, cited in Ryen (2004)) emphasizes the importance for the researchers to get some variation within their sample. He point out that the challenge is to find the heterogeneity that exists within groups that at a first glance appears to be homogenous.

By trying to choose analysts from both the major Swedish banks and smaller investment banks we have tried to get some variance in our sample. Every journalist interviewed works at different financial newspapers or financial websites. We initially set out to conduct interviews with five financial analysts and five journalists but due to the difficulties of getting people to share a little bit of their time we had to settle for fewer interviews. This has also led to the case that we have not been able to choose the firms to interview. The reason for choosing interviewees from both journalists and analysts is that both categories are concerned with analyzing listed companies, but since analysts analyze fewer companies with more time available than journalists (Olbert, 1993) there ought to be a difference in valuation methods.
4 Empirical Results

4.1 Johan Isaksson, Analyst – Remium

Personal Communication - 2006-12-15

Johan Isaksson from Remium says that the analysis process focuses on fundamental analysis and specifically mentions Discounted Cash Flows and relative valuation. The Technical and Beta analysis methods are not used at all. He goes on by saying that meeting management of companies is common when analyzing a company weighing in management competency when determining to what extent a prognosis can be relied upon.

When asked to compare Family- and Non-family businesses Mr. Isaksson says that there are noticeable differences between the two with the family companies generally having a large percentage of ownership remaining in the family. He mentions in passing that family companies are characterized by the family business culture but not in all cases and that in the larger companies there is generally no noticeable difference regarding the corporate culture. Since Remium focuses on smaller noted businesses (below a market value of 1½ Billion SEK) where the A and B share control mechanism is not used very much the family businesses high retention ratio is absent since the family controlling a company will commonly have a large proportion of their wealth invested in the company and have an interest in receiving dividends themselves.

Although Mr. Isaksson has not taken part of any recent academic research regarding family businesses he spontaneously agrees with the possibility that family companies are valued lower than other firms on the exchange and also agrees with the possibility that this could be some sort of control discount. He also finds it possible that family businesses, as a rule, have longer term thinking which he considers positive as the company will grow more steadily over time compared to other companies.

Mr. Isaksson would not value companies differently if they were the same in all but owner structure. This means that family ownership is not taken into consideration when determining the value of a firm other than the competency of the management team.

4.2 Martin Guri, Chief Investment Officer – SEB

Personal Communication - 2006-12-18

Martin Guri, Chief Investment Officer, SEB Asset Management makes a quick description of their valuation process which includes such features as classic Cash Flow valuation methods in order to get a quantitative measurement. A large number of qualitative factors are also taken into account, such as management competence, management turnover, management’s policy and their tendency to stay with these policies and also the credibility of management’s financial predictions.

Unique among our interviewees, Technical analysis is used as a “timing-tool” by SEB in order to decide if the prognosticated value is in line with market price and thereby decides if there is an incentive to execute a trade.

Even though Martin Guri does not feel that there are any major differences between family firms and non-family firms he believes that there can be some differences. He mentions the importance of free float and that a strong family ownership or a foundation can have an
Empirical Results

inhibition effect. He states the great importance of a large free float in order to have a high liquidity of the stock, something that is of importance in case of the need for a quick sale of stocks. He believes that a very low free float can be a direct reason to not invest in a specific company.

Depending on the nature of the portfolio when investing, there is a different view towards dividends, value oriented portfolios are in general interested in higher dividends. Martin Guri has not noticed any direct connection between retention ration and family ownership. However, he points out that that SEB works with companies with a market value that normally exceeds a few billion SEK and thereby many companies are not considered, including the entire small cap index.

Family Ownership is absolutely not a factor to be seen as negative according to Martin Guri and he points out positive features such as a clear strategy and a clear dividend policy that do not change because of a new CEO. On the other hand he mentions the fact that through heritage or through a foundation a firm can get locked up and makes it very hard to be able to acquire a larger stake in the company. Martin Guri do not believe that a reason for undervaluation is families holding control through a dual class share system with a small capital base, but rather through very low free float and mentions a few examples where the free float is so low that the companies can be seen as “listed more for symbolic reasons”.

