

LAW AND MANAGEMENT OF FAMILY FIRMS



FAMILY FIRMS AND FAMILY CONSTITUTION



EDITED BY

HOLGER FLEISCHER & STEFAN PRIGGE

 OPEN ACCESS
BOOK

Family Firms and Family Constitution

LAW AND MANAGEMENT OF FAMILY FIRMS

Series editors:

Holger Fleischer, Max Planck Institute for Comparative and International Private Law

Stefan Prigge, Institute for Mittelstand and Family Firms (HSBA Hamburg School of Business Administration)

The pioneering *Law and Management of Family Firms* series publishes volumes following the annual Hamburg Conference: Law and Management of Family Firms, the international and interdisciplinary forum for family business research.

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Family Firms and Family Constitution

EDITED BY

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AND

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INVESTOR IN PEOPLE

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Preface

The Conference Series

The *Hamburg Conference: Law and Management of Family Firms* is a joint initiative of the Max Planck Institute for Comparative and International Private Law, Hamburg, and the Institute for Mittelstand and Family Firms (IMF), also based in Hamburg. Family firms have increasingly become object of research activities in a variety of disciplines, such as law, psychology, management, and sociology. Exchange between the disciplines has taken place in some cases; for instance, the concept of socioemotional wealth (SEW) reflects contributions from management and psychology. However, exchange between law and management has been very rare so far, although fields like law and economics, law and finance, or corporate governance have been examples of how beneficial such an exchange could be. That was the starting point to originate the *Hamburg Conference: Law and Management of Family Firms*. The conference is supposed to be a forum of exchange for legal and management scholars who share the interest in family firms. It is structured as a research conference with about 10 presentations from both fields, providing enough opportunities for discussion among the participants. Participants include, in addition to the presenters, a small group of further researchers and practitioners with an interest in family firms. In the best case, a cross-disciplinary discussion unfolds. To our great satisfaction, that is what happened in the first edition of the conference. This experience has encouraged us to define the conference as an annual event, taking up a specific topic each year that is of interest for law and management.

The family constitution was the topic of the inaugural edition of the conference. This increasingly important, but under-researched instrument is part of the family governance structure, which in turn forms, together with the business governance structure, the governance framework of family firm and owning family. As already pointed out above, governance is a subject for which the benefits of interdisciplinary exchange between law and management have already been proven. This volume assembles 12 contributions, 10 of them were presented during the conference. For these articles, the book includes a brief summary of the discussion following the presentation. Unfortunately, hurricane “Irma” made it impossible for Isabel Botero to present her paper in Hamburg. The article by Patrick Ulrich and Sarah Speidel was integrated subsequently into this collection, as it adds welcome and substantial information and facts about family constitutions in Germany.

In its entirety, this collection of articles represents the richness of family business research. There are comparative and conceptual papers as well as empirical articles analyzing either a single case or data from a large sample.

Part 1 of the book begins with two surveying articles by Fleischer, and Prigge and Mengers. Therefore, this preface could be rather brief. Fleischer considers historical development and legal nature of family constitutions in five countries. Prigge and Mengers provide an overview of the stock of research on family constitutions that management research has put forth.

Part 2 on managerial research covers conceptual and qualitative analyses. Botero and Fediuk develop further Botero's reasoning about family business governance in a framework made up of equity theory, psychological contracts, and organizational justice. In their article, they claim that governance actually involves interactions between two parties, i.e., sender and receiver. Thus, governance analyses should be aware of the existence of these two parties; their contribution explores the receiving party's perspective in greater detail. Matser and her colleagues Heeringa and van der Vloot van Vliet share their insights they derived from the very close companionship of a Dutch family and its family governance. Jungell focuses on owner families where ownership disperses more and more. She derives from in-depth interviews and her own experiences conclusions about the potential benefits of family governance systems for those families. Kormann introduces the Failure Mode and Event Analysis (FMEA) from the design of mechanical systems into the discussion of family businesses and applies this framework to explore the contribution of governance to the longevity and survival of the family firm.

Part 3, also on managerial research, is dedicated to quantitative analyses and surveys. Graves and his collaborators Caspersz and Thomas have submitted one of the very few studies that explore family constitutions empirically on a large sample, in their case of Australian family-owned businesses. They found a positive and significant relation between the existence of a family constitution or a code of conduct and financial performance, however, surprisingly, not for family-oriented performance. Ulrich and Speidel report about the results of their recent questionnaire of German family firms and provide fresh evidence about, for instance, the reasons why families develop a family constitution and the importance of the development process leading to the final document.

Part 4 focuses on legal research. Bong explores the interplay between a family constitution and the family business's binding legal agreements. In doing so, he describes four different forms of family constitutions that have evolved from different consulting approaches in German practice. Kalss concentrates on the complicated interplay between company law and succession law in family firms. Deckert gives an overview on family constitutions and their legal relevance in the French company law landscape. Holler explains in detail the complexity of family businesses from counsel's point of view. He points out that, contrary to a widespread belief, family constitutions may indeed have legal effects of one sort or the other under German law.

Fleischer and Prigge conclude the book with a brief survey of future research opportunities that were developed by the participants during the two days in Hamburg.

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The IMF is a private research institute that is supported by the HSBA Hamburg School of Business Administration, KPMG, Esche Schümann Commichau, the Hamburg Institute of International Economics (HWWI), and the Hamburg Chamber of Commerce. The IMF particularly acknowledges Esche Schümann Commichau's invitation to the conference welcome reception in their premises.

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Part 1

Legal and Managerial Foundations

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Chapter 1

Family Companies and Family Constitutions: Historical and Comparative Perspectives

Holger Fleischer

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Abstract

This chapter provides an introduction to the world of family companies and family constitutions from a legal perspective. It first studies the legal types of business organizations that family firms have chosen across time and jurisdictions. It then illustrates how early predecessors of family constitutions evolved in the late Middle Ages and what modern family constitutions look like in different countries today. Further considerations are devoted to the governance framework of family firms. The chapter concludes by exploring the potential legal effects of family constitutions under German company and contract law.

Keywords: Family constitution; comparative legal perspective on the family constitution; early precursors of the family constitution; family constitution and German company law; standardization of the family constitution

1.1. The Rise of Family Constitutions and Legal Research

Family constitutions are becoming more and more fashionable in Germany, Europe, and around the globe. Our conference seeks to contribute to a better

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understanding of this new governance instrument. So far, in-depth research has largely come from the field of management studies. Legal scholarship, on the other hand, is lagging behind. The analysis of family constitutions through the lens of company and contract law is still in its early days. Recently, however, a couple of law review articles (Bochmann & Driftmann, 2022; Fleischer, 2016, 2017, 2018; Foerster, 2019; Holler, 2018; Lange, 2013; Reich & Bode, 2018; Uffmann, 2015) and two doctoral theses¹ have been published, so that further progress is in sight.

With this caveat, the following chapter explains how a business lawyer would consider the remarkable rise of family constitutions. Leaving aside doctrinal details, it traces the historical and comparative developments of family companies in general and family constitutions in particular. It first studies the legal types of business organization that family firms have chosen across time and jurisdictions (Section 1.2). Then it demonstrates that modern family constitutions have early precursors, namely the house laws of the high nobility and the guidelines of the moneyed aristocracy. This is followed by a comparative tour through family constitutions in different jurisdictions: United States, France, Spain, Belgium, Germany, and Italy (Section 1.3). After that, family constitutions are located within the governance framework for family firms (Section 1.4). Finally, family constitutions and their potential legal implications are analyzed more closely in the light of German company and contract law (Section 1.5).

1.2. Family Firms and Legal Forms

Family businesses can be classified according to various criteria: age, sector, size, strength of family influence, or economic and financial key figures.² Another taxonomy could be organized around different types of owners in the lifecycle of the firm: founder and sole owner, sibling company, cousin consortium, and family dynasty.³ A trained lawyer would probably first look at the legal form of the family enterprise. This is because in the world of corporate law there is no family company as such, i.e., no specific codified form for family businesses,⁴ but only a family partnership, family limited liability company, family stock corporation, family limited partnership, family foundation, etc. Four spotlights will illustrate which legal forms family businesses have chosen for their respective purposes across time and national borders. In doing so, it will become apparent that family firms have contributed significantly to the shaping of company law with their gradual development from a house community to a trading company.

¹Bong (2022); Hueck (2017); for a doctoral thesis in the field of management studies recently, Neumueller and Henry (2020).

²See the classifications in Davies (2008), Pieper and Klein (2007), and Sharma and Nordquist (2008).

³For example, May and Koeberle-Schmid (2011, p. 661 et seq.); also Gersick et al. (1997, p. 17).

⁴Aptly, Kalss and Probst (2013, p. 115): “no codified company law for family businesses.”

1.2.1. Family Firms as First Users of the Roman *Societas*

According to widespread understanding, the roots of partnership arrangements in Roman law go back to the pre-classical *consortium*.⁵ In the old days, after the death of the *paterfamilias*, all his household heirs remained united in a community of co-heirs, the so-called *consortium ercto non cito*, through which the family continued to exist. Individual heirs did not have a specific part in the inheritance; instead, all rights were vested in the community of co-heirs. Over the course of time, partners who wanted to form a profit-oriented business partnership were allowed to enter into a classical partnership (*societas*) on the model of the co-heirs of an undivided family (see Zimmermann, 1990, p. 452). This type of partnership was often referred to as partnership of brothers (*societas fratrum*).⁶ Against this historical background, it can be rightly stated that family businesses – especially in the form of the jointly continuing household heirs (*heredes*) – were the first users of the Roman *societas* and of partnership law in general (see Fleischer, 2017, p. 1202).

1.2.2. Family Firms as Promoters of the Medieval *Compagnia*, *Accomenda* and *OHG* (Medici, Fugger)

In the Middle Ages, most trading houses had the character of family businesses as well.⁷ Their names were all family names (Peruzzi, Bardi, Medici, Welser, Fugger),⁸ their partners were mostly close relatives who teamed up to form trading partnerships with joint and several liability.⁹ This happened first in the cities of northern Italy, where the so-called *compagnia* emerged in the 14th century.¹⁰ Its very name – translated: community of bread¹¹ – indicates its preferred use

⁵See Wieacker (1936, p. 126 et seq.); more recently, Zimmermann (1990, p. 451 et seq.).

⁶In this sense, the subheading in Meissel (2004, p. 91), paraphrasing a text by Gaius speaking of a “*societas ad exemplum fratrum suorum*”; also Wieacker (1936, p. 152): “*fraternitas of the partners*.”

⁷In-depth, M. Weber (1889, p. 44 et seq.) under the chapter heading “The Family and Working Communities”; further Kuntze (1863, p. 183): “The family is also in the world of commerce the natural starting point for the development of the commercial company.”; Lastig (1879, p. 431 et seq.).

⁸On this, Kuntze (1883, p. 184 et seq.).

⁹More closely, Mehr (2008, p. 55 et seq.), who traces the roots of these family, household and inheritance communities back to the Lex Langobardorum from the seventh century.

¹⁰In summary, Fleischer (2021c: § 1 marg. no. 128 et seq.).

¹¹Derived from the Latin “*cum pane*”; on this, for example, Goldschmidt (1891, p. 272 with fn. 131); further Hawk (2016, p. 210): “[T]he medieval Italian *compagnia* originally reflected small family relationships between father and son or among several brothers – men who lived in the same house, who broke the same bread (as the word *compagno* implies) and who found it natural to accept unlimited liability for each other’s actions.”

as a legal form for family businesses.¹² The Medici, for example, resorted to it when they founded their Florentine banking house in 1397 at the instigation of Giovanni di Bicci de' Medici (1360–1429).¹³ Unlike other banking families of their time, such as the Bardi or Peruzzi, who conducted all their business under the legal umbrella of a single *compagnia*,¹⁴ the Medici Empire was structured as a group of partnerships.¹⁵ At the top, there was a main partnership made up of family members and one or two non-family partners (see McCarthy, 1994, p. 13). It in turn owned majority stakes in various subsidiaries, subject to strict control by the main partnership.¹⁶ All this is exemplified by the partnership agreement of the Bruges subsidiary of July 25, 1455.¹⁷

But the Medici not only knew how to use the *compagnia*, they sometimes also sought to limit risk in the expansion of their business. In doing so, they made use of a Florentine law of November 30, 1408, which allowed the foundation of an *accomenda* or *società in accomandita*, in which some of the partners had only limited liability (see Goldschmidt, 1891, p. 271; also Goldthwaite, 2009, p. 67) – the Italian archetype of today's limited partnership.¹⁸ An example that has come down to us is the partnership agreement of 1422 on the founding of a bank in Naples, to which the partners of the Medici bank contributed a (limited) sum of 3,200 florins and were thus, according to the partnership agreement, exempt from

¹²See Schmidt (1883, p. 8): “In fact, the largest and most famous trading companies of the later Middle Ages grew up on the soil of the family; they are large manorial estates continued through a series of generations. [...] The close bond of trust which embraced the partners gave these companies a special support and enabled them to carry out undertakings for which companies based solely on contracts were not equally suited.”

¹³More closely, de Roover (1946, p. 28 et seq.); McCarthy (1994, p. 10 et seq.).

¹⁴See de Roover (1946, p. 28): “The essential feature of the form of organization exemplified by the Bardi and the Peruzzi companies is that there was only one partnership. It owned the home office in Florence and all the branches abroad.”; de Roover (1963, p. 77).

¹⁵More closely with diagrams, de Roover (1963, p. 81): “In studying the organization of the Medici Bank, one cannot fail to notice how closely it resembles that of a holding company.”

¹⁶See de Roover (1946, p. 29), explaining: “[T]he Medici banking house was not one partnership but a combination of partnerships. A separate partnership was formed for each of the Medici enterprises. The ‘bank’ or home office in Florence, the branches abroad, and the three industrial establishments in Florence.”

¹⁷Reprinted in Grunzweig (1931, p. 53 et seq.); also in Gutkind (1938, p. 308 et seq.); in-depth analysis bei Fleischer (2021a, p. 97 et seq.).

¹⁸See Fleischer (2021c: § 1 marg. no. 91 et seq.); further Goldthwaite (2009, p. 67), explaining that the *accomenda* never realized its potential for evolving into something like a joint stock company; further Hawk (2016, p. 238): “However, the *accomandita* never became widely accepted. Other than by the Medici Bank, it appears that it was infrequently used. From the late 15th century to the 1530s, fewer than six *accomandita* contracts, on the average, were registered annually.”

any further liability (see [de Roover, 1963](#), pp. 43 and 89 et seq.). After decades of economic prosperity and political influence, adverse political circumstances led to the decline of the bank and the expulsion of the Medici from Florence in 1494.

Just in the year in which the Banco Medici collapsed, the brothers Ulrich, Georg, and Jakob Fugger associated themselves in southern Germany to form a family business. Their partnership agreement of August 18, 1494,¹⁹ which has been called the “Basic Law of Fugger Trade” ([Pölnitz, 1949](#), p. 58) is considered one of the first ever commercial partnership contracts (*offene Handelsgesellschaft, OHG*) in Germany. It was concluded under the name “Ulrich Fugger und gebrudere von Augsburg” with a term of six years. Restrictions on withdrawals, individual power of representation, a ban on competition and majority decisions in the event of disagreements testify to the will of the participants to place all individual forces at the service of the overall family business. A follow-up contract of 1502,²⁰ in a special agreement on Hungarian trade, for the first time restricted the succession of partners to the “male line” of one’s own family.²¹ In the event of the death of a partner, the survivors were to continue the trade, pay out the female descendants of the deceased and prepare the fittest among their sons for future participation in the management. With the death of Georg and Ulrich Fugger, the partnership of three brothers with equal rights came to an end; Jakob Fugger (1459–1525), as the last remaining partner, was entitled to continue the partnership on his own. He then concluded a new partnership agreement with his four nephews in 1512 under the name “Jacob Fugger und seiner gebrueder süne,” which reserved him the right to set the profit shares, exclude partners and dissolve the company.²² Until his death, he was the most powerful and politically influential banker in Europe – reverently called Jacob Fugger the Rich by his contemporaries.

1.2.3. Family Firms in the 19th Century Between Partnerships and Corporations (Baring, Rockefeller)

The next major developmental step occurred in the late 19th century with the introduction of new forms of limited liability companies. They had been longed for everywhere, especially by small entrepreneurs who were looking for a way to develop under the protective shield of limited liability ([Fränkel, 1915](#), p. 17). In Germany, an urgent need for reform had been identified especially for family and hereditary companies, which the legislator largely satisfied with the GmbH Act of 1892.²³ In England, practical guides in the last quarter of the 19th century

¹⁹Reprinted in Jansen (1910, p. 263 et seq.); in-depth analysis by Fleischer (2021b, p. 139 et seq.).

²⁰Also printed in Jansen (1910, p. 270 et seq.).

²¹Häberlein (2006, p. 39) adds: “At the same time, the Fuggers were breaking with their own family history, because in the 15th century it had been women who had ensured the continuity of Fugger trade.”

²²Reprinted in Jansen (1910, p. 289 et seq.).

²³See Fleischer (2021c: Introduction, marg. no. 54); Fränkel (1915, p. 17).

contributed significantly to the popularization of the private company.²⁴ This new, but at first still legally unsecured, offer was used primarily by family companies, which converted their already existing small businesses into the legal form of a company.²⁵ The reasons for this were, to a large extent, to protect themselves from the disgrace of private insolvency by compartmentalizing their liability²⁶ – a danger that seemed all too real in view of the Great Depression of 1873–1896 in the late Victorian period (see [Ireland, 1984](#), p. 248). In addition, considerations of business succession played a role.²⁷ Both of these factors may also have guided the case in what is probably the most famous decision on English company law, *Salomon v Salomon*: In 1892, Aron Salomon had transformed his sole proprietorship shoemaking business in London into a company by acquiring his wife and his five eldest children as co-partners – in order to meet the minimum number of shareholders of seven – and endowing them with one share each, while he held 20,000 shares. The House of Lords ruled in 1897 that the privilege of limited liability was also available to such a company with nominee shareholders.²⁸

However, it was not only smaller family businesses that discovered the attractiveness of limited liability, but also large business dynasties. One example is the famous Baring banking house, which was originally organized as a partnership. In 1890, defaults by Argentina and the withdrawal of considerable sums by the Russian government brought it to the brink of collapse putting all family partners in danger of having to assume unlimited liability with their private assets.²⁹ After this existential crisis was overcome with the help of the Bank of England and potent private banks, namely the Rothschilds, the company was converted into a limited liability company and henceforth traded under the name Baring Brothers and Company, Ltd. (see [Landes, 2006](#), p. 61).

On the other side of the Atlantic, the Rockefellers underwent a similar change of legal form under quite different circumstances. Their entrepreneurial rise in the oil business began in 1865 when John D. Rockefeller (1874–1960) teamed up with the English engineer John Andrews in Cleveland to form a partnership under the name “Rockefeller and Andrews” (see [Becht & DeLong, 2005](#), p. 626; [Charnow, 1998](#), p. 87 et seq.). Two years later, Henry M. Flagler joined them ([Charnow, 1998](#), p. 108). In view of their firm’s growing financial needs, they looked for

²⁴For a pioneer publication, Palmer (1877).

²⁵See McQueen (2010, p. 142 et seq.): “Many of these enterprises were conversions of existing family businesses. Conversions were quite often an attempt to revitalize a family firm that had exhausted family financial reserves or managerial talent.”

²⁶See McQueen (2010, p. 221); previously, Cottrell (1980, p. 265).

²⁷On this, Harris (2013, p. 369): “This motivation led hundreds of other family firms, moving from first-generation sole proprietorship to second-generation partnerships, to the corporate form.”; further McQueen (2010, p. 193).

²⁸See *Salomon v Salomon* [1897] (HL) AC 22; for an in-depth and comparative law analysis, Fleischer (2016, p. 44 et seq.).

