SandAire

In *Hidden Champions* Professor Hermann Simon refers to a group of companies of medium to small size that are low profile and highly profitable. They are typically durable but wary of trumpeting their own success. And yet, most impressively, they are often a leader in a narrow or niche market sector.

Hidden champions

Many features of the "Hidden Champions" identified by Professor Simon are characteristic of the type of business that Sand Aire Private Equity is keen to invest in. David Williams met with Hermann Simon recently to discuss some of the points raised by his research that seem particularly relevant and interesting.

Professor Simon's research, resulting in Hidden Champions (published by Harvard Business School Press), set out to examine the top performing small- and medium-sized companies in Germany to understand why the German export market was doing so well. The research grew and grew and Simon has now identified companies around the world that fit the Hidden Champion category.

For Sand Aire, the research highlights a number of characteristics seen in the companies it prefers to back:

They take a long haul view of their business – their commitment is not to short-term results but to long term market leadership. These businesses are built to endure and are neither bought nor sold overnight;

They are intensely customer-focused;

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They aim for market leadership which means "directing all their energy and concentration into one product to achieve customer loyalty, high profits, superiority in innovation, technology, core competencies, trendsetting and market influence";

They retain long term partnerships with customers and suppliers, fuelling both their product innovation, and profitability;

Their employees are seen as long term assets to be nurtured. Consequently the businesses are characterised by their high productivity, low down time, stable industrial relations, low staff turnover and absenteeism and deep loyalty; they have the team-type culture in which social control is more effective than hierarchical formal control;

They emphasise value, not price, as the main selling point;

They focus on narrow markets and through obsessive concentration become winners in them, coining the phrase "Super Nichists";


Professor Hermann Simon

They are in family or closely-held ownership. They often shun publicity and concentrate on quietly developing their speciality, avoiding currently popular management theories such as diversification, strategic alliances and outsourcing; and

Their chief executives are frequently owner-managers or a family member. On average the companies have mature and stable leadership. In four out of five, at least one owner is active in senior management.

Sand Aire's David Williams spoke to Professor Simon to explore a few points:

What do you believe is the most important reason that these companies are successful?

The main reason, in my opinion, is their ability to pursue a long-term strategy. Good business strategy requires a long-term orientation and very ambitious goals. Consider a company in the industrial supply market. Founded in the UK in 1989, the company is now active in 17 European countries and has plans to expand into every European country in the next ten years. It will have taken 25 years to become a fully-fledged European company. Their next step will be to enter the American and global markets and they anticipate this will take two generations.

What allows Hidden Champions to concentrate on the long-term?

Many of these companies are family-owned and, although the companies' leaders are not necessarily family members, this allows them to take a longer view. The stock market introduces much stronger volatility and because many of these firms are in niche markets they become exposed to market cycles. Reacting on a quarterly basis is inconsistent with long-term planning. This is not to say, however, that Hidden Champions do not face problems similar to other companies.

New deal

Bradwell Aggregates sold to Aggregate Industries plc

Sand Aire Private Equity has sold its 40% stake in Bradwell Aggregates in a trade sale to Aggregate Industries plc. Bradwell has seen strong growth in demand from the local construction market and the acquisition will strengthen Aggregate Industries' position in Essex.

Sand Aire originally backed a management buy-in team led by John Turner, Bradwell Aggregates Managing Director, with an Equity*Harvest* investment in July 1998. Bradwell Aggregates Limited was formed to acquire the trade and assets of Bradwell Aggregates (sand and gravel) and Karrimix (ready-mixed concrete) from a third generation family company, Carter & Ward Limited. Carter & Ward continued to work closely with the directors of Bradwell post-investment, as landlord of the majority of the company's sites. One of the family members also remained a member of the management team.

Jonathan Slow of Sand Aire said, "This successful sale demonstrates the value of experienced specialist management and private equity funding for long established family-owned businesses. This combination is at the heart of Sand Aire's Equity*Harvest* approach."

Indeed, in the book you mention that most Hidden Champions face a crisis in their business lives. Did your research suggest that the type of crisis was similar across industries?

In my experience, there are two dominant factors that precipitate crises in Hidden Champions. The first is a change in leadership at the very top. It is not easy to replace a strong leader, in particular if the manager comes from the owning family. Often the next generation isn't willing to take on responsibilities and the company must look outside the family for the next leader or leaders. The second factor is a change in technology – frequently mechanical problems that are solved through electronic means. This can cause a major upset to the existing business order.

You mention that Hidden Champions were beginning to use IPOs to grow or to capitalise on the value they were creating. This seems to be at odds with the desire to remain hidden. Were they able to reconcile the two?

IPOs were driven forward in the new markets in the 1990s and some Hidden Champions did take this path. I do not know how many but, overall, they were not very successful. I can think of nearly one dozen who have now through different means gone private again. One reason they did not succeed is that they were not in industries which were particularly sexy to the average short term investor.

If the IPO route has not been successful, what paths have Hidden Champions taken to find funding to grow the business?