Even though Martin Guri points out that it is very hard to generalize about long term thinking within firms he mentions that companies with the founder still in control or a family firm inherited by a second generation tend to stick to their original business idea since it is about credibility towards stakeholders, something that is even more evident when the founder is an entrepreneur with an industrial background rather than a financial one.

4.3 Anders Roslund, Head of the Analysis Department - Öhman's

Personal Communication - 2006-12-18

At Öhman’s a valuation is based on a cash-flow analysis prognosis to get an internal help to get a rough estimate of the company. Then the company is examined using relative valuation, examining among other things P/E ratio’s substance value and profit margin. This gives an estimate on how the company is valued compared to the rest of the sector. This allows the valuation to be accurate even if the sector as a whole is over-/under-valued. Valuing the sector itself is more advanced and a DCF calculation is used as a basis of the valuation. Technical and Beta analysis is seen as being completely irrelevant for Öhman’s purposes and is not used.

Mr. Roslund explained that at Öhman’s the numbers speak for themselves, so in general management competence is not taken into consideration. However, if a particularly skilful leader or management team takes over a company then a few percent could be added to the valuation. Good management “increases the plausibility of a certain scenario but at the foundation of that scenario is a fundamental number analysis” motivating the valuation.

The most easily seen difference between family and non-family firms is the conservative dividend policy, which is seen as negative in general since these companies tend to have an unnecessarily strong balance sheet and could stand to retain less of their profit than they do. Although this has changed over the last few years, a company which has a history of
low dividend payments is H&M. Mr. Roslund is of the opinion that larger companies with a low but stable growth profile and no real need for investment could stand to increase their dividend payouts and not doing so could lead to internal strife.

A conservative dividend policy is not entirely bad however as for example rapidly growing companies need to retain their earnings to fund their growth and to do otherwise would be insane.

When told about the reports regarding undervalued family businesses Mr. Roslund theorized that this could be associated with irrational behaviour due to tax issues and did off-hand reject the idea that this was a general control discount. He pointed out that a well managed company should not have this sort of discount but in a less well managed one it could very well exist some sort of discount.

Mr. Roslund’s view of family businesses is in general positive one and specifically so when new companies arrive on the stock market as there is often a personal commitment from the management to the company in question. Although a small discount might be needed to draw investors to the company, in order to counteract irrational behaviour that might not be optimal for the management of the capital, there is always an interest in backing up new or well known entrepreneurs.

4.4 Niklas Johansson - Veckans Affärer

Personal Communication - 2006-12-15

Niklas Johansson from Veckans Affärer (VA) states that the analysis process depends on what branch the firm acts upon, for firms that are in a commercialisation phase a cash flow analysis are the most suitable. For this he uses a standardized excel sheet, however this method is for example not very suitable for pharmaceutical companies were other parameters such as investments and R&D are more interesting to focus on. Further on Niklas Johansson state that factors such as management capability are soft factors, and are very hard to put into numbers such as discount percentage for a company that one has not got any faith in. These kinds of factors are more of tipping points when deciding an overall opinion about a company. He is overall sceptical about using Technical analysis, especially since they are working more long-term it becomes uninteresting to use.

Niklas Johansson says that the important question with family firms is if only the large shareholders and owners profit from their own decisions, or if it is beneficial for all shareholders. It is a big minus if the family firms are conservative regarding the capital structure and are keeping the firm over-capitalized, without having any good arguments to do so.

It is hard to make any generalisations that family firms perform stronger then non-family firms, this since VA look into every company as individuals not by branches. Instead it is more a question about confidence for the company’s board and its ownership, if there is a locked owner situation it could be very negative for the company and make it uninteresting. This because it could imply liquidity problems and that nobody can enter the firm with new and useful views in order to “stir the pot”. Nor is it possible to state that family firms are more stable than non-family firms according to Niklas Johansson, instead it is more a question of market risk, product risk and the financial situation of the firm.