²⁹See Landes (2006, p. 58), with the additional remark: “Unlimited liability then still meant just that, and the partners were liable by law to their last shilling and their last acre, not to mention houses, animals, paintings and furniture.”

ways to attract outside investors without losing control. The solution in 1870 was to convert their partnership into a joint stock corporation under Ohio law: the Standard Oil Company. It had a share capital of one million dollars, with the Rockefeller family holding 50% and Andrews and Flagler 13% each. Two years later, there was a large capital increase to a total of 3.5 million dollars (see Landes, 2006, p. 326). Because Standard Oil was not allowed to hold shares in other corporations under Ohio law, further legal restructuring became necessary in 1878, so a trust structure was devised.³⁰

1.2.4. Family Firms and Plurality of Legal Forms in the 20th and 21st centuries (Merck, Bertelsmann)

In the 20th and 21st centuries, the legal landscape of family businesses is characterized by an enormous diversity of legal forms. This is particularly true of German company law which recognizes a wide variety of organizational forms.³¹ This multitude of basic types and combinations of types, which in Europe is only surpassed by Liechtenstein's creative spirit, is not only found in textbooks, but is lived practice – also and especially of family businesses.³² These firms resort, albeit increasingly rarely, to the classic partnerships (commercial partnership [OHG], limited partnership [KG]). They make widespread use of the limited liability company (GmbH), both for small family businesses and for large companies (example: Robert Bosch GmbH). They use the stock corporation (AG) (example: Beiersdorf AG) and recently also the European Company (SE) (example: Freudenberg SE), which can be interesting for family businesses because of its optional monistic board structure. Occasionally, they also choose the partnership limited by shares (KGaA) because it allows family businesses to retain significant influence on the management of the company and at the same time take in non-family investors.³³ One example is the listed Merck KGaA in Darmstadt, about 70% of whose capital is held by E. Merck KG as general partner and about 30% by limited shareholders.

Moreover, type combinations are very popular in Germany, most prominently the limited partnership with a limited liability company as general partner (GmbH & Co. KG). It was and still is praised as the ideal legal form for traditional family businesses (see Binz & Sorg, 2011, p. 221; Fleischer & Wansleben, 2017, p. 642; Nietsch, 2016, p. 218). Some commentators even regard the large, cross-generational family limited partnership (“große generationsübergreifende Familien-KG”) as a normative real type that justifies the recognition of a special legal regime by the courts with extended contractual leeway for the family partners.³⁴

³⁰On this and on further amendments, Becht and DeLong (2005, p. 627 et seq.).

³¹In-depth, Fleischer (2015, p. 128 et seq.).

³²More detailed on the following with numerous examples from corporate practice, Lieder (2017, p. 31 et seq. [basic types], p. 50 et seq. [mixtures of types]).

³³More closely, Reichert (2014, p. 1960 et seq.).

³⁴In this sense, Ulmer (2010a, 2010b); critically, for example, Lieder (2017, p. 59 et seq.).

Family businesses have also newly discovered SE & Co. KGaA, a partnership limited by shares with a European company as general partner,³⁵ which is used by Germany's largest media company Bertelsmann, for example.

In contrast, many neighboring countries manage with far fewer legal forms and are also critical of combinations of types.³⁶ In Switzerland, KG and KGaA lead a shadowy existence, the GmbH & Co. KG is prohibited by law, so family businesses almost exclusively resort to the – very flexible – AG.³⁷ Austria has abolished the KGaA due to its practical insignificance, but has at least introduced the private foundation (*Privatstiftung*) as an alternative legal form for family businesses.³⁸ In terms of numbers, however, the GmbH continues to dominate. In France and England, the *société en commandite* and the limited partnership do not go beyond a niche existence for various reasons (see Fleischer & Wansleben, 2017, pp. 635 et seq., 641). Family businesses there operate predominantly as *société anonyme*, *société par actions simplifiée*, *société à responsabilité limitée* or as a UK company, large listed companies occasionally as *société en commandite par action*. In the United States, on the other hand, the family limited partnership plays a considerable role in succession planning for tax reasons³⁹; however, family businesses in corporate form are the most common (see Drake, 2013, p. 390).

1.3. Family Constitutions Through the Ages

In order to improve the interaction between family and business, owner families today increasingly agree on a so-called family constitution. In this constitution, they document their collective canon of values and their company-related objectives.

1.3.1. Early Precursors

At first glance, the management instrument of the family constitution breathes the spirit of the modern corporate governance debate. However, observers who are familiar with history will recognize striking parallels to intra-family regulations from earlier times.

1.3.1.1. House Laws of the High Nobility (*Habsburg, Hohenzollern*)

The regulative guiding idea of bindingly defining the supporting principles and values of a family is already encountered in the so-called house laws of the late

³⁵More closely, Reichert (2014, p. 1964 et seq.).

³⁶Comprehensive comparative law analysis for the GmbH & Co KG in Fleischer and Wansleben (2017).

³⁷See Chenaux (2015); monograph by Premand (2010); previously, Vogel (1974).

³⁸More closely, Kalss (2017, p. 22 et seq.) under the subheading “Concentration on a few legal forms.”

³⁹See, for example, Schwidetzky (2007) under the heading “Family Limited Partnerships: The Beat Goes On”; in-depth, Drake (2013, pp. 334 et seq., 605 et seq.).

Middle Ages.⁴⁰ From the early 14th century onwards, families of the high nobility used them to lay down family and inheritance laws outside of general state law on the basis of the regulatory autonomy they had been granted. Their enactment probably goes back to the cooperative constitution of the high noble family with lordly duties, but their legal basis soon took a back seat to the determining will of the ruling head of the family.⁴¹ In the center of this private princely law were regulations concerning the bearer of dynastic rule and its transfer in succession, mostly according to the principle of primogeniture, i.e., a first-born succession. In addition, there was the formation of special estates – the so-called *Familienfideikomisse* (Ebert, 2008, p. 1503; Kalss & Probst, 2013: marg. no. 3/16 et seq.) – with the aim of preserving certain ancestral estates permanently and undivided for the family to increase its splendor. The authority to set up such estates was derived from the statutes of the higher nobility, otherwise from customary law, family observance or state law (thus Ebert, 2008, p. 1503). According to a recent body of literature, the continuity that house laws secured for the assets of nobility also offers valuable suggestions for today's entrepreneurial families (see von Thunen, 2016, p. 55; von Thunen, 2015, p. 55 et seq.).

Among the best-known house laws were those of the Habsburgs. Particularly worthy of mention are (a) the Ferdinandean House Rules of 1554 with their commitment to Catholicism; (b) the House Agreements of 1703, initially kept secret, among them the *Pactum mutuae successionis*, which were published by Charles VI in 1713 under the name Pragmatic Sanction (see Turba, 1913); and (c) the Imperial Austrian Family Statute of 1839, signed by Emperor Ferdinand I. and countersigned by State Chancellor Metternich.⁴²

With the end of the monarchical forms of government – in Germany through the Weimar Imperial Constitution of August 1919 – the house laws of the former ruling imperial and royal houses became obsolete in terms of constitutional law.⁴³ At best, they could continue to have an effect as private-law contracts with the consent of all parties involved. A prime example is the House Law of the Prussian Hohenzollerns with its regulations on, among other things, marriage according to status.⁴⁴ Not long ago, the effectiveness of this law was disputed in the German courts: Louis Ferdinand, a grandson of the last German Emperor Wilhelm II., had declared in a notarial deed in 1961, with reference to the House Law of 1920 and an inheritance contract with his father of 1938, that he irrevocably renounced his right of inheritance in the event of his marriage to a spouse not deemed his equal according to the principles of the old house constitution. Later, a dispute

⁴⁰Brief references to this in connection with the family constitution in Fleischer (ZIP 2016: 514); Iliou (2004, p. 163 et seq.); Hueck (2017, p. 13).

⁴¹See Brauner (2012, p. 806), with the addition that the house laws were also called *pactum*, *Ordnung*, *Statut*, or *constitutio*. For a collection of important house laws Schulze (1862–1883).

⁴²Full text in Velde (1839).

⁴³Thus BVerfG NJW 2004, 2008, 2011.

⁴⁴Berner (1884, p. 78); also Schulze (1883, p. 754 et seq.) on the House Laws of the Princely House of Hohenzollern-Sigmaringen.

arose about the validity of this waiver. After 10 years of proceedings, the German Constitutional Court (BVerfG) ruled in 2004 that Hohenzollern's equality clause violated the heir's fundamental right to freedom of marriage under Art. 6 para. 1 of the Basic Law and was therefore immoral or contrary to good faith under §§ 138, 242 of the German Civil Code (BGB).⁴⁵

1.3.1.2. Guidelines of the Moneyed Aristocracy (Rothschild, Peugeot, Schlumberger)

What the higher nobility had demonstrated was later to find many imitators among the moneyed nobility. And as with the former, the unilateral establishment of rules by the patriarch also dominated. An impressive example from Germany is the Rothschilds, who worked their way up from their early beginnings in Frankfurt's Judengasse to become one of the world's most important banking dynasties. Their founder, Mayer Amschel Rothschild (1743–1812), concluded a 10-year non-cancellable partnership agreement with his sons on September 27, 1810, officially transferring his business to "Mayer Amschel Rothschild & Sons."⁴⁶ However, he remained first among equals (see Backhaus, 2012, p. 147 et seq.; Ferguson, 2002, p. 97). He alone was allowed to withdraw capital for the duration of the contract, he alone could hire and fire employees, and he reserved the final say in all business matters.⁴⁷ At the same time, the partnership agreement also contained modern elements, such as a distribution of profits according to capital shares, the principle of joint management and an arbitration clause for partnership disputes after Mayer Amschel's death. In his notarial will of September 17, 1812,⁴⁸ he once again recalled the basic rules for the management of the company that he had already formulated during his lifetime, above all the requirement of unbreakable harmony and community in all business dealings.⁴⁹ In harsh words, he also professed patrilineality, i.e., an exclusive succession through the male line.⁵⁰ Even then, this principle was by no means

⁴⁵See BVerfG NJW 2004, 2008.

⁴⁶Reprinted in Berghoeffer (1923, p. 194 et seq.).

⁴⁷The relevant clause read: "Just as Mr Meyer Amschel Rothschild, with the help of the Most High, has laid the foundation of the present business through his diligence, insight and restless activity alone, which he has demonstrated from his youth onwards [...], so it is certainly of the highest fairness that he should retain himself as the actual head and present associate of the business, but in particular that he should reserve the decisive vote in all transactions [...]."

⁴⁸Also printed in Berghoeffer (1923, p. 201 et seq.).

⁴⁹Insistently, Ferguson (2002, p. 103 et seq.); also Backhaus (2012, p. 153): "The fraternal unity and the maxims of the father also became the central feature of the Rothschilds' external image."

⁵⁰It literally read: "I decree and will [...] that my daughters and daughters' husbands and their heirs have no share in the business existing under the name of 'Mayer Amschel Rothschild and Sons' [...]. I would never be able to forgive one of my children if, against my father's will, they were to allow themselves to disturb my sons in the quiet possession of their business."

self-evident,⁵¹ but from then on it remained an “iron law” (Backhaus, 2012, p. 152) of the Rothschild banks in Frankfurt, London, Paris, Vienna, and Naples. Unspoken, but unmistakable, his will finally contained another core demand: the family should remain Jewish and marry Jewish (Landes, 2006, p. 89).

Distinctive dynastic ideas also existed later in many industrialist families of the 19th and 20th centuries. One example from France is the Peugeotts, who had converted their original bicycle production in the Société Peugeot Frères to cars in 1890. Their great patriarch Robert Peugeot (1873–1945), called “Monsieur Robert,”⁵² drew up a catalogue of rules in the 1930s to avoid splitting up the family fortune: (a) As with the Rothschilds, company shares could only be inherited by sons, never by daughters or sons-in-law; (b) all sons had to immediately reinvest their profits as partners in the company and should therefore earn other income in addition to their investment income, whether in the family business or elsewhere; (c) all sons were given a seat and a vote on the board of the family holding company “Les Fils de Peugeot Frères”; their voting rights were initially restricted, but these restrictions were removed as they grew in age and experience; attendance at one of the *grandes écoles* accelerated this process.⁵³ Based on these guidelines, Robert Peugeot led the third-generation business family with iron rigor,⁵⁴ but treated workers and employees extraordinarily generously in order to create in them a sense of attachment to the family.

Also illuminating is an episode from the Schlumberger business dynasty, which originally came from Alsace and made its money in textiles before succeeding in the oil industry in the United States after the Second World War. One of its co-founders, Jules-Albert Schlumberger (1804–1892),⁵⁵ recorded in his notebook as a young man in 1829 some guidelines that he considered essential for a family business: (a) no partnership agreement without a binding obligation to make a rigorous and accurate annual inventory; (b) binding determination of the amount that each partner is allowed to withdraw per year; (c) partners must inform each other of everything that is important; (d) outside capital is not to be accepted or borrowed; if the need does arise, it must be repaid as quickly as possible; (e) no carriages or horses for the household of salaried employees, they can walk; in addition, they must also pay for all things that they take from the business: oil, vinegar, wood, coal, sugar, etc.⁵⁶

⁵¹See Backhaus (2012, p. 150): “In the Jewry of the 18th century it was quite common for wives to continue their husband’s business as widows or for daughters to be taken in as equal partners and help run the business.”

⁵²Sédillot (1960, p. 119): “Le grand patron: Monsieur Robert.”

⁵³For more details, Landes (2006, p. 270 et seq.).

⁵⁴On his management philosophy, Landes (2006, p. 271): “After Monsieur Robert had put these guidelines into effect, he ruled over the company and the family as an absolute monarch. Every day, wrapped in his cape, he visited workshops and factory halls. There could be no secrets – he wanted to know everything.”

⁵⁵On him, Teissonniere-Jestin (1989, p. 158 et seq.).

⁵⁶Landes (2006, p. 374 et seq.), adding: “This was a charter for a family business that took itself seriously – not a project on the off chance, but a sensibly calculated ensemble of capital and human labour.”

1.3.2. Modern Variations

In a new guise, the family constitution has been celebrating a rebirth since the 1990s. The core themes have remained the same: It is still about intra-family guidelines with reference to company, family or inheritance law.⁵⁷ What has changed above all is the way in which these values and objectives are defined. Whereas in the past it was the patriarchs from the high or moneyed nobility who unilaterally decreed the rules, today they are set in a joint process involving all family members.⁵⁸ According to the self-assessment of the family members and the observations of their professional advisors, the creation process is at least as important as the result.⁵⁹

The content and form of the family constitution vary nationally and internationally. There is no such thing as “the” family constitution in the sense of a uniform model. Rather, different models and types can be found, depending on whether the family constitution is primarily conceived as (a) an instrument of strategic planning, (b) an internal family corporate governance code, or (c) a gap-filler for inadequate inheritance and family law. Five comparative law miniatures are intended to illustrate the forces that have contributed to its dissemination and the extent to which legal scholarship has already taken note of it.⁶⁰

1.3.2.1. United States: Family Constitution

In the United States, the initial impetus for the development of a family constitution came from recommendations in management literature. John Ward of the Kellogg School of Management who first introduced the tools of strategic planning to family businesses in the late 1980s is considered the mastermind (see Ward, 1986; Ward, 1988). Together with his colleague Miguel Ángel Gallo from Barcelona, he coined the term family constitution in its Spanish version as *protocolo familiar* (Ward & Gallo, 1992). A book written together with Daniela Montemerlo in 2005 then compiled practical experience with the development of a family constitution in more than 80 families (see Montemerlo & Ward, 2005).

⁵⁷Fundamental Kalss and Probst (2013, p. 115 et seq.): Corporate Law for Family Businesses, Family Law for Entrepreneurial Families, Inheritance Law for Family Businesses.

⁵⁸So also from the perspective of counseling practice, May and Ebel (2017, p. 101 et seq.): “The bourgeois-patriarchal age has perished and with it patriarchal authority. Tradition and authority have lost their binding force. Anyone who wants to establish continuity in family entrepreneurship today must generate enthusiasm for the joint project”; on individual residual cases in which the business leader writes the essential rules alone and brings them to the attention of the entire family, Hueck (2017, p. 12).

⁵⁹See, for example, the experience report by Gloger (2017, p. 113) under the heading “The path is already part of the goal”; from the consultant perspective, May and Ebel (2017, p. 102).

⁶⁰The following in addition to and in deepening of Fleischer (2016, p. 1510 et seq.).

The US legal literature has hardly dealt with family businesses.⁶¹ Relevant (practitioner) guides deal almost exclusively with succession and tax planning as well as buy-sell agreements among family shareholders.⁶² In academia, too, family business law has not yet formed an independent field of research.⁶³ The findings on the legal nature of family constitutions are even more scanty: They consist of no more than a single sentence of a recently published journal article that refers to the will of the parties involved.⁶⁴

1.3.2.2. France: *Pacte familial*

In France, the family constitution has developed very hesitantly and selectively. The *pacte familial* of the Mulliez family of entrepreneurs, still one of the richest families in France, from 1955 is considered a harbinger. When the founder of the company, Louis Mulliez-Lestienne, died in 1952 without settling his estate, his descendants continued the business together and in 1955 cast their family togetherness into a family pact (Gobin, 2006, p. 160). In doing so, they secured the support of four top-class economic, financial, and legal advisors, among them Stephan Cambien, professor of economics in Lille (Gobin, 2006, p. 163 et seq.). Details of this *pacte de famille* which still exists today in its updated form remained hidden from the prying eyes of the public – true to the family motto “Pour vivre heureux, vivons cachés.”

French scholarship has so far paid little attention to the *pacte familial*. Some authors distinguish it from the *pacte d'associés* as a mere gentlemen's agreement (thus Blondel, 2010, p. 17 et seq.); others argue that, depending on the wording, its provisions could have legal effects.⁶⁵ Therefore, they argue, there is no way around a careful examination of the individual case. Moreover, they put the *pacte familial* in relation to the prohibition of contracts on a future inheritance in French law (see Le Nabasque et al., 1992, p. 247 et seq.). In 2015, the Paris Court of Appeal used the content of a *protocole familial* to interpret the partnership agreement.⁶⁶

⁶¹On point recently, Friedman et al. (2017, p. 426): “[F]amily businesses have received woefully insufficient attention from the legal profession with respect to their unique planning needs.”

⁶²For individual references, Friedman et al. (2017, p. 427 with fn. 9).

⁶³For a first approach, Means (2014); approvingly Smith (2016, p. 31): “Family-business law is not a ‘law of the horse’ but governs a distinctive factual context at the intersection of two important legal forms – the family and the business organization – each of which is animated by its own set of policies and regulated by its own set of rules.”

⁶⁴See Friedman et al. (2017, p. 458): “While every family can decide for itself, most families who create family constitutions do not intend the document to have legal consequences; they are, however, intended to be ‘morally enforceable’ and become a meaningful piece of a family’s culture.”; not relevant despite a promising title, McClain (2006).

⁶⁵In this sense, Le Nabasque et al. (1992, p. 288 et seq.).

⁶⁶See CA Paris, June 19, 2015, Rev. soc. 2015, 734.

1.3.2.3. Spain: *Protocolo familiar*

In Spain, the origins of the *protocolo familiar* are partly traced back to US management literature,⁶⁷ and partly it is thought to have reached domestic consulting practice via French models.⁶⁸ Today, the family protocol is mentioned in various governance codes for unlisted companies and family businesses. In a *Real Decreto* of 2007, the legislator gave it a sector-specific legal definition and created the possibility for companies outside the capital market to disclose the entire protocol or individual regulations in the commercial register.⁶⁹

Legal practice and scholarship have already dealt extensively with the family protocol. According to prevailing scholarly opinion, its regulatory nature and its legal effects cannot be uniformly determined (see Diez Soto, 2010, p. 174). Rather, the *protocolo familiar* can contain non-binding declarations of intent and values as well as legally binding regulations (see Diez Soto, 2010, p. 174; del Pozo, 2008, p. 153 with fn. 39; Valmaña Cabanes, 2013, p. 106). According to some authors, it can also be used to interpret the articles of association.⁷⁰ The aforementioned *Real Decreto* of 2007 equates the *protocolo familiar* with the *pacto parasocial*, the Spanish version of the shareholder agreement, but also leaves room for alternative arrangements.

