Entrepreneur & Innovation Exchange
Published online at FamilyBusiness.org on June 21 2024
DOI: 10.32617/1093-667588b6df806

Single Family Offices as Owners: Long-Term Investors or Financial Optimizers?

Joern Block (University of Trier)
Reza Fathollahi (University of Trier)
Onur Eroglu (University of Trier)

KEYWORDS: Journal of Family Business Strategy, family business advice, Running a family business tips, Family business financial advice.

When a family firm reaches a certain size, the family may decide to transfer their wealth and their ownership into a family office. These offices help business families manage their wealth across assets such as stocks, bonds, real estate, and direct investments. They also offer non-financial services such as travel arrangements, staff hiring, taxes, legal advice, career development, and family governance meetings.

Multi-family offices (MFOs) serve multiple families as their clients, whereas single-family offices (SFOs) offer their services to only one family. Today, multi and single-family offices manage trillions of dollars of business families worldwide.

But, what happens to a family firm when a family transfers their ownership stake and wealth into a single family office? Does the new intermediary change anything in the relationship between the family and the firm? What type of owners are single family offices?

These are not trivial questions. On the one hand, transferring ownership into the family office is a sign that the owning family cares enough about the business that they want to keep it for a long time. After all, they could have simply sold their ownership stake to someone else. On the other hand, the owning family may decide to set up the family office in order to have a strictly business relationship with the firm, treating the family firm as an investment without any emotional entanglements.

Our study puts these two perspectives about single family offices as owners to the test, focusing on the choice of capital structure for the new portfolio company. Higher debt ratios would be a sign of a capital structure more like a financial optimizer, such as a private equity firm. Lower debt ratios would indicate a conservative capital structure, typically favored by family businesses in the "pecking order" of entrepreneurial finance options available to them.

It's important to understand whether single family offices as owners choose a different capital structure for their portfolio firms than families who own the business themselves, because the capital structure of a firm determines its financial viability and creditworthiness. This is why it is so important to understand the influence of different owners on a firm's capital structure.

What We Studied

From reading the glossy private banking magazines on family offices, we initially assumed that single family offices function like financial optimizers, similar to private equity firms, and thus choose a high debt ratio for their portfolio firms to benefit from the leverage effect and to maximize the financial return for the owner family.

We identified 93 single family offices in Germany, Austria and Switzerland, which had 173 firms in their portfolios. We then matched these portfolio firms to a control group of 684 firms, from the same industry and of similar size, that were owned directly by the family instead of the family office. In the next step, we compared the debt ratios of these two types of firms. In the last step, we distinguished between single family offices that sold their family firms and those that still own their family firms.

What We Found

We saw that single-family offices prefer a higher long-term debt ratio for their portfolio firms than the families as owners. However, we saw no differences with regard to short-term debt, and this is what ultimately matters for bankruptcy. Long-term debt is with maturities greater than 12 months. It is in many ways similar to equity. Interestingly, the effect on long-term debt was found to be stronger for single family offices that sold their family firm. We were surprised by these differences and variations that exist within the group of single-family offices as owners. Some of them still have a close and emotional connection to their former family firms; others don't. Moreover, we did not expect to find a difference between long- and short-term debt. This shows that family offices are a special type of owner, aware of the consequences of an overly risky capital structure for their portfolio firms.

Takeaways

Single family offices are often operating under the radar. Our study provides new knowledge about them as owners. It helps stakeholders of all types to better judge and evaluate this type of hidden owner category.

The families behind family offices should be aware that they cannot have it all. They may have to decide whether they want a financially structured investment with a maximum financial return, or a portfolio firm with a financially viable capital structure and some slack resources to grow and capture attractive business opportunities. Owner families need to understand these tradeoffs. Our study shows that the majority of owner families behind family offices avoid excessive short-term debt levels that put their family firms at risk.

The investment logic is different, however, when the family office invests in firms that do NOT have a connection with their former family firm. Family offices treat these unrelated firms more like investments. Investment professionals who manage a family office should treat the former family firm differently from other portfolio firms.

Explore the Research

Capital structure of single family office-owned firms (https://www.sciencedirect.com/science/article/abs/pii/S1877858523000451) . Joern Block, Reza Fathallahi, and Onur Eroglu. Journal of Family Business Strategy, November 2023

EDITOR'S NOTE: This article was produced in partnership with the Journal of Family Business Strategy, a leading journal in the field of family business, spart of our mission to bring research-proven insights and practical advice to our readers.

FamilyBusiness.org (2024)
DOI:
10.32617/1093-667588b6df806