Niklas Johansson states that it very much depends on the company and of what kind the founder is, if it is good or bad for the company to have a strong founder and entrepreneur
that stays in the company. He gives a good example of this in Q-Med, were Bengt Ågerup has shown to be much more long-term in his thinking by taking negative results from new development projects leading to lower stock prices during several years. This was done instead of playing it safe and show positive numbers from profit generating parts of the firm and keeping the stock prices high. It has shown that Bengt Ågerup was right, and the market was wrong in there opinion about how to run the company. Niklas Johansson also talks of Swedbergs as a more negative example were the founder and large shareholders kept the company over capitalized. The reason was probably since they thought it was showing on long-term intentions with the company, while Niklas Johansson rather thinks it reveals an irrational behaviour.
5 Analysis

5.1 Analysis Process

We have found through the interviews that as expected from the research of Olbert (1993) the fundamental analysis methods are the most commonly used, with the most common methods of those found in fig 2.4 being Discounted Cash Flows Valuation and Relative Valuation, key ratios was also used while Gordon’s Growth model suggested in Malmer and Petterson’s model fig 2.1 was not mentioned by any of the interviewees. Technical and Beta analysis was in most cases not seen as being of interest for the analysts and reporters, however they were used as a timing tool at SEB. Meaning that even if family businesses Beta value differs from the non-family businesses it doesn’t really matter since that factor isn’t taken into consideration. This is also consistent with the findings of Olbert (1993).

The interviewees use several different ways of coping with soft factors such as management ability. One interviewee met with the management and tried to get a feel for their skills and abilities; the presence of good management is by some seen as “the drop that made the glass flow over” when it comes to buying the stock. Other analysts give the stock a few percent higher value if the management is perceived as good. Thereby they take these softer factors into account when creating recommendations of companies.

5.2 Family Companies vs. Non-family Companies

All the interviewees see some differences between the family and non-family firm, such as a stricter dividend policy with commonly high retention ratios, however this is not always seen as a bad thing and in growth companies it can even be seen as a positive trait to have. However, according to Mr. Isaksson at Remium, this is also not prevalent in all family businesses and especially in the smaller firms, without a dual class share system, where the founding family still is in control there is a low retention since the family wealth is tied up in the company and the controlling family would also like to have some yield on their money. In the companies which do not fulfill that criterion however the dividend policy is one of the bigger challenges for listed family businesses to accommodate the investors and is in effect lowering the valuation of the company as was suggested by Holmén & Högfeldt (2005).

Management competence among family businesses was noted by Mr. Johansson to be highly individual between firms and a family business with good management should be able to take advantage of the tight control of the owners. This is in line with the result from Anderson & Reeb’s study from 2003 where they found a correlation between family management and firm performance in the U.S. stock market.

Another difference between the two types of businesses is that the family owned business has a tendency for planning with a long term perspective which is generally viewed as a very positive trait for a company to have. The long term thinking will allow the company to grow more steadily and consistently, giving a slow but steady increase of the share price.

After being told that family businesses are undervalued several of the interviewees provided possible explanations, Mr. Isaksson from Remium being of the opinion that this could be a control discount, while Mr. Ghuri and Mr. Roslund suggested that the cause for the lower valuing could be associated with a low free float, or irrational behavior caused by taxes, re-
spectively. Mr. Roslund did however say that a control discount might exist if the company is badly managed.

In general the family business is perceived positively by both analysts and journalists but the valuation of the firm does not take this into account. The positive picture is associated with stability, long term thinking and high management competence, if it is a first or second generation business. The reason for not treating the family business differently is simply that the interviewees do not value companies in that way. A positive “feel” does not warrant a higher valuation by itself. Analysts look at hard numbers and if these numbers show the very model of a well run and profitable company they will give it a positive recommendation, but if the company shows clear signs of overcapitalization, a conservative dividend policy or other negative traits then it will, quite naturally, be given a lower valuation and perhaps a sell recommendation.
6 Conclusions

From this study we have arrived at several conclusions: firstly the conclusion that analysts do not see the family ownership as a valuation factor when conducting a valuation, instead they look at the business hard numbers and they perform the valuation from that basis. Even though the interviewees all saw family ownership as a positive trait to have in a business with several beneficial features attached to this ownership form, the interviewees were still of the opinion that it is not very wise to generalize and assign a value to a company based solely upon the fact that it is a family company. They are simply of the opinion that one simply cannot assign a value to the family company and use that as a factor when performing a valuation.