1.3.2.4. Belgium: *Charte Familiale*

In Belgium, the idea of a family constitution has received significant impetus from the general corporate governance debate. Immediately after the Belgian Corporate Governance Code for listed companies was introduced in December 2004, a commission of experts drew up another set of recommendations for unlisted companies. This code, also known as the *Code Buyse*, recommends that family businesses draw up a family charter (*charte familiale*, *familiaal charter*) and explicitly advises that it be binding in nature.⁷¹

The specific legal aspects of the family charter are only dealt with in passing.⁷² However, reference is made to a judgment of the Court of Appeal in Brussels in 1999 concerning a company between three brothers from the tourism industry. Before founding the company, they had concluded an “accord de fonctionnement” which provided for a basic division of tasks between them. When the brothers later got into a dispute, the court ordered two brothers who had disregarded this agreement to buy out their third brother’s shares at a price fixed by

⁶⁷In this sense, Diez Soto (2010, p. 167).

⁶⁸In this sense, Valmaña Cabanes (2013, p. 103 et seq.).

⁶⁹See Royal Decree 171/2007, of 9 February, which regulates the publicity of family protocols.

⁷⁰In this sense, del Pozo (2008, p. 168).

⁷¹See Code Buyse, Corporate Governance. Recommendations à l’attention des entreprises non cotées en bourse, 2nd ed. 2009, para. 9.5; see Laleman (2010, p. 10), pointing out that many charters nevertheless limit themselves to legally non-binding guidelines.

⁷²So explicitly Lievens (2009, p. 23): “stiefmoederlijk behandeld.”

the court.⁷³ Such a compulsory acquisition for good cause has been known in Belgian company law since 1996. With reference to this ruling, it is assumed in the literature that a family constitution can also have legal effects.⁷⁴

1.3.2.5. Germany: *Familienverfassung*

In Germany, the Governance Code for Family Businesses (GKFU) was an important stimulus for the family constitution. It was created in 2004 on the basis of a private initiative and has been available in its third edition since May 2015. According to its preamble, it aims to help owner families ask the relevant questions and find individual answers tailored to the respective situation of the business and the family. Among other things, it recommends that they draw up their own governance code⁷⁵ and also regulate “the legal quality of the code and its contents, especially in relation to articles of association and other legal documents.”⁷⁶

There is now no shortage of practice-related literature on the family constitution.⁷⁷ However, there is a need to catch up with regard to its doctrinal classification. The state of research is still in its infancy (Hueck, 2017, p. 70), even though the degree of legal inquiry has been rising sharply recently. We will return to the details later.⁷⁸

1.3.2.6. Italy: *Patto di famiglia*

In Italy, management literature has focused more on family agreements as an instrument of strategic planning since the turn of the millennium. Terminologically, they were and are referred to as *patti di famiglia* (see, for example, Tomasselli, 2006). Under the same designation, the civil legislator created a new type of contract in Art. 768-bis of the *Codice civile* in 2008, which allows for the early transfer of family businesses contrary to the fundamental prohibition of agreements on succession.⁷⁹

In terms of company law, the phenomenon of the *patto di famiglia* in the sense of management theory has hardly been dealt with. Occasionally, one reads that it can gain significance as a secondary agreement under the law of obligations (*patto parasociale*) (see Adducci, 2007, p. 98 et seq.; Zanchi, 2011, pp. 89 et seq., 122 et seq.).

⁷³See CA Brussels, April 20, 1999, Tijdschrift voor Rechtspersoon en Vennootschap 1999, 431.

⁷⁴See Lievens (2009, p. 77), under the heading “A family charter can have legal effect” and (2009, p. 81): “The importance of this judgement cannot be underestimated for the practice of family businesses. It undeniably gives legal force to agreements that have hitherto been in the realm of declarations of intent and good intentions. Family charters now have teeth”; before that already Lievens (2004).

⁷⁵See point 8.1 GKFU.

⁷⁶See point 8.4 GKFU.

⁷⁷For a list of relevant sources, Hueck (2017, p. 5 with fn. 1).

⁷⁸For more details, see below 1.4.5.

⁷⁹For a comparative analysis, see Kindler (2007, p. 954) and Kratzer (2009).

1.4. Family Constitutions within the Governance Framework for Family Firms

The governance framework for family firms has to coordinate three overlapping and interacting social subsystems, each with their own needs, expectations, and responsibilities: ownership, family, and business.⁸⁰ It usually consists of a series of layers that are at times corporate, contractual or non-normative in nature.⁸¹ These layers together make up the whole, summoning up the image of the layers of an onion.

1.4.1. Statutes

Statutes are necessarily the first port of call for regulation in the legal framework for family firms. They offer a governance pattern with varying levels of flexibility depending on the type of company in question. In Germany, the Stock Corporation Act (AktG) provides the least room to maneuver with the iron principle of statutory stringency enshrined in § 23 para. 5.⁸² This explains why German family firms aiming to access the capital market are increasingly turning from the rigid corset of the stock corporation (AG) to the softer vestments of a partnership limited by shares (KGaA), a European Company (SE) or a hybrid SE & Co. KGaA.⁸³

1.4.2. Articles of Association

Usually, the most important rules governing family partnerships and limited liability firms are found in the articles of association rather than legislation. According to § 109 German Commercial Code (HGB) and § 45 para. 1 German Limited Liability Company Act (GmbHG), shareholders can set up tailor-made organizational structures in family firms and establish the ownership rights according to their specific needs. This is complimented by the creation of additional corporate organs, for example an advisory board made up of non-family members.

⁸⁰Perfectly captured in the three-circle model by Tagiuri and Davis (1992, p. 49); see also Tagiuri and Davis (1996).

⁸¹In more detail, Kalss and Probst (2013: marg. no. 4/1 et seq.). Generally on the many-layered governance framework for closed corporations, Fleischer (2017, p. 319); also, but with some differences, McCahery and Vermeulen (2008, p. 5 et seq.), explaining that the three pillars of the governance framework differentiate between company law, contract and optional guidelines.

⁸²From a comparative perspective, see Rothärmel (2006).

⁸³In more detail, Lieder (2017, p. 37). The situation is different for example in Switzerland, where family businesses are primarily organized as stock corporations, see Premand (2010).

1.4.3. Shareholder Agreements

In addition to the relevant legislation and the articles of association, shareholder agreements may also contain provisions on corporate governance in the family firm. Their most significant items include voting rights agreements, transfer restrictions, pre-emptory purchase rights and agreements regarding the composition of the various corporate organs. From a strictly legal perspective, these are independent agreements between some or all shareholders that operate *alongside* the articles of association, something the nomenclature in other languages makes clear, such as the Italian *patti parasociali* and the Spanish *pactos parasociales*. The relationship here is purely contractual, and in contrast to the articles of association, can only be altered with unanimous agreement, rather than a qualified majority. The contents of these agreements, and even their very existence is usually shielded from the curious gaze of the outside world; they remain “the invisible side of the moon.”⁸⁴

1.4.4. Codes of Governance for Family Firms

Codes of corporate governance provide a further layer of regulation that has already reached the privately held limited liability corporation (Konnertz-Häusler, 2012) and the family firm.⁸⁵ The main instrument in Germany is the “Governance Code for Family Businesses” mentioned above.⁸⁶ In legal terms, it is distinct from the German Corporate Governance Code for listed companies in that it, *inter alia*, lacks a statutory comply-or-explain mechanism like that of § 161 AktG.

1.4.5. Family Constitution

Last, but by no means least, the family constitution has begun to appear more frequently under a slew of terminology, including family charter, family protocol, or family code. In substance, it is a written document in which the owner family commits to paper their collective values and commercial goals for their ownership, family and business. The family constitution differs from the articles of association and shareholder agreements in two ways: It is usually signed by all family members – shareholder and non-shareholder alike; and, according to widely held opinion, it is not legally binding on its signatories, representing only a moral obligation.⁸⁷ Whether this assessment is legally accurate under German law is addressed in the next section.

⁸⁴Forstmoser (2004, p. 501), playing on a poem by Matthias Claudius.

⁸⁵Hirsch (2011, p. 126 et seq.): “Starting in the early 2000s with just a few countries engaged, the list of corporate governance guidelines including or focusing on family businesses is steadily expanding at national as well as international policy levels.”

⁸⁶See above 1.3.2.5.

⁸⁷See, for example, Baus (2010, p. 137) and Felden and Hack (2014, p. 321).

1.5. Family Constitutions in the Light of German Company Law

Regarding the possible legal effects of a family constitution, the recent discussion in Germany has gained enormous momentum and depth. Three lines of development are emerging which can be succinctly described as the juridification, theorization, and standardization of the family constitution.

1.5.1. Juridification of the Family Constitution

Among professional non-legal advisors, it was considered common wisdom that the family constitution is located in the pre-legal sphere: It is a mere declaration of intent⁸⁸ without legally binding effect,⁸⁹ neither enforceable nor executable (thus [Lange, 2013](#), p. 44), even a legal nullity ([Bause, 2010](#), p. 140).

This view, which has remained unchallenged for a long time, has recently been called into question by legal experts, and rightly so (see [Fleischer, 2016](#), p. 1515 et seq.; [Hueck, 2017](#), p. 70 et seq.; [Kalss, 2014](#), p. 350 et seq.; [Kalss & Probst, 2013](#), marg. no. 3/21 et seq.; [Kirchdörfer & Breyer, 2014](#), p. 21 et seq.; [Uffmann, 2015](#), p. 2441). Their observation that there is no such thing as “the” family constitution speaks for itself (see [Fleischer, 2016](#), p. 1515; [Hueck, 2017](#), p. 78). Instead, very different variations are encountered in practice. In view of this diversity of types at home and abroad, the sweeping judgment that a family constitution cannot a priori have any legal effect is far too undifferentiated. Rather, there is no way around a careful examination of their legal nature in individual cases (see [Fleischer, 2016](#), p. 1515; [Claussen & Waldens, 2017](#), p. 129 et seq.). Such a differential diagnosis is also considered necessary by scholarly contributions from Spain and France.⁹⁰ The first German monograph on the family constitution recently points in the same direction (see [Hueck, 2017](#), p. 335 et seq. (summary)).

As an interim finding, one can therefore state that the juridification of the family constitution has begun – not in the sense of a hostile land grab, but as a faithful exploration and determination of the actual will of the family members so as to classify this expression of will in the existing categories of law.⁹¹ Professional

⁸⁸For example, see Kellersmann and Winkeljohann (2007, p. 411) and Schulze and Werz (2007, p. 313).

⁸⁹See, for example, Heigl (2016, p. 42): “A family constitution is never legally binding, as it is not prescribed and there is also no prescribed form for it.”

⁹⁰For Spain, see fn. 101; for France, see fn. 94.

⁹¹On this from contractual practice, for example, Claussen and Waldens (2017, p. 131): “However, a legal non-binding nature cannot be achieved in all cases with this, but is also unlikely to correspond to the actual will of the participating family members”; from an academic perspective, Hueck (2017, p. 203 et seq.) under the subheading “Compatibility of a legal relevance of the family constitution with the will of the family shareholders.”

advisors and owner families must therefore already deal with the possible legal effects of a family constitution during the drafting process, and they are increasingly doing so.⁹² It is also to be welcomed that the German Governance Code for Family Businesses, in its latest version of 2015, raises awareness of the problems faced by owner families in this respect.⁹³

1.5.2. Theorization of the Family Constitution

For company law scholarship, this poses the task of dogmatizing the family constitution. In other words, it must be integrated into the doctrinal framework of contract and company law. Again, a one-size-fits-all solution is not convincing. Depending on the case, the family constitution can be classified in different categories, which can be of a corporate, contractual or non-normative nature.⁹⁴ It is conceivable but rather rare, that the family constitution is raised to the corporate level by a shareholders' resolution.⁹⁵ Occasionally, it may turn out to be a shareholders' agreement under the law of obligations, which applies (only) between the contracting parties, but is not subject to publicity in the commercial register (see [Fleischer, 2016](#), p. 1515). This possibility is explicitly mentioned in French, Spanish, and Belgian literature.⁹⁶ Probably even more frequently, the family constitution will be a so-called moral obligation, which goes beyond a mere social relationship but does not yet attain the quality of a contract (see [Fleischer, 2016](#), p. 1516; [Hueck, 2017](#), pp. 183 et seq., 192 et seq.). There is a remarkable degree of agreement across national borders that it could be described as a gentlemen's agreement, *pacto de caballeros* or *patto tra gentiluomini*.⁹⁷ Finally, it may be that in a specific case there is only a social agreement below the threshold of legal relevance (see [Fleischer, 2016](#), p. 1516; [Hueck, 2017](#), p. 180 et seq.).

From a direct legally binding effect, one has to separate indirect legal effects,⁹⁸ for which various doctrinal paths of transmission are available.⁹⁹ It is conceivable that individual provisions of a family constitution may become valid by virtue of internal company practice, either as derogating or as explanatory or

⁹²Most recently, for example, Claussen and Waldens (2017, p. 128 et seq.) under the subheading "Legal quality and legal effects of the Code."

⁹³See the text and the reference in fn. 108.

⁹⁴On the "onion-skin model" of governance regulations in family businesses Fleischer (2016, p. 1509 et seq.).

⁹⁵See Hueck (2017, p. 118 et seq.), for further references.

⁹⁶See for France, Dom (1998: marg. no. 263); for Spain, del Pozo (2007: marg. no. 29, 139, 143 et seq.); for Belgium, Lievens (2009, p. 73 et seq.).

⁹⁷See for France, Blondel (2010, p. 17 et seq.); for Italy, Tomaselli (2006, p. 28); for Spain, del Pozo (2007, p. 153 with fn. 39).

⁹⁸Very clearly, Hueck (2017, pp. 129 et seq. [direct legal effect], 197 et seq. [indirect legal effects]).

⁹⁹For more details, Fleischer (2016, p. 1517 et seq.); T. Hueck (2017, p. 201 et seq.); Uffmann (2015, p. 2450).

supplementary observance (see [Fleischer, 2016](#), p. 1517; [Hueck, 2017](#), p. 99). Incidentally, the high nobility already had similar house observances to accompany their house laws (see [von Thunen, 2015](#), p. 39). In addition, a family constitution can be used as a tool to interpret or supplement the partnership agreement (see [Claussen & Waldens, 2017](#), p. 130; [Fleischer, 2016](#), p. 1517 et seq.; [Hennerkes & Kirchdörfer, 2015](#), p. 65; [Hueck, 2017](#), p. 252 et seq.; [Kalss & Probst, 2013](#), marg. no. 4/115 et seq.). As mentioned above, this is what the Paris Court of Appeal recently did.¹⁰⁰ Those who wish to strengthen this effect may think of including the family constitution in the preamble of the articles of association or at least mentioning it there (see [Fleischer, 2016](#), p. 1518; [T. Hueck, 2017](#), p. 204; [Kalss & Probst, 2013](#), marg. no. 4/117 et seq.). Finally, the family constitution may be relevant for the concretization of the shareholders' duty of loyalty vis-à-vis the company or their fellow shareholders.¹⁰¹ This was already indicated by the German Federal Court of Justice in 1968,¹⁰² and in Belgium the cited ruling of the Brussels Court of Appeal in 1999 provides valuable illustrative material.¹⁰³ In this context, the family constitution is particularly informative because it spells out the legitimate expectations of family members and thus contributes helpful standards for managing intra-family conflicts.¹⁰⁴

1.5.3. *Standardization of the Family Constitution*

The gradual maturing process of the family constitution can, over the course of time, produce certain types of constitutions to which concrete legal effects can be assigned or which precisely avoid such juridification. In banking and commercial law, for example, the comfort letter has undergone a similar process of standardization over time, resulting in a hard and a soft version, each with its own legal consequences.¹⁰⁵ For the family constitution, the value of standardization would lie above all in giving the owner family and its advisors a more reliable orientation as to which types they must use in order to achieve the degree of commitment they may desire.¹⁰⁶

¹⁰⁰See the text and the references in fn. 108.

¹⁰¹See Claussen and Waldens (2017, p. 130); Fleischer (2016, p. 1518 et seq.); Hueck (2017, p. 267 et seq.); Kalss and Probst (2013: marg. no. 4/122 et seq.).

¹⁰²BGHZ 51, 204, 206.

¹⁰³See the text and the references in fn. 105.

¹⁰⁴See from a management perspective also Mengers and Prigge (2017, p. 93): "The elaboration of the content of a family constitution thus represents the step from purely so-called psychological contracts, which mostly each person keeps to himself, to a general consensus within the family and the business"; conceptually on organizational justice in family businesses Botero et al. (2015).

¹⁰⁵In detail on the gradual differentiation between hard and soft letters of comfort Koch (2005, pp. 11 et seq., 23 et seq.).

¹⁰⁶On various legal design options also Hueck (2017, p. 313 et seq.).

1.6. Key Findings

1. Family businesses have shaped partnership and company law from its earliest beginnings. The cradle of the ancient Roman *societas* was the house community continued by the heirs of the *paterfamilias* which was often also referred to as the community of brothers (*societas fratrum*).
2. In the Middle Ages, family businesses acted as promoters of the *compagnia*, *accomenda* and *oHG*. The Medici, for example, made use of the *compagnia* – literally: community of bread – in the 14th century when they founded their Florentine banking house, which was organized as a group of partnerships. They also made use of the *accomenda*, which a Florentine law of 1408 had made available to them. In Southern Germany, the partnership agreement of the brothers Ulrich, Georg, and Jakob Fugger of 1494 formed one of the first ever commercial partnership contracts.
3. The next major leap forward came in the late 19th century with the introduction of new forms of limited liability companies. In Germany, an urgent need for reform had been identified, especially for family and hereditary companies, which the legislature took into account with the GmbH Act of 1892. In England, many family businesses converted their small business into a private company, which the House of Lords approved in the famous Salomon decision of 1897. The change of form from a partnership to a limited liability company was also undertaken by large business dynasties, for example the Baring banking house in England after a near collapse in 1890, and the Rockefellers in the United States in 1870 to tap new sources of finance.
4. In the 20th and 21st centuries, the picture of family companies in Germany is characterized by an enormous diversity of legal forms. In addition to the numerous basic types, including the KGaA (e.g., Merck), combinations of types have gained in popularity – from the GmbH & Co. KG to the SE & Co. KGaA (e.g., Bertelsmann). In contrast, many other jurisdictions manage with fewer legal forms and are also critical of type combinations.
5. Nowadays, more and more family businesses are supplementing their basic corporate legal framework with a so-called family constitution, in which they document their collective set of values and their company-related objectives. This modern control instrument has early predecessors in the so-called house laws of the late Middle Ages, with which families of the high nobility (e.g., Habsburg, Hohenzollern) established family and inheritance laws outside of state civil law. Patriarchs of the national and international moneyed aristocracy (e.g., Rothschild, Peugeot, Schlumberger) later did the same by establishing guidelines for their family business.
6. The core themes of today's family constitutions have largely remained the same with their references to company, family, and inheritance law. What has changed above all is the way in which these guidelines are established: They are no longer unilaterally decreed by the heads of the family of the high or moneyed aristocracy, but are consented to by all family members in a joint process. This process is often as significant as its outcome.

7. Family constitutions are not a purely German phenomenon, but an international one. They have gained a foothold in the United States (family constitution), France (*pacte familial*), Spain (*protocolo familiar*), Belgium (*charte familiale*), and Italy (*patto di famiglia*). Almost everywhere, they are still in the early stages of being worked out in terms of company law.
8. The view, long unchallenged in advisory circles, that a family constitution has no legal effect whatsoever, has recently been called into question by legal experts, and rightly so. Three lines of development are emerging, which can be succinctly described as juridification, theorization, and standardization of the family constitution. They are not intended as a hostile takeover of a field hitherto worked on mainly by business consultants, sociologists, and psychologists. Rather, it is an attempt to faithfully ascertain the actual will of family members and to adequately classify it in the categories of law.

