

Investment Insight

Vincit Perseverantia:

Families and the Challenges of Succession

Over the last few months, we have seemingly coincidentally been approached by a number of current and prospective clients who are dealing with succession issues. But is it really a coincidence? We think not. Succession is for every family, in any geography, in virtually any industry, the most difficult topic of all to deal with, let alone solve, and sometimes even to discuss amongst family members and outside stakeholders. The issues are so multi-faceted and have such far-reaching consequences, to be felt for generations to come, that it is virtually a full-time job to discuss, understand and to resolve.

Why do people look to discuss this difficult topic with us? There are a number of reasons: (1) We are a sixth generation family business ourselves and hence we have passed the baton multiple times. What have you learnt? What is your magic recipe? How did you make it through 200 years?; (2) Several of our partners have had previous careers in investment banking and have then worked with family businesses who have dealt with generational transition, sometimes—but not always—ending with an M&A transaction; (3) Lastly, J. Stern & Co. functions as a private office for the Stern family and for other families. Can you help us through this transition? What are my objectives from a family perspective? Do I want my family business to be passed on the next generation? Or do I rather want to leave fungible assets to my children, who as and when they come of age can take their own investment and management decisions? Now that I have sold my professional life's work, what do I do with the proceeds? Do I need a family office? Is a trust the right structure? Do you know of good trustees? These are all familiar questions to us, and we are exposed to these almost daily.

Why now? On the one hand valuations look attractive for sellers. Since the financial crisis both corporates and private equity are awash with cash to (over-)spend on acquisitions. On the other hand, many families are navigating this challenging environment and are asking themselves whether to dispose of their businesses and to transition from a family owning an operating business to a family primarily owning financial investments.

The other side of selling is how to reinvest the cash. The disposal process can help to solve and diffuse tensions amongst family members and potentially the management, but after the transaction many families face the sad fact of disaggregation and dispersion. The reinvestment of the cash proceeds in the current zero interest rate environment can also be a daunting challenge, with advisors and banks all too often advocating complex and unfamiliar investments and structures. Again, we operate in this familiar territory and have answered those questions many times.

So let us come back to the core question of how to deal with succession. Let us take as an example a family with a successful operating business. The first question is what are the dynastic objectives of the key owner and decision-maker? If the goal is to pass the business to future generations, then the family needs to admit whether they have within their immediate family tree, members interested, yet alone competent to drive the business

further. Those family members can be already part of the business or they may be successful in their own right, whether active in related industries or running completely different businesses. If the result of that search is negative, then the family may need to focus attention on the even younger generation and find an outside executive to carry on the family business as a bridge to the next generation.

Is this a difficult balancing act? Yes, without a doubt. We have seen situations where there was more than one family member wanting to lead the business, whether competent or not. In this situation it can become hard to find a value-creating solution that lasts for the long-term. Perhaps at that point a sale of the business and a split of the proceeds can sadly indeed be the best option.

How did the Stern family solve this conundrum within our family history? In Frankfurt, Jacob S. H. Stern converted a successful business as a wine merchant into a bank in 1805 and got into the business of financing enterprises and governments during the Napoleonic wars, where there was more value to be created than in just trading wine. There were no negative interest rates then! Having married his younger sister to Salomon von Rothschild, Jacob had twelve living children and created the first family succession by sending three pairs of sons across Europe to create three other Stern family banks in Paris, London and Berlin, each with a different entrepreneurial project in mind.

For several generations, our banks were passed from one branch of the family tree to the other. Did this happen in a straight line? No, definitely not. In some instances, our family was exceedingly lucky to have passed on some of the banks to entrepreneurial and highly competent family members. Sometimes, it was the opposite. The family also had its fair share of members who were uninterested in the banking business but rather focused on industry or on the arts. They needed to be progressively bought out over time so the banks could continue to remain in family hands.

Then came the two world wars with devastating effects on the family, its wealth and the family businesses. Everything in Germany was lost and the German branch all but extinguished, Jacob S. H. Stern Bank having been at the turn of the century the tenth-largest privately owned bank in the German empire. In France during the Second World War, we had to flee to the United States. Our bank in Paris was placed under non-Jewish administration. Our assets were stolen, our homes rampaged and our possessions looted.