It is the presence of the features that are commonly attached to a family business that leads us on to our second conclusion, that despite that family ownership cannot be assigned a value, family businesses have certain beneficial traits such as the longer term planning and some detrimental traits such as conservative dividend policies and overcapitalization which may affect the company’s value when performing a fundamental analysis. As the fundamental analysis is seen by all of the interviewees as the main approach to creating an estimation of the company’s value these factors are vital when it comes to the crafting of the finished valuation. The usage of Technical and Beta analysis was like Olbert (1993) suggested very sparse, not one of our interviewees used Beta analysis and only one used Technical analysis, and he was only using it as a timing tool. This means that for the most part the valuation of a company will be the numbers you can get out of your fundamental analysis.

Another conclusion is that the factor of management competence is not always seen as very important. Some interviewees stated instead it was more of a tipping point when forming a general picture of the company in question or it can help to increase the plausibility of a certain scenario happening but in no way was it used as a factor for the analysis itself. Having extraordinary leadership in the senior management is however not a bad thing as it is still taken into account, just not in ways that we would have foreseen.

To answer our research questions: there are several key factors that differ between conducting a valuation of a family firm and conducting a valuation of a non-family firm, primary among those differences are dividend policies, overcapitalization and other factors that can be spotted from a company’s annual report and is commonly used when conducting a fundamental valuation. The fact that a company is a family firm is not however among those factors.
Discussion

7.1 Result Discussion

The conclusion of this thesis is that the reason for the undervaluation of family firms has more to do with the individual company's financial statement and how the company is being run than anything else. The reason for many family businesses being undervalued is not related directly to the company form but is rather connected to certain traits which are commonly associated with the family business such as the above mentioned conservative dividend policy.

This means that family businesses whom are concerned over being undervalued should devote some time and effort into looking over their own company in order to locate areas where their policies and actions can reduce the value of the company in the eyes of the analysts studying it.

7.2 Criticism of Thesis

A major point of criticism should be directed towards the small number of interviewees; the limited number reduces the generalisability of the thesis and is a problem. The reason for this is that while those that did answer the requests for interview where extremely helpful several contacted newspapers and analysis firms had policies to not answer questions for thesis work. For this reason we have chosen not to divide the results into journalists and analysts. We initially planned to compare the two groups to see if there were differences between their valuation processes, however this was not possible due to the low response rate. Nevertheless when looking at the received answers one can get the impression that there are actually no obvious differences in the valuation process between journalists and analysts.

7.3 Further Research

An interesting subject to investigate is to look in more detail what impact the different factors have upon the valuation of the family firm. A better understanding of how much of a difference in the valuation the different factors create could be highly useful for the listed family businesses wishing to increase their share value.
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Appendix 1 CAP

On the 2 of October 2006 the stock exchanges of Copenhagen, Stockholm and Helsinki, all under ownership of OMX created the Nordic stock exchange, replacing the old indices with a new Nordic list. The companies on the Nordic list were segmented based on market value and business sectors making it easier for businesses and investors to compare companies (OMX, 2006b).

The Large Cap, Middle Cap and Small Cap divide the market into segments based on their stock value. The Large Cap contains companies with a market value exceeding 1 billion Euros. Companies in the Middle Cap have a market value of between 150 million and 1 billion Euros and the Small Cap companies’ market value being below 150 million Euros. The segments are revised biannually on the 1st of January and the 1st of July based on the weighted average of the May and November. Each individual segment also sorts the companies according to the Global Industry Classification Standard (GICS). This classification helps comparison between companies in different countries and the basis of the classification is the company’s main business area (OMX, 2006b).
Appendix 2 Interview Questions

How do you perform a valuation of a listed company, what tools and models do you use?

Is Technical or Beta analysis used?

Can you see when a company is family controlled? How? Is there a difference if the founder is still present?

A few recent Swedish scientific reports have come to the conclusion that, in general, family businesses are undervalued on the Swedish stock exchange.

Is this in line with your own experiences?

Why do you thing it is like that?

Is it possible that this is connected with dividend policy?

Could this be some sort of control discount because of control mechanisms, for example A and B shares?

How do you take owner and management competence into account?

Do you spontaneously see family ownership as something positive, negative or irrelevant?

Theoretically, if you would compare two identical businesses with one being family owned and the other not, would you value them differently?