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Chapter 2

Family Firms and Family Constitution – A Management Perspective

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Abstract

This chapter presents the current research status of family constitutions from an economics perspective. It locates the family constitution as part of the family and business governance structure of a family firm and the owner family. The typical structure and content of a family constitution are introduced. The chapter focuses on the status of research about family constitutions and provides a structured map for future research. With regard to extant research, it must be stated that the stock of literature is small. The contributions to literature are categorized in surveys; conceptual contributions; survey data; small sample, qualitative, empirical studies; and big sample, quantitative, empirical studies. The latter group includes three studies with a separate family constitution variable. This small number symbolizes that the family constitution still is an under-researched area. Therefore, family constitution research is far away from being able to answer central questions of advice-seeking owner families like, for example, whether a family constitution affects family performance, firm performance, or both; or whether the development process of a family constitutions disposes of an effect on family or firm performance separately from the hypothesized effect of the family constitution document.

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Keywords: Family constitution; typical content of a family constitution; family governance codex; classification of managerial family constitution research; survey of managerial family constitution research; future paths of managerial family constitution research

2.1. Introduction¹

This chapter presents the current research status of family constitutions from an economics perspective. A short, quite superficial overview of the research on family firms from an economics perspective will precede the main argument, given that some of our readers will have a legal background on this topic (Section 2.2). Section 2.3 puts the family constitution in perspective within the governance system of family firms, which does not only contain business governance but also the element of family governance. The family constitution is one instrument of family governance. Its typical content as well as its connection to the governance codex of family firms are presented in Section 2.4. Subsequently, the family constitution of family Hoyer (HOYER GmbH Internationale Fachspektion) is looked at as a real-life example. Section 2.5 outlines the research status of the economics literature. As is the case for academic law literature, there is only limited research we can draw upon. This is also the reason why consultancy literature is included in this chapter since it contains valuable information from the daily work with family firms. This being said attention needs to be drawn to the fact that these brochures will at least partially be published as marketing instruments. The main focus is put on the empirical research in the section on academic studies. They can be clustered in studies with large samples, which are analyzed econometrically, and studies that have their focus on one singular case or a small number of cases, which are then analyzed qualitatively. Studies with a large sample are to be distinguished into those which consider the family constitution as a separate variable or as part of a composite family governance variable. Only the results of the former type will allow imminent conclusions on the effects of a family constitution. In Section 2.6, ideas are developed concerning paths the inevitable further research on family constitutions could or should take. A short summary in Section 2.7 concludes this chapter.

2.2. Are Family Firms Special? A Primer on Family Firm Management as a Field of Research

The economic research on family firms is still a comparatively young branch of general business administration. The first journal related specifically to this topic was the *Family Business Review*. First published in 1988, it is still today one of the

¹This chapter draws on Mengers and Prigge (2017), but it is significantly revised and updated, representing the research status as of 2022.

leading journals in this field. In its coexistence – and its rivalry – of management’s various sub-disciplines the research on family firms is still not fully recognized as an independent discipline. Yet some structures have been established internationally, which allow for researchers to get organized and discuss the topic. Amongst them can be found for example Ifera (International Family Enterprise Research Academy), the Strategic Interest Group (SIG) Family Business Research which takes place within EURAM (European Academy of Management), and the yearly Workshop on Family Firm Management Research within EIASM (European Institute for Advanced Studies in Management). In 2016, German researchers on family firms formally organized the research group Family Business as part of the Förderkreis Gründungs-Forschung (FGF).² Complementary to genuine economic concepts research on family firms foremost is based on psychological imports. The exchange with the discipline of law is at a very early stage.

When reflecting on the question if family firm research should be granted the status of its own independent sub-discipline, ultimately the following questions should be considered: Are family firms different? Do they differ from other companies? And more considerably: What defines a family firm?

Family firm researchers have been dealing with this question of the right definition and it has not been decided as of today. This question cannot and must not be resolved now but the following can be said: If the majority of shares is in the hands of the family and there is a willingness to hand the company over to the next generation, then this defines a family firm (refer to [Brigham et al., 2014](#) for the long-term orientation of family firms). It is disputable if family members have to take positions on the top boards of the company.³ The size of the company is undeniably not a critical feature for the definition of a family firm: Family firms can be small or big; the decisive difference from non-family firms is the central role of the family. Therefore, the terms family firms and small-and-medium enterprises (SMEs) should not be understood as synonyms.

The three-circle model is an established, simple, yet surprisingly differentiated form to display the accentuated significance of the family and to systematize the different roles ([Tagiuri & Davis, 1992](#)).

In comparison to non-family firms, the family is added as a third circle, while business and ownership circles are present in family firms as well as in non-family firms. A family member can have no further relationship to the company (besides the natural closeness of the firm and the family); he or she can be a family member and shareholder, can be operationally employed in the family firm or can be active as a shareholder. This classification already shows some of the many roles family members can engage in. When talking about the involvement in the family firm, one could differentiate between non-leading positions, positions within the operational governance of the company (management) or within supervisory or advisory boards. The term “family” itself contains a great deal of

²Subsidizes research on the foundation of firms.

³An elaborate discussion about the definition can be found in Harms (2014), and Alderson (2012) discusses the differences between family firms and non-family firms.

heterogeneity: Conflicts between generations are a known phenomenon within the families standing behind the family firm. Potential for conflict can be found in questions like the spouses' participation in the company in terms of employment or their role as shareholder (cf. the empirical dissertation by Schäfer, 2016); similar questions can be asked for illegitimate partnerships as well as for adopted or extramarital children. The "family" can include people who have become part of the family through their longstanding (professional) relationship (Angus, 2005, p. 7).

The pure presence of the family in a family firm in comparison to non-family firms does neither automatically lead to the conclusion that these two types of firms differ nor does it justify research on family firms as its own discipline. For this to happen, there has to be a specific effect of the family on the family firm. Quite known is the quote by Peter Zinkann, late executive director at Miele: "Family firms have an enormous advantage and an enormous disadvantage, and both is the family. A family at peace is the best that can happen to a company, a family at strife the worst" (quoted from Wimmer, 2007, p. 30). The family can be an asset but also a liability for the company. It is an asset when the family functions as an active, reliable, and long-term oriented shareholder, what hundreds of thousands of free float shareholders of a Bearle-Means-enterprise never could do.⁴ It will be a liability to the company if for example family conflicts threaten to paralyze it.

This is where economic research on family firms has started and has developed many approaches and concepts throughout the past years, concerning why and how family firms are different, why and to what extent the owner-families can turn into the "enormous advantage" or the "enormous disadvantage" for the company.⁵ According to the Resource-Based View (Habbershon & Williams, 1999), the family brings particular resources to the company. Sirmon and Hitt (2003) name as potential positive resources human capital, social capital, patient financial capital, "survivability capital" (the family will help out in case of the company's distress) and lower agency costs. But family resources can also give a negative impulse – for example certain forms of altruism (Carney, 2005) or – more generally speaking – the interpersonal potential for conflict: There are numerous examples of cases of failed family firms due to selfish acts, distrust, missing arrangements for heritage, or non-existent rules for succession (to only name some of the reasons). Close personal relationships between family members,

⁴A Bearle-Means-enterprise (Bearle and Means 1932) entails a publicly traded company, where control and ownership are separated. Management controls the company's resources, while the shares lie exclusively in the hands of a multitude of free-float shareholders. They act rationally passive (free-rider-problem) and typically display no connection to the company.

⁵Even a short outline of the different approaches would go beyond the scope of this chapter. Therefore, the quite superficially mentioned terms have to suffice in this context. For continuative overviews and further references, the interested reader is referred to the *Sage Handbook of Family Business* (Melin et al., 2014).

which have been naturally governed by trust and altruism, can suddenly turn into a dilemma, for example when succession and the attribution of roles between siblings are not clarified. Envy and distrust toward family members with an allegedly preferred treatment provide another source of conflict (Achleitner et al., 2010). All of these conflicts cause costs of various types through lost time, opportunities, labor, motivation, and so forth.

Do family firms perform better or worse than non-family firms due to these family firm-specific resources or does it make no difference at all? The superiority of (future) family firms is comparatively well documented in the founding generation. Unsettled remains the question if this is due to the founding effect or the family effect. From the second generation onwards, the evidence is inconsistent.⁶ But this is not the whole extent of complexity in terms of the performance question of family firms. The empirical studies use the typical measures for company success, accounting ratios as well as – for listed companies – measures related to the capital market like dividend yield, value relations, and market-to-book relation. But don't families maybe follow non-financial goals with their companies, so that they would measure success differently and therefore be inadequately accounted for by the standard measures mentioned above? Gómez-Mejía et al. (2007) have introduced into the discussion of non-financial goals a highly influential concept with their Socio-Emotional Wealth (SEW) (more about SEW refer to Berrone et al., 2012). A family firm may have underperformed according to the usual standard measures but considering the SEW the family can consider the expired business year as successful.

At the end of this short overview, the complexity for another main variable in such studies is pointed out: So far researchers mainly have differentiated between family firms and non-family firms, just like a 0/1-variable. Black or white. Yet even the three-circle model in the beginning of this chapter has already shown that the connection between the family and the family firm can be diverse. The family could exclusively take on the role as shareholders and even act passively within this role, they could additionally also take on influential positions within the company, only to name the two extremes for a simple constellation. It is plausible that the influence of the family on the company differs in both cases; the same should be true for the resources, which they make available to the company. It is also quite obvious to assume further characteristics – ultimately a continuum – between the two extreme poles of exercise of influence and allocation of resources by the family. Consequently, efforts within family firm research are being made in order to develop the discrete differentiation between family firms and non-family firms toward more continuous measures. One influential concept in this context is the F-PEC Scale, presented by Astrachan et al. (2002). The F-PEC Scale allows us to determine the degree of familiness in a family firm with a continuous value

⁶Further details in the overview article by Amit and Villalonga (2014); limited to Total Shareholder Return as a measure for success Grelck et al. (2017) summarize the evidence and undertake their own study on listed German family firms, which does not show a general superiority of family firms.

between zero and one. Using its indicators, the F-PEC Scale goes beyond the family's purely *potential* influence on the company through ownership and placement on boards (Power) and the duration of family ownership (Experience), by providing a Culture Subscale.

However, data for this sub-index can empirically only be raised through surveys which means it relies on the collaboration of the sample family firms. This is the reason why this scale has rarely been completely used, that is to say including the Culture Subscale; these studies include [Klein et al. \(2005\)](#) and [Holt et al. \(2010\)](#). A related but also competing concept is the FIFS (Family Influence Familiness Scale) by [Frank et al. \(2017\)](#) which has already raised some attention.

2.3. The Family Constitution's Position in Family and Business Governance

[G20 and OECD \(2015\)](#) define corporate governance as follows:

Corporate governance is a set of relationships between a company's board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance are determined.

This is quite a general definition: It doesn't provide an organizational goal, for example, maximizing the market value. It rather shows that corporate governance is a universally applicable concept which is not only useful to the profit-organization. Ultimately, the goal is to create a governance structure in such a way, that the organization's resources can be applied efficiently and that the organization's stakeholders are satisfied. This applies to the profit-oriented listed company as much as to the non-profit government organization collecting donations. Even though corporate governance is interpreted in a broad sense, recommendations usually are limited to the organization (the business), in which the operational activities take place. Due to the assumed central role of the owner-family in a family firm, family governance is added to the notion of business governance when dealing with family firms. Governance of the family has only found its way into family firms in recent years. After all, through the strategic, conceptual, and especially not directly measurable considerations, there is an effort which not every family will consider as necessary and therefore might not take it into consideration at all. However, also in this case, it is better to take precautions than to heal the wounds afterward.

Family governance therefore represents the "organisation of the owner-family" ([INTES et al., 2021](#), pp. 41, 49). Family governance's "basic aim is to create a tight relationship between the family and the business and ensure a functioning business-owning family – one that acts in unison to safeguard the long-term existence and well-being of the business and does not put the business at risk through destructive conflicts." ([Süss-Reyes, 2014](#), p. 141)

So the owner-family defines rules and guidance within the framework of these two governance-sectors, for them to act and lead by. In order to do this, the family uses different instruments on the level of the company as well as the family. Family governance is the hinge between the owner-family and the family firm. It contributes to the family being an asset as opposed to a liability for its company. As usual for governance structure also the family governance disposes of various instruments. In addition to the family constitution, one could mention, for example, a family council, a family office, a family meeting, a family day, family education, family philanthropy or a conflict management. The entirety of family governance instruments in place should probably be considered as a system, meaning that there can be substitutional as well as complementary relationships between single components of the system. The scope of this chapter does not allow us to follow this through any further,⁷ nor is it possible to go more into depth of the other components mentioned above.⁸ Much rather a more detailed look shall be taken at the family constitution. It can be considered as the core of family governance since often within the constitution other instruments of family governance will be treated and it even might include other components of business governance.

2.4. Typical Content of Family Constitutions

There exists more than one denomination for the document which is called family constitution in this chapter: family charta, family protocol, family codex, or even family business governance constitution (Fleischer, 2016, p. 1510). Fleischer defines the family constitution as a

written document in which the owner family writes down their collective set of values and their goals for the company taking into account the potential conflicts between company, family, and ownership. There are two distinctive differences between the family constitution on the one hand and the articles of association and the shareholder agreement on the other hand: Firstly, the family constitution is typically signed by all family members, both shareholders and non-shareholders. Secondly, according to widespread understanding, it is only morally, but not legally binding for the signatories. (Fleischer, 2016, p. 1510; own translation)

⁷Refer to Rediker and Seth (1995) as well as Prigge (2008, 2010) for further references. Gnan et al. (2015) empirically study the family governance instrument family council and find out that partially the business governance instruments of shareholders' meetings and Board of Directors substitute ownership and monitoring in their governance function.

⁸Refer to for example, Hauser (2002), Kellersmann and Winkeljohann (2006, 2007), von Andreae (2007), Fabis (2009), Lange (2009), Koeberle-Schmid et al. (2011) as well as Siebels and zu Knyphausen-Aufseß (2012).

However, a discussion has been started among legal scholars about the actual binding effect of the family constitution (Fleischer, 2016, 2017; Prütting, 2017).

According to Baus (2013, p. 135), the family constitution has the goal “to create a functioning owner-family which is aware of its responsibility to generate sensible rules about the distribution of power and money, about the goals for the family, about conflict resolution mechanisms and the collaboration of the family.” In Germany, there is a special correlation between the Governance Codex for Family Firms and the typical content of family constitutions.

Indications and suggestions for potential actions found in the typical corporate governance codices like the German Corporate Governance Codex in Germany are partially compulsory and are founded on implicit assumptions, which are only rarely applicable in family firms (Klein, 2009, p. 64). Furthermore, it has been shown that family firms introduce governance structures which are quite different from non-family firms (Bartholomeusz & Tanewski, 2006) which is the reason why the Governance Codex for Family Firms has been developed. The Codex was initiated by a consultancy, which has also worked on the content and its revision, to a great extent in collaboration with family firm owners and researchers.⁹ In the meantime, the Codex is available in its 4th edition (INTES, FBN Deutschland und Die Familienunternehmer 2021).

The Governance Codex for Family Firms is supposed to be a reference for the owners of a family firm to develop their own individual leadership and monitoring structure.

The Code supports owner families to ask the relevant questions about their family business governance and to find tailor-made answers appropriate for the specific set-up of family and company. The owners could document their answers in their individual family code (family constitution, family charta, governance constitution). In turn, this only morally binding document is the foundation for setting-up the provisions under company and inheritance law as legally binding documents.¹⁰

Presumably, the content of the Governance Codex provides orientation for the content of the family firm governance. Looking at said Codex therefore makes sense in order to approach the typical content of a family constitution. The

⁹Initiatives and studies led by consultancies are not a rare appearance in the sector of family governance in order to create demand and demonstrate competency. This is a phenomenon which can be observed internationally (Fleischer, 2016; Parada, 2015; Prigge & Thiele, 2019).

¹⁰INTES, FBN Deutschland, ASU Die Familienunternehmer: Governance Kodex für Familienunternehmen. “Kodex.” <http://www.kodex-fuer-familienunternehmen.de/in-dexamplephp/kodexample> Own translation. Accessed on 23.12.2021.

following chapters can be found in the Codex ([INTES, FBN Deutschland and Die Familienunternehmer 2021](#), p. 7):

1. The self-conception of the owners

Establishing suited governance structures belongs to the responsible and successful leadership of a family firm. Among these structures are values and goals, dealing with other stakeholders' interests as well as the significance of keeping the company a family firm.

2. The structure of owner rights and duties

The Codex describes universal and individual design parameters which deal with the realization of responsibility as the highest instance of decision-making.

3. Supervisory and advisory board

This aspect deals with the basics of this non-mandatory board, like its tasks and inner structure, its composition as well as its members' remuneration and accountability.

4. Company management

This chapter describes the tasks and composition as well as the remuneration and accountability of the managing board.

5. Measurement and disposition of earnings

In order to ensure capital and liquidity across generations, various aspects are pointed out about the determination and the use of the financial result.

6. Transfers of ownership, withdrawal from the group of owners

A family firm should ensure that shares stay within the family which results in a limited freedom of transferability and sale of shares.

7. Special features of indirect ownership

New chapter included with the 4th edition. It addresses specific issues that must be observed when the family firm is held indirectly, e.g., by a family foundation.

8. Handling of assets not tied up in the family business

New chapter included with the 4th edition. It considers specific governance issues related with assets held outside the family business, e.g., for the purposes of risk diversification or preparing inheritance tax payments.

9. Family Governance

Even though also on this topic no schematic advice can be given, it is important to be well organized as the owner-family. Sharpening the feeling of belonging together, the identification with the company, and avoiding or solving potential conflicts belong to this aspect.

The 10th and last chapter is dedicated to creating the family's very own individual governance codex – the family constitution. In its first nine chapters, the Codex makes suggestions about questions, which might need rules, but mostly without giving implicit guidelines about the content of these rules. This approach seems to make sense in the light of the great heterogeneity amongst family firms, which are addressed by the Codex (Prigge, 2013). The family constitution and other, legal documents like the articles of association will then contain the rules individual to the family (INTES, FBN Deutschland and Die Familienunternehmer 2021, p. 48).

Potential content for family constitutions can also be found in textbooks dealing with the topic of family constitution. According to these books, a family constitution will most likely include the following chapters: foreword, values, goals, roles, boards, instruments, final remarks, and appendix (Felden et al., 2019, p. 393)¹¹:

- Preamble
 - Foreword
 - Definition of the scope
- Values
 - Values for family and company
- Goals
 - Goals for family and company
 - Financial goals
 - Expectations toward growth, yield, and dividends
- Roles
 - Significance of the family for the company
 - The family as shareholder
 - The family as management
 - The family on the advisory board
 - Employment and service of family members
 - Responsible for the family
 - Responsible for the company
 - Spouses

¹¹Felden et al. (2019, p. 393) inspired by: Baus, Kirsten: *Die Familienstrategie. Wie Familien ihr Unternehmen über Generationen sichern*. 3rd edition. Wiesbaden Gabler: 2011. [own translation].

- Committees
 - Family council
 - Family office
 - Family manager
- Instruments
 - Management of conflict
 - Family activity
 - Family education
 - Family philanthropy
- Final Remarks
 - Final remarks and signature line
- Appendix
 - Family tree
 - Rules for marriage, testamentary, and endowment contracts
 - Rules for changes of shareholders
 - Rules about qualifications
 - Rules about the information policy in- and outwards
 - Rules about the qualification of potential successors in ownership and management

During the search for relevant topics of a family constitution, one might look at research and identify the “success patterns of multi-generational family firms” as a useful source. [Wimmer et al. \(2009\)](#) have looked for such patterns and identified seven so-called paradoxes, “the handling of which the authors have found to be key to the longevity of companies” ([Wimmer et al., 2009](#), p. 148). These paradoxes give another insight into the special challenges of family firms, as described by the three-circle-model in the beginning:

- Paradox I: Family-led influences as resource and threat to the company
- Paradox II: To be loyal toward their own closed family and the wider family ties
- Paradox III: To account for short-term (individual) shareholders’ interests and ensure the company’s future in the long run
- Paradox IV: To fulfill equal-opportunities expectations by the family and attend to the inequality demands of the company
- Paradox V: To grow respecting the entrepreneurial autonomy
- Paradox VI: To maintain entrepreneurial transformability and preserve (family) traditions
- Paradox VII: To satisfy expectations to protect the family and ensure the performance of the company and its management.