From his new base in New York, Maurice Stern, my grandfather, started investing in quality businesses through the stock market, based on his own research and with a long-term perspective. After the Liberation of France, he returned in 1946 to rebuild the family bank from its foundations and grew it to become a successful private merchant bank with an equally successful asset management arm. Two Stern generations later, in 1988 the family was faced with a dilemma. Swiss Bank Corporation had made an offer too attractive to refuse. After much debating, our family business was sold. And we were then at that very moment in the situation that many of the families with whom we work today are facing.

We transitioned then from an operating business to an investment business. There was much disagreement and debate at this point of our history. Some family members decided to follow separate paths. I remember it vividly as I was eighteen at the time and was asking myself what impact this event would have on me as I was commencing my business studies. But there was one thing which all parties around the table agreed on: the

J. STERN & CO.

The Value of Long Term Investing

investment strategy. We chose to continue to do what we were accustomed to and had executed successfully within Banque Stern. We continued to buy and hold quality businesses, based on our own research for the long-term.

The strategy held formidably. Twenty years later, after a career in investment banking, I became more and more involved in our family business. The baton was then passed to me from the previous generation in a seamless fashion as I was operating in a different but nevertheless related part of the financial services industry. A few years later, having invested in those quality stocks for a while, quarterbacked by analysis which my friend and future co-founder Chris Rossbach had championed, we chose to devote ourselves completely to the long-term investment businesses for families and other like-minded long-term investors.

J. Stern & Co. was created with three missions in mind. Firstly, my family needed an efficient centre for investing its assets based on our long-term investment strategy. Secondly, after having been asked by other long-term investors to manage significant parts of their assets, we chose to open our investment capabilities to others. Lastly, the firm needed as well to be able to advise my family on other parts of their asset spectrum. Hence, the need for the private office.

As a guiding principle, we chose to build and operate our business in a clear, simple and transparent fashion. Over the years, we have been loyal and long-standing clients of financial services businesses, enabling us to experience the good, the bad and the ugly. For us it was clear that there was an opportunity as our family had specific requirements that the market was not interested in providing. We were convinced at the time that other like-minded families would experience similar distress at the lack of service and at the opacity of the investments they are presented with. Today, we see the living proof of it on a daily basis and the questions which we have posed above are just the tip of the iceberg.

Now, looking backwards, if I were to highlight three key factors for how our family was able to sustain the ownership of its family business over more than two tumultuous centuries, what would those be?

Firstly, I am convinced today that we were very fortunate that in almost every generation, we had at least one entrepreneurial and successful family member, who took leadership and ownership of the bank and who rebooted it to become a champion of its age. We can naturally highlight Jacob Stern in 1805, but also Hermann de Stern in London, then Jacques Stern in Paris and Theodor Stern in Frankfurt. Hermann refinanced an already financially troubled Kingdom of Portugal in the 1830s and Jacques created next to our family bank another bank in 1869 to finance Baron Haussmann's infrastructure works in Paris. Banque de Paris was born, later to become Paribas. Theodor Stern, then leader of the Frankfurt bank, was a pioneer in financing emerging market businesses, leading to the family's successful investments in railroads in the biggest emerging market of the nineteenth century, the United States, but also in China and elsewhere.

Secondly, we had and still have a core set of family values, some of which date back to Jacob's original family business, which we broadly adhere to. Those guide our long-term decisions and help us especially in troubled times.

Finally, those values also allowed us to have difficult discussions, take the right decisions, and put in place a family governance framework that allowed us to keep the business

within the family until we decided otherwise.

Our heritage enables us to adequately discuss the fascinating yet extremely complicated and versatile topic of succession. We can advise and sometimes provide solutions if only as a sparring partner to help and guide families through this minefield. At the end of the day, there is no one solution to everyone's problems. Every family has its own prerogatives, every situation is different and therefore looks for a tailor-made solution.

What is clear however is that the risks and opportunities for families to preserve and increase their wealth over generations are very different from the short-term considerations and the language of volatility, correlation and other financial terms offered by many private banks and advisors. As probably all families know, the biggest risks come from doing nothing, from not taking difficult decisions, from not taking risks or from not investing because of fears of an uncertain environment. Even the low interest rates that challenge us today and may well prevail for a long time, are a phase like many others we have seen, and families have no choice but to confront them, and best adapt their business and other investments to it.

Sydney Stern, Lord Wandsworth, a scion of the English branch, adopted as his motto *Vincit Perserverantia*, Persistence Conquers All: Making the right choices and taking the right risks has allowed us to prosper over time and his motto reminds us of the duty and care we must take in our endeavours.

Jérôme Stern

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