Most Hidden Champions do better with private investment but the risk of IPO limits the exit strategies. That doesn't mean to say that there are not interesting opportunities for investors with these companies. In my experience the people who sell the companies are not always interested in the maximum price they can make. Often they are more interested in continuing the traditions of the business and in having some future involvement, though obviously not as the business leader. This requires the buyer to behave in a manner consistent with the desire of the seller. Some investment companies have a culture that clashes with this ethic. These companies are more wild west, riding into town saying, "Just turn it over to me and I can make anything better." For families and people who have spent years building a very successful business, this is not an attitude or approach that is terribly appealing and therefore successful.


David Williams

In your research have you noticed differences in the way Hidden Champions operate their businesses?

Yes, very much so. I think one key difference is how close all the Hidden Champions are to their customers. I do not think that this can be stressed enough.

COFFEE & MUFFINS

Sand Aire brews up £12.9m for BB'S Coffee & Muffins

Sand Aire Private Equity has invested £4.2 million in return for a 42% stake in RFG (UK), which operates over 60 BB's Coffee & Muffins outlets across the UK, Ireland and Germany. Bank of Scotland has committed total debt facilities of £8.7 million as part of the deal. This will support a rapid roll-out in the UK and Ireland, and further expansion into continental Europe.

Phil Abbot, Managing Director and Robert McLeary, Operations Director

BB's has an exclusive focus on shopping centre locations where it is the UK market leader. It operates well away from expensive high street locations where other chains have struggled to generate profits. The brand is differentiated by its formula of muffins and baguettes baked freshly on site and served throughout the day, and its successful Meal Deals options. This takes average customer spend to among the highest in the industry.

BB's originated in Australia, where Phil Abbot, Managing Director of RFG (UK), was heavily involved in the development of the brand. Abbot started trading in the UK in 1997 with fellow shareholder and Operations Director, Robert McLeary. The team has been strengthened with the recent addition of David Mezher as finance director.

Exit Strategies Conference

Rupert Bell (Sand Aire Private Equity) will be speaking at the "Benefits, Pitfalls and Current Trends in Exit Strategies" conference run by IBC Global Conferences on Tuesday 18th June in London. If you are interested in attending, call 01932 893854 or visit www.ibc-financial.com/FB1113.

You also mention that Hidden Champions regularly return profits even in difficult economic times. Why is this?

I think that there are two main reasons. The first is that Hidden Champions have a markedly higher profit margin than many others. A fifteen percent profit margin allows for a dip in sales which would be disastrous to a firm with a three percent margin. The second reason is that many Hidden Champions are more flexible in their approach to everyday issues. This flexible approach extends into the workforce as well. There is a willingness, not seen in many other firms, for people to pull together and react to difficult situations. I've found that Hidden Champions spend much more time on recruiting the right people for the company. They have recognised that job interviews do not tell the whole story and they are much more likely to use probationary periods to weed out unsuitable candidates. For employees who have served their probationary period, they have very low turnover rates.

Where do the Hidden Champions come from and are any of them going to develop into the IBM of the future?

Ninety eight percent are not going to be the next IBM. They are well advised to stick to their knitting and grow within their niche market. In most cases, Hidden Champions still have lots of room to grow and can create further value. Where do Hidden Champions come from? It is very hard to say. Most businesses aim to become market leaders, but the ones that do often have the right combination of technology and marketing.

And are Hidden Champions continuing to emerge? Are the Hidden Champions of tomorrow there to be found today?

If you ask business leaders or gurus who are the great companies of today most will give you similar answers. I believe, however, that in the long-term there are more great companies that are not yet known today.

Hermann Simon is the author of Hidden Champions (Harvard Business School Press), which is available in twelve languages. He is a Founder and Chairman of Simon-Kucher & Partners Strategy and Marketing Consultants and a Permanent Visiting Professor at the London Business School. Simon Kucher & Partners has just opened a London office. www.simon-kucher.com

A full script of the interview is available: please email private.equity@sandaire.co.uk or telephone 020 7290 5210.

Institute for Family Business (UK) launched

The IFB, launched this year, aims to support through learning the ongoing development of a dynamic family-owned business sector in the UK, making a powerful contribution to the overall economy. Membership of the association is of benefit to owners, family members or managers of family companies in the UK, who want to access information relating to those aspects of their companies influenced by their family-owned status - such as succession planning, family charters, family councils. The IFB is an independent, not-for-profit organisation controlled by its members. For further information, visit www.ifb.org.uk or telephone 0870 872 8388.

ifb Institute for Family Business

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Sand Aire Private Equity

Sand Aire Private Equity is a leading specialist investor in family-owned and closely-held companies. We are dedicated to understanding the ownership dynamics and the special potential for enhanced value that exists in strongly managed businesses in this important sector of the economy. In addition we invest in MBO and MBIs. We take a long term view and prefer to commit £2-10m per investment.

Sand Aire Private Equity is part of the Sand Aire asset management group. The business is built on the foundations of a substantial family-owned company which has invested successfully in the UK for five generations.

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