To conclude this section, a closer look will be taken at the family constitution of family Hoyer and thereby their company HOYER GmbH Internationale Fachspedition (hereafter HOYER) from Hamburg.¹² Currently active in the company

¹²More information to be found at www.hoyer-group.com/en/. Accessed on 23.12.2021.

is the second generation of four siblings. Mr Thomas Hoyer used to be CEO and has now been heading the advisory board for a couple of years. Two of his sisters alternate in the advisory board, the third sister is responsible for the family. Operations are led by non-family managers. Until recently each of the siblings held 25%, in the meantime, the transfer to the third generation has begun involving twelve people. The following statements are based on the family constitution from 2006¹³ as well as on two conversations which one of the authors was able to lead with Mr Thomas Hoyer.

Mr Thomas Hoyer started dealing with the governance at HOYER very early on. In the beginning of the 21st century, it became clear that – at least for a certain period of time – the management would consist exclusively of non-family managers for the first time in the company's history. Mr Hoyer wanted to change from management to the advisory board due to his age. The third generation wasn't and still isn't ready to take on a leading position at HOYER. At the same time, it was obvious that with the third generation the family structure would become more complex and therefore also more prone to conflicts. Mr Thomas Hoyer took an active approach to this matter by contributing to the group that developed the first version of the Governance Codex for Family Firms in 2004. He also belonged to this group and was therefore part of the revision processes in 2010 and 2015. The exchange with other group members as well as the input from a consultancy which was also part of the codex-development supported the four siblings of the second generation in generating their family constitution. They signed it in August 2006. The document is kept in everyday language. Currently, the second and third generations are revising the family constitution. Hereafter, the content of the 2006 version is summarized.

Before the signatures in the beginning there is a statement that the family constitution can be altered at any time but that amendments are in need of "the overwhelming willingness of the shareholders." Every family member at the age of 16 receives the document. As shown hereafter the family constitution consists of the following chapters: foreword, values and goals, rules, institutions.

Foreword

The foreword sets as its highest goal the continuation of HOYER as a family firm. The family constitution is addressed to all members of the family including the spouses and children, next to the four siblings. However, it looks like only the four siblings have worked on the family constitution as shareholders. There ought to be unity within the family without thinking about family branches. With regard to the values, the family constitution makes reference to those characteristics which laid out the success for the founder of the company Walter Hoyer: entrepreneurial thinking, hard work, discipline as well as personal responsibility toward the company and its employees.

¹³Family Hoyer's family firm constitution is printed in Plate et al. (2011, p. 554 et seq.).

Values and Goals

This chapter is by far the longest. It is divided into the “Credo for the company” and the “Credo for the family.” The former details which implications the overall goal, to keep HOYER a family firm, has on profitability, dividend policy, and share capital quota. The part “optimal leadership” defines the family’s system of values and goals as an orientation for the exclusively non-family management. Furthermore, the family’s role in the company’s boards and within the company is defined. Finally, the Credo for the company highlights the solidarity of the family and the company as well as social responsibility for the employees. The Credo for the family clearly defines the rule “company first.” This main rule influences the rules on the employment of family members, dividend payments, and payments upon exit of shareholders. Furthermore, behavior rules are described for the interaction of the family members.

Roles

The distribution of the roles between the four siblings has been described in the beginning (Mr Thomas Hoyer as chairman of the advisory board, two sisters alternating as members of the board and the third sister as responsible for the family).

Institutions

This last part deals with three institutions: the shareholders’ assembly shall also be used “to discuss important matters only in the circle of shareholders.” The primary objective of the annual family day is the company. Topics listed as examples are family culture, the transmission of values, preparation of succession, management of conflict, and career planning. The charitable Friedel-und-Walter-Hoyer-Foundation receives a share of the company’s profits on an annual basis.

Since the whole process was accompanied by an influential consultancy and took place parallel to the first creation of the Governance Codex for Family Firms, it is not surprising to find many of those elements which are classified as typical by the consultancy literature in Hoyer’s family constitution. The central role of the family constitution for the governance of the family and the company is also supported by the Hoyer example: The family constitution deals with the responsible for the family, family activities (family day), family philanthropy (foundation), shareholders’ assembly, advisory board and management.

2.5. Current Status of Literature

Overall, there exists little academic management literature on family constitutions so far. Even though the portfolio is – slowly – growing, in general [Gersick and Feliu’s \(2014, p. 212\)](#) evaluation can still be agreed with:

So far the literature on family mission statements and constitutions is primarily descriptive; (...) We could not identify any

formal study aggregating governance provisions from a large sample of family constitutions, or assessing the impact or specific benefit of family mission statements on governance or family firm performance.

This is also the reason why the consultancy literature cannot be ignored. It gives an impression of the distribution and handling of family constitutions. At the same time, it has to be clear that, after all, these studies are instruments used by consultancies to create demand for family governance instruments and who want to be its competent service provider.

2.5.1. Status of Literature – Consultancy Literature

This overview is limited to the consultancy literature for Germany. So far, PwC (May et al., 2015; Schween et al., 2011; Vöpel et al., 2013), partially together with the pioneers of family firm consulting, INTES, which meanwhile belongs to PwC, and KPMG (Koeberle-Schmid et al., 2016) have published empirical brochures. Each one of the four studies contains a specification, how many of the questioned family firms have a family constitution. It ranges from 16% to 35%.¹⁴ There is conformity that a family constitution rather exists in bigger and older family firms with several family shareholders (Schween et al., 2011, p. 15). Koeberle-Schmid et al. (2016, p. 39) contribute that there is a bigger spread when the family is organized in clans.

Partially, the consultancy literature hints at a connection between the family constitution and the success of the company,¹⁵ however, these claimed connections do not live up to scientific standards; at least no documentation can be found in these brochures accordingly. Schween et al. (2011) show more connections in their consultancy study, which is the only one dealing exclusively with family constitutions: Trigger for the creation of the constitution was not current conflicts but the succession within the circle of shareholders and conflict prevention. The impulse to create a constitution was predominately initiated by the shareholders. The main expectations toward the family constitution clearly are the preservation of peace and stability as well as the promotion of unity and identification; increasing the economic success is clearly subordinated. Families

¹⁴Two dissertations from the academic area can be added about the distribution of constitutions: Papesch (2010) shows that 4% of 173 questioned family firms have a family constitution, for Ulrich (2011) it is zero of 16.

¹⁵Higher profit margin for companies with family constitutions (Schween et al., 2011, p. 26). May et al. (2015, p. 20) phrase this slightly more carefully: Between family governance mechanisms and success of companies — measures: turnover, profitability, employee growth rate, and market share in comparison to the most important competitors according to voluntary disclosure of companies — there is no direct, statistically significant correlation, but an indirect one: Family governance instruments improved solidarity and capability to change of the owner family; both having a positive impact on company success.

and family firms with constitutions are organized in a more structured way than their pendant without a constitution: Written rules for many aspects of business as well as of family governance are substantially more frequently fixed.

These findings are highly welcome in light of the low level of knowledge about family constitutions. At the same time, for the interpretation the same holds true as mentioned above for the correlation with the economic success: As far as can be told, the correlations have been assessed purely bivariate, meaning the influence of further factors has not been considered. Furthermore, the interpretation of the direction of causality has to be treated carefully. For example, the data do not clearly show if families are better organized because they have a family constitution or if families have a family constitution because they already are better organized.

The consultancy brochures keep emphasizing the importance of the creation process itself (for example, [Schween et al., 2011](#), pp. 22–21, 36–38). Based on this, it is not clear what would lead to the assumed conflict avoiding impact in the end: the document itself or would it also be the creation process, i.e., the discussions, the decisions, the exchange about expectations and requirements, or both? Family business professors [Montemerlo and Ward \(2011, p. 47\)](#), who are also quite active in family business consulting, state: “We believe the process of developing the family agreement is more important than its contents.”

The family itself writes its constitution ([May et al., 2015](#), p. 12). The content is neither of legal nature nor is it partially pre-written for the family members to take note of it and then have it disappear in a drawer. This document is supposed to live and be lived. And the autonomous writing and phrasing are part of this. This way every family member is not only given the feeling but also the opportunity to make an input, to create and therefore become part of the whole process. The probability is very high that there will be discussions during the creation process, emotions will be awoken, and fights cannot be avoided. Often the consultants accompany the family during this process of creating the family constitution and can moderate and smooth ([Fogel, 2003](#), p. 44).

If the family firm takes the family business governance model as guidance, it can deduct that the family constitution should be adapted when the structure and complexity of the company or the family change over time. It is essential to take care of and work regularly on the document ([Schween et al., 2011](#), p. 38).

2.5.2. Status of Literature – Scientific Literature

Scientific articles can be systemized as depicted below in [Table 2.1](#).¹⁶ A single article might be classified into several sections, for example, the theoretical hypothesis development under 2) Conceptual Contributions, while the empirical analysis itself might fall under 4) or 5).

¹⁶This literature survey does not include the contributions assembled in this book. The only exceptions are [Graves et al. \(2023\)](#) and [Ulrich and Speidel \(2023\)](#).

Table 2.1. Classification of Family Constitution Research.

I. Surveys

Gersick and Feliu (2014); Suess (2014); Mengers and Prigge (2017)

II. Conceptual Contributions

Berent-Braun and Uhlaner (2012); several studies from the Research Institute for Family Business of the Vienna University of Economics and Business (e.g., Lueger & Frank, 2012; 2015; Lueger & Suchy, 2012; Korunka & Nosé, 2012); Botero et al. (2015); Parada (2015); Arteaga and Menéndez-Requejo (2017); Arteaga and Escribá-Esteve (2021)

III. Survey Data

Ulrich and Speidel (2023)

IV. Empirical Studies: Small Sample, Qualitative

Several studies from the Research Institute for Family Business of the Vienna University of Economics and Business (e.g., Lueger & Frank, 2012; 2015; Lueger & Suchy, 2012; Korunka & Nosé, 2012); Parada (2015); Jungell et al. (2016); Jungell and Wincent (2017); Matias and Franco (2020)

V. Empirical Studies: Large Sample, Quantitative**a) Separate Family Constitution Variable**

Arteaga and Menéndez-Requejo (2017); Arteaga and Escribá-Esteve (2021); Graves et al. (2023)

b) Family Constitution Part of a Composite Family Governance Variable

Berent-Braun and Uhlaner (2012); Parada (2015); Michiels et al. (2015); Parada (2015); Laveren and Molly (2017)

Ad I. Surveys

Gersick and Feliu (2014), Süß-Reyes (2014) and, with a focus on family constitutions, Mengers and Prigge (2017), present still current literature overviews of family governance overall with their own chapters on family constitution.

Ad II. Conceptual Contributions

Next to their empirical analysis (see in Vb)) Berent-Braun and Uhlaner (2012) also contribute to the theoretical foundations by applying concepts from the organizational social capital as well as from group dynamic and teambuilding in order to explain the correlation between family governance practices and company success.

The research institute for family firms at WU Vienna around Professor Hermann Frank is very keen to bring scientific approaches and revelations closer to practice using real-life examples (Lueger & Frank, 2012, 2015). Their theoretical basis often is system theory. Frequently, the real-life examples also look at the family constitution. Not all of the real-life examples can be analyzed here, some

examples have to suffice: [Lueger and Suchy \(2012\)](#) describe a family with a clear distribution of roles within their company. Due to this division of roles, overlapping work areas are reduced, mutual expectations are structured and therefore potential lines of conflict are minimized. In another real-life example by [Korunka and Nosé \(2012, p. 154\)](#), the role theory by [Katz und Kahn \(1966\)](#) is mentioned, which points out “that the role inhabited by a person in most social situations, especially within organisations, significantly contributes to the understanding of their individual behaviour.” This justifies that a distinct assignment of roles, as it is for example worked out in family constitutions, leads to a better understanding of the tasks and the responsibilities within the company and the family.

The conceptual article by [Botero et al. \(2015\)](#) depicts a similar line of arguments by leaning foremost on the concepts of organizational justice and equity theory in its theoretical part (more in-depth in the family firm context, see [Barnett & Kellermanns, 2006](#)). Expectations and anticipations, which every family member has toward the others and the company, are often not talked about. A family which takes its time intensively once and then routinely recurrent to develop their family constitution, has a forum allowing to publish within the family otherwise unknown expectations and thereby also potentially latently existent conflicts. The compilation of the family constitution’s content hereby represents the step taken from purely so-called psychological contracts, which usually everyone keeps to themselves, to a universal consent within the family and the company. [Botero et al. \(2015\)](#) hence theoretically substantiate the importance which is attributed by the consultancy literature to the creation process.

[Parada \(2015\)](#) has presented an extensive dissertation on governance in family firms. She presents a theoretical frame (category II in our systematic) and executes two empirical studies on this basis: a big-sample quantitative analysis (category Vb) and a qualitative study with three cases (category IV). In both cases, the sample is taken from Spanish family firms.

In her theoretical part, Parada works out possible determinants of the governance structure of family firms and owner families on the basis of different theoretical approaches ([Parada, 2015](#), pp. 75–93). She divides these determinants into three groups: legitimacy reasons, family contingent factors, and business contingent factors.

Concerning the governance structure, Parada differentiates between family governance (family meetings and family constitution) and business governance (board of directors and executive committee), so in total four elements. She divides their determinants into two big categories: Striving for legitimacy and striving for efficiency. Generally speaking, legitimacy is the result of conformity with formal regulations and social norms ([Parada, 2015](#), p. 68). In this specific case, Parada investigates two variables for legitimacy: The affiliation to organizations and other professional associations [+]¹⁷ as well as the weight of the business

¹⁷[+]/[-]/[0] shows on a 5%-level a significant positive/ a significant negative/ no significant correlation between the determinants and the existence of governance instruments in Parada’s regression analysis ([Parada, 2015](#), p. 129).

logic relative to the family logic within the company's policy of the owner-family [+]. Striving for efficiency, so to say the strive of the owner-family to govern the company as efficiently as possible and therefore among other things secure the survival and the transfer to the next generation, represents by far the bigger category of determinants. The determinants of the strive for efficiency are further systemized into the sub-categories family (concentration of shares [+]; which generation is dominating [+]; number of overlapping generations [0]; number of family members in the company's management [0]; agreement of values between the family members who work in the company and those not active in the company [+]) and the sub-category company (company size [+]; company age [0]; internationalization [+]; diversification [0]).

The empirical big-sample study (sample size: 918 companies) shows that family firms apply 1.62 of the four governance instruments on average (Parada, 2015, p. 124). There is no itemization of the four instruments, but it seems that the family constitution has the least distribution (Parada, 2015, p. 123). With regard to its order of appearance, the results indicate that the board of directors is introduced first, followed by the management's committee, the family council, and finally the family constitution (Parada, 2015, p. 123). The real-life examples back the findings that the family constitution is introduced rather at a later point (Parada, 2015, pp. 229–230). This result undermines the advice given in the survey of the consultant's literature to take caution with regard to the direction of causality. Most of the determinants are statistically significant for the number of used governance instruments in the actual regression analysis; please refer to the indications in square brackets. Separate results for individual governance instruments do not exist, thus, this also not the case for the significance of the family constitution.

In the conceptual part of their paper, Arteaga and Menéndez-Requejo (2017) develop an agency theory-based reasoning why having a family constitution might enhance family firm performance. Their reasoning addresses the classical agency problem between owner and manager (agency problem I), the agency problem between majority and minority shareholders (agency problem II) as well as intra-family agency problems (agency problem IV) (refer to Villalonga et al., 2015 for this numbering of agency problems). Moreover, Arteaga and Menéndez-Requejo derive from theory reasons why the performance effect of a family constitution might not be identical across family firms. More specifically, they posit that the origin of the CEO (family or non-family), the dispersion of (family) ownership, and the generational stage of the family business moderate the link between family constitution and company performance.

Arteaga and Escribá-Esteve (2021) aim to unveil the antecedents of the adoption of family councils and protocols. Based on social systems theory, they define four types of family firms (founder-centric, protective, consensual, and business-evolved) which differ with regard to their communication needs and analyze for which type of family and family firm family constitution and family council might be particularly appropriate tools to address these communication needs. Their empirical results support their theoretical reasoning (see below).

Ad III. Survey Data

Ulrich and Speidel (2023) have presented overview data originating from a survey of 65 big German family firms – among them 37 with a family constitution. Some of their most interesting findings shall be named here: The existence of a family constitution neither correlates with size or age of the company nor with the number of generations. 97% of the families with family constitution named as their main goal connected to the family constitution an emotional additional value, only 3% were hoping for an effect on the company's success as their most important goal. 75% of families with a family constitution have already made amendments to their constitution; the first revision usually occurred after three to four years.

Ad IV. Empirical Studies: Small Sample, Qualitative

Next, the real-life examples are being looked at. The studies of the research institute for family firms at the WU Vienna have already been discussed earlier. They belong to this category of small sample qualitative studies just as much as the part of Parada's dissertation (2015) in which she analyzes three Spanish family firms in detail. This has also already been looked at above. Jungell et al. (2016) explore in their real-life studies of 17 family firms in Europe, Asia, and the USA, how the families have handled the situation when the hitherto mutual consent is questioned through changes in the family, company, or the environment. Before these changes occurred, all of the owner families already disposed of a document about family politics, by which the authors understand, amongst others, recorded values, behavior codices, family plans, and family constitutions. Hence, the authors are enabled to look at the role of this document in a situation of conflict. In a companion working paper, Jungell and Wincent (2017) discuss the divergence (the authors call it "decoupling") between the paper version of the family constitution and practice in family and company life. Matias and Franco (2020) analyze in an exploratory case study on a Portuguese family firm how the family constitution shapes the succession process.

Ad V. Empirical Studies: Large Sample, Quantitative

Only few empirical studies with big samples about the family constitution are known to the authors. In the majority of the studies, the family constitution is not a separate variable but part of a composite variable, most of the times joint with further family governance instruments, so that no independent conclusion can be drawn about the family constitution. Only Arteaga and Menéndez-Requejo (2017), Arteaga and Escribá-Esteve (2021), and Graves et al. (2023) so far have presented a big sample study with a separate family constitution variable. This small number of studies already document the research deficit.

Ad V.a) Separate Family Constitution Variable. Arteaga and Menéndez-Requejo (2017) analyze a sample of 530 Spanish family businesses from 2003 to 2013. Half of the sample firms disposed of a family constitution. Results show that the existence of a family constitution increases future firm performance (measured with return on assets) significantly. More refined analyses with interaction variables reveal that this relation does not hold generally, but that the

performance-enhancing effect of a family constitution is significant for family firms with a non-family CEO, for family businesses with multiple family owners, and for family firms in later generations.

Based on a sample of 490 Spanish family firms, [Arteaga and Escribá-Esteve \(2021\)](#) compare four clusters of companies, who apply either a family constitution, a family council, both instruments or none of these instruments, for significant differences. They find that the existence of a family constitution seems to be dependent on family (generation, and family involvement in management and ownership) and firm characteristics (size, and management and governance characteristics). More specifically, family constitutions were significantly more prevalent in bigger, second or later generation companies in which there was a family CEO and where family ownership was highly concentrated.

[Graves et al. \(2023\)](#) have conducted a big sample analysis with 396 Australian family firms. They researched the correlation between a number of business governance and family governance instruments on the one hand and the company's success on the other. The governance instruments were not aggregated and analyzed as a composite variable but separately, so that distinct results about the family constitution (more precisely: "family constitution/code of conduct") are available. The company's success is not calculated based on the annual statements or data from capital markets; instead, the success variables are based on survey results. They are summarized into three aggregated success measures through factor analysis: family-oriented performance, financial performance, and non-financial performance. 16% of the sample companies dispose of a family constitution. The regression analysis yields a positive significant correlation between the family constitution and financial performance but no significant connection to the other two success measures. Concerning the financial performance, the results support the above-mentioned indications in consultants' studies about the family constitution's impact on company's success; in this case however profoundly better based on facts. In contrast, the positive effect on the family also indicated by consultancy brochures cannot be affirmed.

Ad V.b) Family Constitution as Part of a Composite Family Governance Variable. The big-sample analysis from Parada's dissertation ([2015](#)) which has already been discussed above also belongs to this category of studies.

[Berent-Braun and Uhlaner \(2012\)](#) use regression analysis to look at the correlation between family governance practices and company's success of 64 family firms from 18 countries. Family governance practices are a composite variable for family constitution, family behavior codex, family council, existence of formal communication mechanisms, and the presence of distinct selection and responsibility criteria. The company's success is not measured objectively but is rather based on the subjective impression of the questioned family firms. The aggregated family governance practices are significantly positively (1%-level) connected to the company's success; a separate analysis for the family governance practices does not take place.

[Michiels et al. \(2015\)](#) also present a big-sample empirical study. For 295 Belgian private family firms, they analyze if intra-familial principal-principal-conflicts between active and passive family shareholders show a correlation to the

dividend policy and if family governance practices have a moderating effect on this correlation. The 0/1-variable family governance instrument has the value 1, if there is a family constitution, a family forum or both. The moderating effect of this variable is statistically significant; the use of at least one of the family governance instruments makes the dividend policy more efficient. In this case, there is also no separate analysis for the family constitution.

Laveren and Molly (2017) present preliminary evidence for a sample of 407 Flemish family firms. Family governance instruments considered are family forum and family constitution. The family governance variable is 0 if no instrument is applied, 1 if one instrument is in place, and 2 if both instruments are used. Laveren and Molly analyze the link between family governance and succession planning. The preliminary results in the first draft of their paper indicate that the existence of family governance instruments in a family firm improves succession planning. This effect is particularly pronounced in smaller companies with less restrictive requirements with regard to business governance, pointing at a potential substitutionary effect between business and family governance instruments.

2.6. Paths of Future Research

The literature overview has shown that there is some progress in comparison to Gersick and Feliu's (2014) evaluation, yet the family constitution is far away from being an over-researched topic. Which direction could future research take?

Botero et al. (2015) name in their outlook four fields of research for the topic of family constitution:

- 1) Which entrepreneurial families (don't) use the instrument family constitution?
- 2) Creation process of a family constitution
- 3) Does the distribution of family constitutions differ geographically?
- 4) Effect of the family constitution on family harmony and company success

All of these aspects, except for the third one, are incorporated in the research program roughly presented hereafter in Fig. 2.1, which could easily be complemented by an international comparison component. So far, a holistic concept model of the family constitution is missing in order to grasp the whole range of this area. At its core, it should depict the influence of the creation process on the document as well as the influence of the creation process and the document itself on the development of the company and the family. In doing so, the possibility should be contemplated that the creation process could have its own, meaning dissociated from the document, and influence the family and the company. The question of what initiated the first creation as well as the revision of the family constitution also belongs to this model core. Potentially the initial creation process has to be analyzed separately from the following revision cycles. Forces from which a uni- or a bidirectional correlation with the model core can be expected could be grouped around this model core. The very extensive approach by Parada (2015) can be used as a starting point for this analysis.

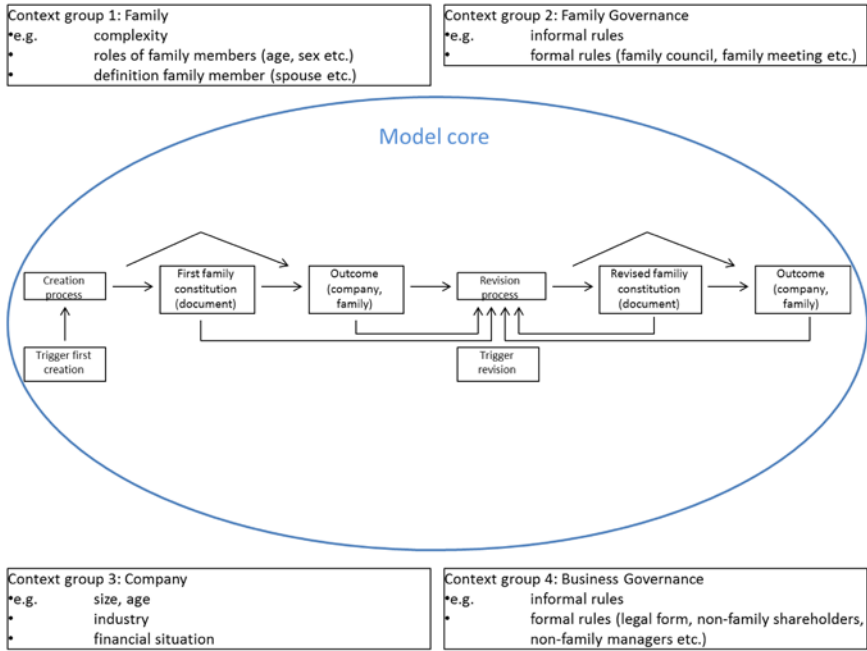


Fig. 2.1. Conceptual Model Sketch Family Constitution. *Source: Mengers and Prigge (2017, p. 95) [own translation].*

The family could be the first context group. To this group belongs, for example, the family's complexity, the different roles which can be taken by family members (parents/children, age, gender, and so forth) or even the definition of family membership (spouses, etc.). [Papesch \(2010\)](#) supports in his dissertation the observations made by the consultancy literature, that family constitutions will rather be found with more complex family structures. Scientific articles also show that regular family meetings suffice for family firms in their first stages, however, as soon as succession becomes a topic or several family branches are involved, more formal family governance structures, for example, a family constitution, can be found ([Süss-Reyes, 2014, p. 150](#)). There is backlog demand, especially for the indexing of single roles which a family member can take, as well as for the analysis of conflicts potentially resulting out of it. For a long time, intra-familial (agency) conflicts have been disregarded in family firm research, because the alleged agency advantages of family firms have been put forward and the family has rather been considered as a homogenous (meaning free of conflict) group.¹⁸

¹⁸This statement is intended to describe the tendency followed for example by Fama and Jensen (1983). It should, however, not claim that this direction has not been given any attention at all; for example refer to the agency analysis of family firms by Schulze et al. (2003).

In recent years, more research has been undertaken with regard to intra-family conflicts,¹⁹ which could certainly be used for this area of the family constitution analysis, since the family constitution after all is an instrument to reduce exactly these conflicts.

A second and third context groups could be the formal and informal instruments and characteristics of family governance and business governance, respectively. Examples of family governance being the family council or the family assembly, examples of the area of business governance being the company's legal form, its committees, and their composition, especially the significance of non-family members or the shareholders' structure (refer for example to [Nordqvist et al., 2015](#)). The family constitution is a (family) governance instrument. The concept of substitutes or complementary relations between governance instruments in general has been established (see above references), and even in terms of the family firm's context there are references to correlations between the family governance instruments.²⁰ This is the reason why future research should analyze the correlations between the family constitution and other family governance and business governance instruments and characteristics.

Company characteristics like size, age, internationality, or the financial situation could finally make up the fourth context group. In empirical corporate governance studies, it has been custom for a long time to include variables of this sort as control variables in the study. Also, for family firms, there is evidence that their governance structure is dependent on the company's characteristics (for example, [Hauser, 2002](#), p. 14).

Furthermore, the theoretical equipment within the framework of the above-drafted holistic conceptual model has to be extended. In the literature overview, some of the theories have been listed, which have so far been used to analyze family constitutions. A systematic testing of those theories typically used in the context of family firms (and beyond that) so far has not taken place, but seems promising. Finally, it should be noted that the assessment of crises analyses and conflicts in family firms (for example [Großmann, 2014](#)) could foster further components for the conceptual model.

2.7. Conclusion

From a business management perspective, the conclusion about the family constitution can be kept short: So far, management research cannot contribute a lot to the question, if, for whom and under which circumstances a family constitution

¹⁹For example, Michiels et al. (2015) [dividend policy], Songini and Gnan (2015, esp. pp. 750–752), Villalonga et al. (2015), Zellweger and Kammerlander (2015) [intra-blockholder-conflicts], Basco and Calabrò (2017) [differentiation between active and passive family members], Prigge and Thiele (2019) [consideration of intra-family conflicts in governance codices for family firms].

²⁰This article refers to the related works of Parada (2015), Songini and Gnan (2015), and Laveren and Molly (2017).

is of advantage. Theory and empiricism are still in the fledging stages. This opens many opportunities to research, but is at the same time of disadvantage to the limited consulting contributions management research can make at the moment. This disillusioning finding can be explained by the fact that the attention for research in this area has only recently been drawn to this topic. Moreover, the empirical branch additionally fights with the typical problem of empirical family firm research: bad availability of data. It is normal for listed companies, for example in the empirical corporate governance research area, that the number of new studies p.a. has been two- or three-digits for years. Such dimensions are completely unrealistic in this area. On the contrary, it can be positively mentioned that with [Arteaga and Menéndez-Requejo \(2017\)](#), [Arteaga and Escribá-Esteve \(2021\)](#), and [Graves et al. \(2023\)](#) the first big-sample empirical studies are available, which analyze the family constitution as a separate variable. The output of new research on the topic of family constitutions should speed up in the coming years, but it will stay moderate. As is known the marginal gain of knowledge is especially big in the beginnings of a research area. Therefore, the hope should be justified that despite its moderate number of studies, management research should soon be able to better support family firms and owner families as well as their consultants seeking advice.

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Chapter 3

Discussion Report Part 1: Legal and Managerial Foundations

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Holger Fleischer: Family Companies and Family Constitutions: Historical and Comparative Perspectives

Stefan Prigge/Katharina J. Mengers: Family Firms and Family Constitution – A Management Perspective

A managerial scholar and practitioner took up Fleischer's analogy of onion layers. He agreed that it fits well into the present context. In his view, family governance could be understood as a security architecture for proper management with different layers (elements) of security, e.g., shareholder agreements and the family constitution. A managerial scholar raised the question of whether all security elements were necessary or partly redundant. Fleischer replied that from a legal perspective redundancy was not that relevant. As long as no negative consequences occurred even partial redundancy would not be a problem. A larger problem in legal practice was no or weak consistency and coordination between different documents. The managerial scholar and practitioner continued that contracts regulated deficiencies, whereas family constitutions could act as a positive codification of shared goals and rules of behavior. The difficulty of family constitutions was the missing binding force.

Prigge, returning to the redundancy topic, stated that the family constitution as part of the security system could also have a positive effect on performance. Thus, it might be better to have more security elements in place, although they are partly redundant because mitigating turbulence might be a positive performance effect. A legal consultant added that the family constitution could increase performance. That was his key take away from another event he had

Family Firms and Family Constitution, 57–59



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attended. For example, board diversity which was often defined or recommended in the family constitution could lead to better performance. Prigge wanted to include the results of academic research on the performance effect of family constitutions and asked Graves about his experience in this context based on the results of his study. Graves explained that their study only considered whether there was a family constitution present, but they had no further details on the content of the constitutions. Thus, for future studies, a governance index would be better rather than a 0/1 variable for the existence of a family constitution. The document was only one governance mechanism among many others, its substance and the process of how the document was put together could be very different and should be considered as well. A managerial researcher and consultant added that a governance index or models, such as the model Prigge presented in his talk, were important for research and discussions because so far it was still difficult to define family governance and its elements. There existed a heterogeneity of terms, e.g., family constitution, protocol, plan, or charta. The same applied to other elements of family governance, such as family meetings, family academies, etc. There was a variety of terms which were not equally used and understood worldwide.

Next, the discussion focused on the role of consultants and the question of whether extant family constitutions were very much alike or rather heterogeneous. Fleischer initiated this discussion when he asked the managerial researcher and consultant whether family constitutions were diverging over time. She answered that this was, according to her impression, actually the case, but mainly due to the variety of terms and their understanding. Fleischer added that in the legal field, they observed that the documents became more and more similar due to consultants. A managerial scholar and practitioner confirmed that this development could also be observed in the field of family constitutions. He reported that there were five large consultants for family governance in Germany. Each family thought they had their own document, but in the end, he could recognize from the wording of the constitution document, who had been the moderating consultant. He was only aware of two families who had set up a constitution without any consultant.

Another managerial scholar reported from her experience that consultants were helpful to establish the first version of the constitution. But what happened afterwards? Was the family really using the constitution? She underlined that this was also an important question, as the usage of the constitution took place without consultants. A further managerial researcher added that the discussion of the consultants' role was important. He talked about his experience in Australia. He knew that consultants sometimes sold family constitutions without a real need for it on the side of the buying family. Put differently, a lot of good reasons for family constitutions existed, but these reasons could not be observed at every family with a constitution. The managerial scholar and practitioner added a reconciling view to this. From his point of view, this could be interpreted in a way that families were concerned about being responsible business owners and thus they tended to follow researchers and consultants, who suggested family constitutions as a tool for responsible ownership.

A legal consultant stated that in his opinion, a family constitution had to be a living document; otherwise, it was not good to have it because the environment and the family changed. A managerial researcher, referring to her own experience, supported the “living document” argument. Moreover, she added, that it was important to manage expectations, conflicts, and discussions, which could get emotional. Therefore, she thought that it was important to have a moderator, whether this was a consultant or a lawyer or someone else.

Fleischer then asked the plenum whether it made sense having a standardization of documents at this developmental stage. A legal consultant replied that basic ideas could be put in a “one size fits all” document, but that the rest had to be individual. The managerial researcher with a family-firm background on her own agreed. A certain general structure could be helpful at the beginning, but based on this there had to be an individualization. A managerial scholar introduced the family structure into the discussion. If a family was complex, not only in size, the need for a family constitution was high. But small firms might not be able to pay expensive consultants. Thus, a standardization with basic guidelines might be helpful for those families, as it could make the whole process less expensive. Referring to the complexity of the family structure, another managerial researcher added that communication was important in this context and that the communication was often perceived as good among older generations, while the young and subsequent generations perceived the communication as weak. Therefore, from his point of view, the power of a family constitution lay in the process, not in the results. The results were good to have, but the process was more important. One could not assess a family’s complexity before talking to the family; one measure of complexity might be the frequency of conflicts.

A managerial researcher and consultant agreed on the importance of the process. She added that the justice perspective was also relevant. Who was involved in the decision to establish a family constitution and also in the development of the constitution? This needed to be transparent and fair. A legal consultant also agreed on the importance of the process compared to the documents in the end. Concerning the adoption of standard documents, he saw two potential dangers: First, there was the danger of conflicts with other documents and contracts. Second, there was the danger of not running through the whole process, which was, as we just heard in this very discussion, really important. There was a large heterogeneity among family businesses and, thus, family constitutions had to be individual as well. The importance of the process in general also raised the question of whether documentation of the process would be necessary in the future.

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Part 2

Managerial Research I: Conceptual and Qualitative Analyses

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Chapter 4

A Receiver Approach to Governance in Family Firms: The Role of Justice Perceptions

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Abstract

Justice perceptions describe an individual's evaluation of whether decisions or actions are fair or unfair. These perceptions are important because they affect individual attitudes and behaviors in different situations. Family firms develop and implement governance policies and structures (i.e., governance systems) to diminish the problems that can arise from the overlap between the business, the family, and the ownership systems of a firm. Governance systems help family firms have a clear structure of accountability and a clear understanding of the rights and responsibilities that family and non-family members have toward the family enterprise. Research on governance to date has focused on the practices and policies that exist and their effects on the family firm. However, in the governance context, individual perceptions are important because they are likely to affect the attitudes that family and other members have toward the family enterprise and the likelihood that they will follow the different policies when they are implemented. This chapter takes a receiver perspective to explain how individuals create justice perceptions based on governance mechanisms and the effects of these perceptions. The goal is to

Family Firms and Family Constitution, 63–80



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understand how we can use this information when developing governance practices in family firms.

Keywords: Family firms; governance mechanisms; receiver perspective; justice perceptions; policy implementation; fairness perception

4.1. Introduction

Family businesses¹ are the most dominant form of business around the world (Colli, 2003). These firms have an important role in the world economy through their contributions to each country's GDP and the number of people that they employ (FBN, 2008; Mandl, 2008). One of the characteristics that make family businesses unique is the interaction between family, business, and ownership sub-systems (Tagiuri & Davis, 1992). These interactions can bring both positive and negative outcomes for family firms. On the positive side, family firms are associated with better performance, greater employee retention, more attentiveness to social responsibility, and more responsiveness to the environment (Anderson & Reeb, 2003; Berrone et al., 2010; Dyer & Whetten, 2006; Stavrou et al., 2007). On the negative side, family firms are often associated with nepotism, preferences for family members, and an increased probability of conflict, particularly between family members (Miller & Le-Breton Miller, 2003).

Continuity and viability across generations are two important challenges that family businesses face (Gersick et al., 1997). Researchers argue that one of the reasons continuity and business viability can be challenging is the conflict that emerges when family and business mix (Pieper et al., 2013). Family and business have different logics and norms that can affect the interactions between these two systems (Davis, 1983; Ward, 1997), and the expectations that individuals develop regarding what is fair and what is not (Barnett & Kellermanns, 2006; Botero et al., 2015). Families are guided by egalitarian logic in which all members should be treated equally independent of their capabilities (Davis, 1983). On the other hand, businesses are guided by meritocracy logic (Davis, 1983). Meritocracy suggests that those who show greater capabilities, effort, and work should be rewarded, and those who do less and are not as capable should be removed from the system. When these two logics contradict, they are likely to result in conflict that affects both family (i.e., family dynamics) and business performance (Eddleston & Kellermanns, 2007; Kellermanns & Eddleston, 2004; Olson et al., 2003). These conflicts can lead to situations that prevent the continuity of the family business or its viability for future generations.

There are multiple ways to prevent and manage harmful conflict in family firms. However, scholars and practitioners agree that the development and implementation of governance policies and practices can help families in clarifying

¹This chapter uses the terms family firm, family business, and family enterprise interchangeably.

the relationship between the family, the business, and the ownership system to prevent harmful conflict from occurring (Aronoff et al., 1998; Gallo & Tomaselli, 2006; Ward, 2000). This has sparked an interest in further understanding of corporate and family governance. Up to date, corporate governance is the most studied topic within the family business literature (De Massis et al., 2012; Debicki et al., 2009). The focus of this research has been on exploring the different types of policies and practices that are available, the implementation of these practices in the family business context, and the effects that governance policies and structures can have on the family and the business (Gersick & Feliu, 2014). Although there is less research on family governance, the focus in this area has been on understanding the different approaches that families use as part of their governance efforts (Binz Astrachan & Botero, 2021). One aspect that has received less interest is how policies and practices within the broader family business governance system (i.e., the combination of governance mechanisms available to the family, business, and ownership systems) are received and perceived by family and organizational members. Perceptions about the fairness of governance policies and practices are important because they can affect the behaviors of family and organizational members, and how likely they are to use and follow these practices (Botero et al., 2015).

This chapter takes a recipient approach to understanding family business governance. Using equity theory (Adams, 1963), psychological contracts (Rousseau, 1995; Rousseau & Tijoriwala, 1998), and organizational justice (Greenberg, 1990; Greenberg & Colquitt, 2005) as guiding frameworks, this chapter explains how and why perceptions of the users and recipients of governance structures and policies need to be actively considered in the development and implementation of governance practices and policies. This chapter is structured to first review the literature on corporate governance in family firms and explains how the perceptions of recipients have been included in this work. This is followed by an explanation of what a receiver approach perspective is, how individuals assess their justice perceptions of a situation, and why these processes need to be considered in the governance context. To finalize, the receiver perspective is applied in the context of family firms, and areas for future research are identified and discussed.

4.2. Family Business Governance

In the broadest sense, corporate governance describes the structures, processes, and policies organizations use to manage, direct, and control people, resources, and the interests of those involved in a firm (Aguilera & Jackson, 2010). In the context of family firms, understanding the governance is important because of the link it has to the success and sustainability of family businesses (Miller & Le Breton-Miller, 2006; Steier et al., 2015; Suess, 2014). Family involvement in a firm introduces important considerations and complexities to our understanding of corporate governance (Cadbury, 2000; Pieper, 2003). For example, the inclusion of the family in the business system requires the creation of structures, policies, and processes that enable parallel thinking to support, integrate, and balance the interests of the family, the business, and its owners (Carlock & Ward, 2001). Thus, research suggests that the corporate governance of family firms

needs to include structures, processes, and policies that describe how elements from the family, the ownership, and the business systems interact with each other (Pieper, 2003). In the *business* system, corporate governance mechanisms help outline what managers need to do to help the organization achieve its goals (Gersick & Feliu, 2014). In the *ownership* system, governance structures are designed to help maintain equity for the owners by establishing structures and procedures that will help with the legal and accounting requirements, setting risk and return parameters, and tracking all data on performance to ensure that owners maintain their equity in the firm (Gersick & Feliu, 2014). Finally, in the *family* system, the governance structures and procedures help the family organize and manage the relationships between one another, between the family and business (Berent-Braun & Uhlaner, 2012), family and ownership (Montemerlo & Ward, 2011), and family and management (Mustakallio et al., 2002). The purpose of governance structures and procedures in the family system is to explicitly articulate and clearly outline the rewards and demands that are linked to being part of the family business, to clearly identify the opportunities for family members when involved in the business, and to ease the flow of information that is trustworthy between family members (Gersick & Feliu, 2014).

Historically, the study of family business governance began with a focus on the individual governance bodies and structures available to family businesses. Initially, the emphasis was on understanding the boards of directors and their composition (Pieper, 2003). A result of this initial work was the emphasis on the need for independent board members in family business boards to better recognize opportunities and pitfalls for the business and the family. Following this, the focus shifted to the professionalization of boards, the functions of boards, and their effectiveness (Pieper, 2003). However, the focus on boards exclusively became one of the main critiques of research on governance (Pieper, 2003). Thus, scholars decided to explore other forms of governance in family firms, and the relationship between governance and performance (Pieper, 2003). Later research focused on the exploration of governance in the family system (Suess, 2014), how the presence of family governance structures affects the performance of the firm (Berent-Braun & Uhlaner, 2012), and how it can affect decision-making about the business (Mustakallio et al., 2002). More recently, researchers have begun to explore governance systems used by family firms based on industry contexts, family business characteristics, and the importance of stakeholders (Steier et al., 2015).

When combined, the research on family business governance up to date has focused on understanding three general aspects of governance: (1) What are the structures and policies that family businesses can use? (2) What are the characteristics of these structures and policies? And (3) how do these structures affect performance and the family? Answers to these questions provide an important baseline to understand what are the different governance tools available for family businesses and why these tools are important. However, this research has not provided a good understanding of how members of the family, business, and ownership system evaluate these tools, and the impact that they have on the continuity of the family firm. To us, this is problematic because it fails to acknowledge the role that users of policies and structures have in understanding the

governance of family firms. That is, if we continue to study and practice the governance of family firms as we do today, we are assuming that the success of governance structures and policies are primarily linked to the choice of practice by a family firm (i.e., the identification and implementation of structures and policies) and not by how that practice may be perceived and evaluated by the users. In this chapter, we argue that we need to consider both sides (i.e., sender/decision-maker and receiver/user) to better understand family business governance.

This project introduces what we call the receiver approach to governance. This approach focuses on understanding governance from the family member, business member, and owner's point of view. Our focus is on understanding what do we need to take into consideration when developing and implementing governance structures and policies in the context of family firms. The argument that we advance is that to further our knowledge about family firm governance, we benefit from taking a receiver perspective to understand how individuals are likely to capture and process information about governance decisions (i.e., how do individuals assess justice perceptions of a situation). The following sections define and explain the receiver approach and introduce it within the context of family business governance.

4.3. A Receiver Perspective on Governance in Family Firms

In their work on family protocols, [Botero et al. \(2015\)](#) argue that it is important to consider a receiver perspective when developing family protocols. As a governance policy, one of the primary roles of a protocol is to help formalize the expectations and norms that family members have about the relationship between the family and the business systems. These authors indicate that harmful conflicts between family members are likely to occur due to

unmet expectations regarding the distribution of resources between family members (e.g., profits and dividends), the different roles that family members can take in the firm and the requirements for those roles, or the benefits and responsibilities that come with ownership in the firm. (p. 219)

Thus, protocols help because they unify the expectations for family members. Implied in this work is the idea that the presence of a governance practice or structure by itself will not diminish the conflict that can occur in the family firm. For a governance practice or structure to help the family firm, it needs to anticipate the information that users are looking for and how they are likely to use and interpret that information to assess their justice perceptions. When individuals perceive unfairness because of a governance practice, they are likely to react against the organization and are less likely to acknowledge the policies and structures in place ([Botero et al., 2015](#)). Therefore, the recipient also plays an important role in the governance processes within family firms.

From our point of view, the receiver perspective on governance considers how individuals assess justice in the context of family firms. This understanding

then helps to develop and implement governance structures that articulate the expectations and norms that family and non-family members have regarding their responsibilities toward the family business and the rewards that they can obtain from their membership and participation. Taking a receiver approach helps identify how individuals compare themselves to others, who they compare themselves to, what type of information they look for, how individuals use this information when evaluating the fairness of a system, and why they do this in the context of family firms. We argue that understanding the characteristics of those who use governance structures and policies should play an important role in the development and implementation of governance mechanisms and their potential success. From our point of view, governance involves interactions between two parties (i.e., a sender and a receiver) who may have different goals and expectations that need to be considered. Thus, to have a comprehensive understanding of governance, scholars and practitioners benefit from understanding both perspectives. Governance research in family firms up to now has primarily focused on the sender perspective (i.e., what should family businesses do regarding governance and why), providing a one-sided view of this area. To move forward in our understanding of governance, we need to incorporate a receiver approach to have a holistic understanding of the governance process.

Three frameworks help us understand how and why the psychologies of individuals matter in governance situations: Psychological contracts, equity theory, and organizational justice. *Psychological contract* is a term used to describe an individual's belief about the obligations that they have negotiated with another party (Rousseau, 1995; Rousseau & Tijoriwala, 1998). These beliefs are based on "the perception that a promise has been made and a consideration offered in exchange for it, binding the parties to some reciprocal obligation" (p. 679; Rousseau & Tijoriwala, 1998). In general, this area of research indicates that, in organizational contexts, individuals are likely to develop an unwritten contract with the people they interact with and with the organization in general. This contract is based on expectations and determines how a person evaluates the actions of the organization and organizational representatives.

Psychological contract has been primarily used to understand employment relations (Zhao et al., 2007). This view suggests that in any employment relationship, individuals develop certain expectations about the behavior of the organization based on the psychological contract that they have. These expectations can be met or violated according to the organization or individual's behaviors or actions. In instances where expectations are met, the behavior of the organization/individual matches what the other party is waiting for as part of their exchange relationship. Violations of expectations can either be positive or negative. Positive violations describe situations in which an organization goes above and beyond the perceived psychological contract held by the stakeholder. In instances where expectations are met or positively violated, supportive behavior is likely to result. However, not all individuals view incidents from the same point of view and what some view in a positive way may be the same issue that others view in a negative way. Negative violations, on the other hand, describe situations in which the

behavior of the organization/individual contradicts, in a negative way, what they expected. These negative perceptions can act as the trigger for behaviors.

When applied to the governance context, a psychological contract represents the expectations that family members, owners, and business members develop based on the role they play in the family enterprise. Psychological contracts are unwritten. Thus, family members, organizational members, and owners will hold others accountable (i.e., family business decision-makers) based on their expectations regarding how the other party should behave, or what they believe was promised to them. The violation of these expectations will affect the future behaviors of the individual in the firm. Therefore, an important contribution of the psychological contract framework to the receiver perspective is that it highlights that within organizational contexts (i.e., family firms) individuals create unwritten expectations regarding what the organization or their representatives have “promised them.” Even though these expectations may not be aligned between the parties, they affect individual behavior.

A second framework that is useful is *equity theory*. This theory suggests that, in social situations, individuals are likely to compare their actions to those of others to determine the fairness of their outcomes (Adams, 1963). In any interaction, an individual will assess the outcomes they obtain by engaging in two comparisons. First, they will compare the outcome they obtain based on their level of inputs. This comparison will set expectations for the person regarding what others around them should be receiving for the work that they do. The second comparison involves assessing what outcomes other people around the individual obtained based on their level of input. These two assessments help the individual determine whether the outcomes given to them are equitable/fair or not and help set the expectations for future relationships. When individuals perceive inequity in their outcomes, they are likely to experience cognitive dissonance (i.e., a mental discomfort felt when there are contradictory thoughts; Festinger, 1962). Because of this dissonance, a person who perceives inequity will feel tension that is related to the magnitude of the inequity felt, and they will try to reduce this tension through a change in their behavior (Adams, 1963).

Although, in the organizational literature, equity theory has been primarily used to explain employee motivation, it can also be useful to understand the receiver perspective to governance in family firms. Equity theory emphasizes the comparative nature of individual actions. Thus, when organizations develop and implement mechanisms to manage, direct, and control their resources, individuals will compare how these mechanisms are being used to regulate their actions and those of others. To obtain buy in from an individual, organizations need to develop and implement governance structures and policies that will be perceived as fair by organizational and family members (i.e., that is being used the same way across all members based on their level of input). In this sense, equity theory provides three important pieces of information that can be used to understand the governance context: (1) individuals constantly compare their actions and outcomes with those of others; (2) individuals select who they compare themselves to, and (3) when individuals perceived inequity, they are likely to modify their behavior.

A third framework that can help us understand the recipient approach to governance is organizational justice. *Organizational justice* is an extension of equity theory and explains how individuals react after they perceive an inequity has occurred. The organizational justice literature focuses on understanding fairness in the workplace (Colquitt et al., 2001; Folger & Cropanzano, 1998; Greenberg, 1990; Greenberg & Colquitt, 2005). In the context of family firms, organizational justice has been used to explain how family members can develop fair processes in the treatment of family, business, and ownership relationships (Barnett & Kellermanns, 2006; Van der Heyden et al., 2005). In the context of governance, organizational justice has been applied to explain how agency theory can be used to understand governance in family firms (Lubatkin et al., 2007). There are three forms of justice that are relevant (Colquitt et al., 2001). *Distributive justice* refers to perceptions of fairness that are tied to the distribution of resources (Adams, 1963; Colquitt et al., 2005). *Procedural justice* reflects the fairness of the decision-making procedures that lead to outcomes (Colquitt et al., 2005; Thibaut & Walker, 1975). *Interactional justice* describes the perceptions that individuals have about the nature of the interpersonal treatment received from others (Bies & Moag, 1986; Greenberg, 1993). Interactional justice can be broken down to interpersonal and informational forms of justice (Colquitt et al., 2001; Greenberg, 1990; 1993). Interpersonal justice describes the degree to which people are treated with respect and dignity while informational justice refers to perceptions of fairness about explanations provided to people that convey information about why procedures or outcomes occurred (Colquitt et al., 2005).

Taken together, this framework suggests that individuals evaluate the distribution of outcomes, the procedures used to come up with these outcomes, and the quality of interactions with those making decisions to determine whether they have been treated fairly or not. These assessments are based on the expectations that individuals have regarding the inputs and outputs of the situation for them and for other parties. Perceptions of unfairness emerge when individuals believe that other people are receiving greater benefits from smaller inputs. Unfairness motivates individuals to try to restore their feelings of fairness by changing their inputs or fighting for more benefits. Applied to the receiver perspective, the organizational justice framework helps us understand which factors individuals evaluate to determine fairness in organizations, and how they are likely to react when they perceive unfair treatment.

The combination of these three frameworks provides relevant information to understand how receivers form impressions about justice within family firms. In the governance context, perceptions of justice are relevant given how they can affect and enhance the presence of conflict in the family and the business (Barnett & Kellermanns, 2006). Given that governance mechanisms are one of the ways to diminish and manage the negative conflict that can emerge from the interaction of the family and the business, we argue that understanding how justice perceptions are created in family firms can provide a guideline of how to design and implement governance structures and policies within the family firm. The following section presents a cognitive model to understanding the process individuals are likely to follow when assessing justice within the family firm.

4.4. Individual's Cognitive Model for Assessment of Justice in Family Firms

Taking a receiver's approach to governance implies an understanding of the cognitive processes that individuals go through to assess the fairness of situations. To assess the fairness of a situation, individuals go through several steps. This process occurs very fast in the mind of individuals, which makes it difficult to identify the precise moment where one step begins and the other ends. In this chapter, we present the process as having separate and identifiable steps. However, it should be noted that in application it might not be as clear-cut as presented here. As indicated in Fig. 4.1, we begin the discussion of justice assessment by presenting the individual's prevalent logic as the point of departure.

In family firms, there are two logics that are prevalent in the context: (1) egalitarianism from the family system and (2) meritocracy from the business systems (Davis, 1983; Pieper et al., 2013). Consistent with these ideas, we suggest that, when assessing justice perceptions in family business contexts, individuals are likely to subscribe to these two logics as the starting point for analyzing a situation. An egalitarian logic views individuals as having equal rights, status, and opportunities. It emphasizes the treatment of all individuals in the same way independent of their effort and capabilities. An example of this would be the belief that parents will not have preferential treatment when interacting or providing opportunities to their children. Thus, an egalitarian logic suggests that parents will treat all their children the same way, independent of the characteristics of each child or what the child has done to them (either positive or negative). Individuals who use an egalitarian logic in the family business will compare themselves to others and assume that they should receive the same outcome (e.g., rewards, opportunities, salary) independent of their qualifications or quality of their outputs. As mentioned earlier, equity theory suggests that individuals tend to compare themselves to others and rely on the assessment of their inputs and outputs to compare them against the inputs and outputs of relevant others. Therefore, individuals who use

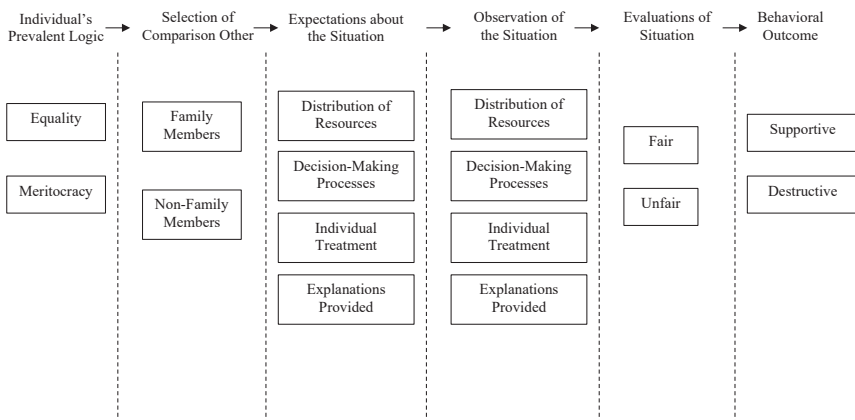


Fig. 4.1. Individual Cognitive Model for Assessing Justice in Family Firms.

egalitarianism as their prevalent logic are likely to compare themselves to others by assuming that all outputs obtained by individuals should be the same independent of the inputs that they provide to the system. In the context of family firms, family members are more likely to use this logic when comparing themselves to other family members given that this is the prevalent logic in the family.

Meritocracy logic, on the other hand, assumes that individuals are chosen and move ahead in a system based on their talent, abilities, and achievements. This logic is prevalent in the organizational context where individuals get hired, rewarded, and promoted primarily based on their abilities. When comparing themselves to others, individuals using this logic evaluate and compare the inputs and outputs of themselves and others such that the ones who obtain better outputs should be the ones with the best inputs. In the context of family firms, individuals who use this logic assume that when they provide greater inputs that can help the family business, they will obtain better rewards when compared to those who did not provide as much input and benefit to the firm. Within the context of family firms, this logic is more likely to be used by non-family members.

An individual's prevalent logic helps determine which comparison others they find more relevant to analyze a situation. The selection of a comparison other is important because it will activate individual expectations, identify what information the person will perceive as relevant for a situation, and help frame the information gathered. Individuals can select a family or a non-family member as their comparison other. The selection of either of these will activate the expectations that they will have about the situation that they are assessing. Building on the organizational justice framework presented above, there are four areas in which expectations are relevant when assessing perceptions of justice. The first set of expectations is related to the beliefs regarding what resources they should obtain based on their contributions to the system (i.e., distribution of resources). The second set of expectations focus on the decision-making followed to make choices about the distribution of resources. The third set of expectations focus on how individuals expect to be treated in a specific situation. The fourth set of expectations revolves around the explanation that is provided for why procedures or outcomes occur.

To assess whether a situation is fair or unfair, individuals compare their expectations with observed results and actions. This comparison will result in the assessment that indicates a violation of expectations or indicates the meeting or exceeding expectations. Individuals who perceive that their expectations are met or exceeded will assess the situation as fair and are likely to be supportive in their actions toward the organization. On the other hand, individuals who perceive that their expectations have been violated will go through additional processing to determine why their expectations were violated. This additional evaluation process is like the one followed by individuals who perceive there has been a violation of their psychological contract.

Research on psychological contracts suggests that contract violations range from a subtle misperception on the part of the exchange partners to stark breaches of perceived contract terms (Rousseau, 1995). In the strictest sense, a violation is a failure to comply with the terms of the contract, but given the nature of the

psychological contracts, individual interpretations for the circumstances of failure determine whether they experience a violation (Rousseau, 1995). Contract violations can be assessed on two factors: willingness and ability to hold to the terms of a contract (Rousseau, 1995). Willingness refers to perceptions of whether the other party involved in the contract is willing to live up to the terms of the negotiated contract. Ability, on the other hand, refers to whether the other party is able to hold to the terms of the negotiated contract. External factors can sometimes prevent or alter the possibility of the other to hold to the terms of the contract. Thus, interpretations of violations are in the eye of the beholder. This means that parties can interpret a violation as an inability or an unwillingness of the other party to fulfill their part (Rousseau, 1995). This interpretation is important for understanding how violations are experienced and how individuals respond to them (Bies & Moag, 1986; Bies & Tripp, 1996). Contract violations begin with the perception of a discrepancy between the expected and actual outcome, but not all discrepancies are noticed and not all that are noticed are perceived as violations (Rousseau, 1995).

Contract violations can be of three forms according to the combination of the willingness and ability dimensions: inadvertent violations, disruptions, and reneging (Rousseau, 1995). An *inadvertent* violation occurs when “both parties are able and willing to keep their bargain, but divergent interpretations lead one party to act in a manner at odds with the understanding and interests of the other party” (Rousseau, 1995, p. 112). Any contract can have some inadvertent violations, and the parties involved will often accommodate for these small violations (Rousseau, 1995). An inadvertent violation may also occur if one party was not aware of the expectation by the other party. The actor did not willingly violate any contract. But lack of awareness kept the actor from holding to the terms of the contract. Due to the inadvertent violation, the actor may then hold to the terms of the contract or engage in new negotiations addressing the contract. The second type of violation, *disruption*, occurs when “it is impossible for one of the parties to fulfill their end of the contract, despite the fact that they are willing to do so” (Rousseau, 1995, p. 112). *Reneging* or *breach of contract* is the third type of violation. In this type of violation, one party refuses to fulfill their part of the contract even though they can do so (Rousseau, 1995). This is the most extreme of the contract violations, in that it is a deliberate violation of contract terms. In the context of family firms, violations of expectations will result in perceptions of unfairness. However, the degree of unfairness of a situation can vary depending on the degree of violation. Breaches of expectations generate the strongest perceptions of unfairness and are likely to also result in behaviors that can be destructive for the organization (Jensen et al., 2010) and for the family.

4.5. Designing and Implementing Governance Mechanisms in Family Firms

One of the functions of the governance mechanisms in family firms is to align the expectations between family, business, and owners regarding the benefits and responsibilities of members in relationship to the business (Botero et al., 2015).

Identification and alignment of expectations between members and organizational representatives is important because it can affect an individual's perception of justice and their reactions toward the organizations. Building on these ideas, this chapter suggests that understanding how individuals form justice perceptions in family firms provides important information for the design and implementation of governance mechanisms within family firms.

Daspit et al. (2018) suggest that in family firms, governance includes a mix of informal and formal mechanisms that affect the strategic behaviors and performance of the firm, and this varies greatly between family firms. This means that each family firm is likely to consider different aspects when creating their governance structures. Given this, we focus on the information that needs to be explicit when articulating the governance of a family firm. Our suggestions are based on the individual cognitive model presented in the previous section. Using this framework, we argue that there are five considerations that are useful in the design of governance policies. The first consideration is *the participation of family and non-family members or representatives in the design of practices and structures that are relevant to them*. The central thesis of this chapter is that recipients/users of governance policies have opinions and beliefs about the policies, what they should include, and how to implement them. Thus, employees and family members who use governance structures and policies, need to be consulted during their creation, implementation, and/or change. This participation can provide insight into the expectations that these individuals have about what the policy should cover and how the policy will affect different stakeholders. Having a clear understanding of expectations helps policy developers be explicit in what they want, why they expect these behaviors, while participation provides buy-in from those affected by the policies and procedures.

A second consideration in the development of policies is *the need to explicitly articulate the logic that is prevalent when determining the distribution of resources for family and non-family members that work within the business*. Given that family businesses are characterized by the presence of two dominant logics – equality and meritocracy – and that these two logics can be at odds with each other, it is important to explicitly articulate what logic is going to be used. For example, when there are family members working in the family firm and there are non-family members employed, there should be a clear articulation of how salary increases, and performance rewards will be determined for both family and non-family members. Clarifying these expectations will help all organizational members understand how decisions are made and why decisions are made that way.

A third consideration in the development of governance policies in family firms is *the articulation of who comparison others are going to be for the different governance situations*. For example, when there are multiple family and non-family members employed in the business, HR policies should explain whether family members will be compared to each other or to non-family members when determining who is going to be promoted within the firm. Given that comparison others activate the expectations to determine fairness, governance policies should explicitly determine what the comparison others are and why these comparison others are chosen. By doing this, organizational members are able to better

understand why decisions are made and can help manage assessments of justice within family firms.

A fourth consideration is related to the importance of *clearly articulating policies to avoid perceptions of unfairness*. The organizational justice literature suggests that there are four types of information that are used to assess fairness inside of an organization. These include information about the distribution of resources, information about the decision-making process followed to allocate resources, information regarding the expected treatment of individuals, and information that will be provided regarding explanations given as part of the process. Taking this into account, policy makers should make sure that articulation of any governance policy is explicit regarding these four aspects of any policy developed.

A final aspect to consider in the design of policies in family firms is that *a policy should provide mechanisms to express perceptions of unfairness*. Governance policies should also be able to articulate what can individuals do when they perceive that the policy is unfair or is applied differently to different people. This is important because some of the policies in family firms could have been created a long time ago, when there were different considerations in the decision-making about the firm. Creating opportunities for those affected by a policy to voice their opinions can promote more commitment from members, and stronger perceptions of fairness (Bies & Shapiro, 1988).

In addition to these five considerations for the design, we find two additional ideas related to the implementation of governance policies and practices. First, *the implementation phase of any governance mechanism can benefit from the inclusion of a fairness assessment of the users of the policy*. Given that perceptions of unfairness can trigger conflict between parties (Cropanzano et al., 2001), and that parties may differ in the expectations that they have about what they have agreed to (Rousseau, 1995), it is important to assess the perceptions that users of a policy have at different stages of the implementation process. These evaluations can help in the revision and evaluation of the policy so it can achieve its purpose. A second aspect of the implementation process that is relevant based on the receiver approach is *the need for periodic evaluation of governance mechanisms*. As mentioned earlier, given the long-term orientation of family firms, policies that govern them may be created by early generations of the family. In this sense, as more and more generations become members of the family business, their perceptions may change or the norms may change, which can result in different expectations for different generations. Thus, governance policy implementation can benefit from incorporating an evaluative component as part of the implementation. This can help policies remain relevant for all members of the family firm.

4.6. Concluding Thoughts and Ideas for Future Research

There seems to be a disconnect between academic research and practitioner view of governance in family firms (Binz Astrachan & Botero, 2021; Gersick & Feliu, 2014). One of the reasons for this is that academic research exploring governance in family firms focuses on what practices exist and the effects that they have in family firms, while practitioners seem to be more interested in how to help family

firms develop and implement governance mechanisms. This chapter tries to close the gaps between these two approaches by proposing a receiver approach to governance. A receiver approach acknowledges the role that the user of the governance policies and structures plays in the development and implementation of such mechanisms. This chapter focused on three goals: (1) introduce and explain the receiver approach to governance, (2) explain how and why this approach can help us advance our understanding of governance in family firms; and (3) provide guidelines for the design and implementation of governance practices based on the receiver approach. The receiver approach is an important angle in the study of governance. It acknowledges that governance implies an interaction between the members of the family, business, and ownership systems and the family firm, and that most of what we know comes from the organization's point of view. Thus, the receiver perspective to governance considers how individuals assess justice in the context of family firms to develop and implement governance structures that will help formalize the expectations and norms that family and non-family members have regarding their responsibilities toward the family business and the rewards that they can obtain from their membership and participation. As we have discussed, like in any interaction, individuals are likely to develop expectations about a firm based on the interactions that they have with its members, and other experiences. These expectations represent their basis for determining justice within a context. Justice perceptions are important because they affect individual behavior toward the organization (Colquitt et al., 2001; Cropanzano et al., 2001; Jensen et al., 2010).

This chapter uses principles from literature about psychological contracts, equity theory, and organizational justice to develop a cognitive model of how individuals make decisions about justice in family firms. Building on the works of Davis (1983) and Pieper et al. (2013), we argue that in family firms, individuals rely on equality and meritocracy as the two primary logics that guide the interpretation of the environment, and the relevant others that individuals decide to compare to. We suggest that these interaction logics prime individuals to consider and activate specific expectations from the environment and significant organizational members. These expectations are then compared to what they observe in day-to-day interactions to assess fairness in a system. When actions and situations are perceived as fair, individuals are likely to engage in positive behaviors toward the family and firm. However, when individuals perceive actions as unfair, they are likely to engage in destructive or retaliatory behaviors toward the family and the firm. We suggest that to advance our understanding of governance in family firms, we need to incorporate ideas about justice in our development and implementation of practices and policies. By doing this, we can better understand what needs to be included in the development of governance policies and practices and how these practices and policies can be implemented.

Given that governance mechanisms help formalize the expectations and norms regarding the family business, information about how individuals evaluate justice in a firm is relevant because it highlights what needs to be included when developing policies. Based on the model presented, we suggest that considerations that are prevalent when designing policies should include: (1) participation of family and

non-family members affected by the policy; (2) identification of logic to use in decision-making about policies; (3) identification of comparison others; (4) explicit articulation of how resources will be distributed, why they are distributed that way, and how will interactions be managed as part of governance; and (5) what to do when a person perceived that a policy is unfair. Additionally, we argue that in the implementation phase, there needs to be ongoing monitoring of the perceptions of justice by the users of the policy. Monitoring should include periodic evaluation of the perceptions and policies. Thus, practitioners can use this information when helping family firms develop and maintain governance mechanisms.

There are several approaches to explore the ideas advanced in this chapter. First, very little research is done on how family and non-family members perceive governance mechanisms. This chapter provides an initial framework to explore the perceptions that family and non-family members have and how they develop these perceptions. This knowledge can help us better understand whether individuals have different logics when assessing situations in family firms and how these logics affect their assessment process. Additionally, it also helps us understand whether individuals in family firms make justice assessments in a similar way as individuals in non-family firms, or whether there is unique information that gets considered in this assessment. Data to explore these ideas could be obtained in different ways. For example, data could be collected using survey approaches within specific family firms or by comparing family firms. We could also rely on experiential situations and case studies to better understand specific situations.

A second area of research could explore how family firms decide what to include in their governance policies and practices. It would be useful to understand how family firms design and implement governance policies, and the degree of consideration that they have regarding the recipients of these policies. Understanding how family businesses make decisions and how they include family and non-family members would provide more details to see how the receiver plays a role in the process. It also can help us understand heterogeneity in family firms by showing how different governance structures may work with different family enterprises. This information could be collected by surveying consultants, family businesses, or by using cases to understand what family businesses do.

A third area that would be interesting to explore is how cultural expectations of different regions affect the relevance that is given to the receiver in the development and implementation of governance in family businesses across the world. It may be that in some cultural context, the participation of all of those involved is more important. Right now, we know very little about the differences in governance practices and policies of family firms around the world and why these differences may exist. Thus, international exploration of governance and reasons for the use of diverse policies and practices would be interesting. Data for this topic could be collected in the form of case studies or general surveys.

A final area of interest for future research would be the effect of taking a receiver approach to governance in family firms on the behaviors and support of family and non-family members regarding the implementation and use of governance structures and practices. As mentioned earlier, we know very little about the perceptions of the users of governance practices and structures in family firms.

Thus, it would be interesting to better understand the effect that an individual can have in the development and implementation of different governance practices. Data for this could also be collected via interviews, using surveys, or conducting cases with different family firms.

This chapter integrates research from psychology, organizational behavior, and family business to provide a theoretical foundation for a receiver approach to governance in family business. We hope this work is useful for both academics and practitioners and can generate further interest in governance through a different lens.

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Chapter 5

Family Governance in Practice: Lessons Learned from a 100-Year-Old Entrepreneurial Family Firm*

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Abstract

Family governance is a topic of substantial practical relevance that merits much more attention in family business research (Gersick & Feliu, 2014; Suess, 2014). The purpose of this book chapter is to use the framework of a fair process to gain a better understanding of how family governance practices can help an entrepreneurial family firm flourish. Central to the analysis is the case of a 100-year-old entrepreneurial family firm that will serve as a best practice. Interviews with key members of the family and the business were held, and secondary data were gathered and analyzed. The chapter starts with a theoretical outline of the family as strategic resource and the family governance as a mechanism to manage this strategic resource.

*The case in this chapter has been developed in 2017. Five years later the NNZ is celebrating its 100 year anniversary. This is also an important milestone for the family Boot as a business family. A valuable family governance practice is one of the pillars of this achievement.

Family Firms and Family Constitution, 81–100



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The principles of fair process are introduced as an underlying framework for the well-functioning of family governance practices. This is followed by the introduction of the case and the discussion of the key findings. This chapter ends with some concluding remarks.

Keywords: Family governance; family constitution; framework of fair process; family as strategic resource; single-case study; Netherlands

5.1. Family Governance: Some Theoretical Perspectives

5.1.1. *The Family as a Strategic Resource*

The notion of [Tagiuri and Davis \(1996\)](#) that family firms have unique resources which can create positive and negative outcomes for the firm has been referred to as the “familiness” of the firm ([Sirmon & Hitt, 2003](#)). [Habbershon and Williams \(1999\)](#) describe familiness as the unique bundle of resources created by the interaction of family and business that can stimulate competitive advantage. The Resource-Based Theory (RBT) can be used as a theoretical foundation for understanding the distinctive attributes of a family firm.

The Resource-Based View (RBV) is one of the most influential theoretical frameworks in the field of strategic management ([Barney et al., 2001](#); [Newbert, 2007](#)). [Wernerfelt \(1984\)](#) introduced the notion that firms can be analyzed by focusing on the resources of the firm rather than on its products. A resource is defined by Wernerfelt as “anything which could be thought of as a strength or weakness of a firm.” The key objective of the RBT is to establish a causal relationship between resources and a long-term competitive advantage. [Barney \(1991\)](#) argued that resources should have four characteristics to establish a competitive advantage. They should be: valuable; rare; difficult to imitate; and non-substitutable. These resources are labeled “strategic resources.” Examples include reputation, patents, and unique knowledge ([Barney, 1991](#); [Crook et al., 2008](#)). Barney based the RBT on two assumptions: resources are both heterogeneously distributed among firms and imperfectly mobile. These assumptions allow for differences in firm resource endowments to exist and persist over time.

The RBT has proven its value as an appropriate theoretical framework in the field of family business research ([Chrisman et al., 2003](#)). With this framework, the competitive advantage of a firm can be discussed by referring to the underlying resources, specific strategies, and skills instead of regarding the family effect as one specific advantage that is held by all family firms. [Habbershon and Williams \(1999\)](#) stipulate that this focus on underlying resources, specific strategies, and skills is the appropriate level of analysis to assess family firm advantage. Various

scholars discuss the possible sources of competitive advantage (Carney, 2005; Eddleston et al., 2008; Habbershon & Williams, 1999; Miller, Le Breton-Miller & Miller, 2006; Miller et al., 2008; Sirmon & Hitt, 2003).

Sirmon and Hitt (2003) discuss five possible family firm-specific resources with the following positive outcomes: human capital, social capital, patient financial capital, survivability capital, and the governance structure. In this chapter, we are specifically interested in the last category: the governance structure. However, it is also important to understand that the total effect of family on the business is a combination of the various categories and that these resources interact and have the potential to create synergy. For example, social capital works as a leverage for attracting human capital (Arregle et al., 2007; De Massis et al., 2018). The opposite is also true; for instance, a lack of trust between the family members will have a negative impact on the willingness to provide the business patient financial capital.

5.1.2. Bivalent Characteristics

There is a commonly accepted understanding that familiness is not always a positive characteristic. Sharma (2008) coins the terminology “distinctive familiness” and “constrictive familiness.” “Distinctive familiness” refers to the situation when family commitment and involvement are a source of benefit for the family business. “Constrictive familiness” refers to situations in which, overall, the family attributes have become a negative factor for the business. To explain this, Tagiuri and Davis (1996) emphasize that family firms have several unique attributes and that each of these attributes can be a potential source of benefits as well as a source of disadvantages. Because of their latent positive and negative potential, the characteristics are labeled as bivalent attributes. These bivalent attributes are the immediate consequences of the overlap of family, business, and ownership characteristics. Tagiuri and Davis identify seven bivalent attributes: simultaneous roles; lifelong common history; emotional involvement and ambivalence; private language; mutual awareness and privacy; a shared identity; the meaning of the family company. In relation to the attribute of private language, Jaffe (1990) describes this as family members often having a special shorthand language; they share information quickly and therefore get things done efficiently. However, this doesn’t imply that families know how to communicate about sensitive issues. Flören (2004) mentions the notion that within families, taboo subjects exist ever so often, also in connection to the business. Topics that are rather left unspoken to avoid conflicts to surface can disrupt the family harmony. However, issues that are not confronted can develop into a conflict that eventually can make it impossible to do business together.

Another “classic” example is the role of the founder. He or she has played a crucial role in building a successful firm but if the business founder neglects to train or create sufficient favorable conditions for a new generation to come into play, the whole business may age together with its founder (Jaffe, 1990). This negative effect can be even worse when the successor is reluctant to let go and when the business culture is not innovative (“this is the way we do things around here”). In general, the RBT emphasizes that the availability of appropriate resources is a

necessary but insufficient condition to achieve long-term competitive advantage. The key is the management of resources in such a way that it leads to capabilities that make it possible to achieve a competitive advantage (Sirmon & Hitt, 2003). So, what does this mean within the family firm context?

5.1.3. Management of Strategic Resources

Tagiuri and Davis (1996) suggest that the success of the business will depend on how effective the bivalent characteristics are managed. The success of effective management of these attributes would result in a positive outcome for the business dimension as well as the family and ownership dimension. The idea that long-term prosperity of the family business system requires positive outcomes in both the business dimension and the family dimension is widely acknowledged (e.g., Litz, 2008; Sharma, 2004; Ward, 1997). Sharma argues that recognition of the intertwinement of family and business leads to the definition of high-performing family firms as organizations that take into account financial and non-financial goals to achieve the expectations of various stakeholders of the family, business, and owner group. The expression “warm hearts and deep pockets” stands for those family business systems that have achieved high levels of emotional and financial capital. Sharma proposes that for short-term family firms can overcome low levels in one of the two dimensions. But for long-term sustainability family firm systems need to achieve positive scores in both dimensions.

Another element that is important for the realization of longevity is entrepreneurship. To achieve continued growth and continuity, business families must pass on the entrepreneurial mindsets and capabilities that enable them to create new streams of wealth across many generations – not just pass on a business from one generation to the next. This practice is referred to as transgenerational entrepreneurship. The family’s entrepreneurial orientation (Nordqvist & Zellweger, 2010) denotes the extent to which the overall managerial practices can be viewed as entrepreneurial and reflects the risk-taking, innovativeness, proactiveness, competitive aggressiveness, and level of autonomy within a family firm (see Lumpkin & Dess, 1996; Zellweger et al., 2012). Such entrepreneurial management practices have been shown to improve firm performance (Rauch et al., 2009), especially in rapidly changing and hostile environments (Covin & Slevin, 1989).

The viewpoints discussed in this section articulate the fact that family business scholars widely acknowledge the idea that family firms have distinctive characteristics that stem from the interaction of the three subsystems: family, business, and ownership. These characteristics are bivalent: reflecting their latent positive and negative potential. Furthermore, when these characteristics have a positive effect (distinctive familiness) they can be regarded as a strategic resource leading to competitive advantage. Also, the notion that there is a need to manage these resources in such a way that it results in a positive balance, both for the family system and business system and will lead to transgenerational potential, is accepted by family business scholars.

5.1.4. Family Governance

Family governance is defined as “the voluntary mechanisms established by the business family with the primary aim of governing and strengthening relations between the business and the family, as well as between the members of the business family itself” (Suess, 2014, p. 139). Family governance fits with the concept of relational governance as opposite of contractual governance mechanisms like formal contracts and monitoring systems (Jensen & Meckling, 1976). Relational governance refers to informal social controls, based on mutual trust, a shared vision, and commitment to the firm by owners and management, and embedded in social relationships among owners and management (Mustakallio et al., 2002; Uhlaner et al., 2007). For family-owned companies, Mustakallio et al. (2002) talks about family institutions – including informal get-togethers, formal family meetings, family councils, and family plans – all with the purpose to represent and integrate the needs and interests of the owner-family members and to link the family with the company. A more in-depth understanding is necessary, especially to understand what family governance instruments are applicable for which type of family business (Suess, 2014).

An interesting aspect of relational governance is the balancing act between sustaining trust between individuals and incorporating a certain level of “check and balances” to make sure that everyone involved understands and follows the rules of the game. Where Sirmon and Hitt (2003) argue that the mutually shared objectives, trust, and family bonds make it possible to reduce more formal governance costs it is also acknowledged that this is not something that holds for all family firms. During the life cycle of the family firm, especially when a firm changes from a founder-led firm to a sibling partnership or cousin consortium, the relationships between family members change which could imply that a more formal governance system becomes necessary (Steier, 2001; Sundaramurthy, 2008). Steier (2001) talks about the evolving role of trust where the crux is to change the processes and systems in such a way that it fits with the new stage of the family business with the ultimate goal to sustain the level of trust (Sundaramurthy, 2008). It’s a continuous process, like a circle: in a later phase in the life cycle of the business, the owning family may need some forms of formal governance mechanisms to return to the same level of trust that was between the founders at the time of the establishment of the firm. However, Sundaramurthy (2008) acknowledges that too much focus on formal governance instruments can also be destructive for the level of trust.

Another purpose of installing checks and balances via family governance is the creation of an “insurance policy” against the deviant behavior of family members. It can be seen as a security mechanism to prevent negative behavior and/or conflicts. An example of such deviant behavior is known as the “Fredo effect,” after the middle Corleone son from Puzo’s *The Godfather* novel and films. Conditions unique to the family firm may lead some family members to develop a heightened sense of entitlement and weaker bonds to the firm. This could result in a family member’s incompetence, opportunistic behaviors, and/or ethically dubious actions that can impede the business’s success potentially resulting in a scandal that could lead to the firms’ demise (Kidwell et al., 2012).

In this book, the topic is the family constitution. However, it is important to acknowledge that this code of conduct should not be seen as a standalone governance instrument, but that the constitution is embedded in the broader family governance package and that it relates to the business governance installed. A family constitution is a normative agreement including fundamental principles and guidelines according to which the family organizes its relationship with the business (Berent-Braun & Uhlaner, 2012). Family constitutions are also known as family agreement, family charter, family code of conduct, family statement, or family protocol (Suess, 2014). While the adoption of family constitutions has received an increasing amount of attention in recent years, it is not a modern phenomenon per se: Montemerlo and Ward (2011) name some examples of families' agreements that dates back centuries ago. However, now there seems some momentum: empirical findings suggest that a formal family agreement is nowadays quite common in large family businesses, for example, 50% of the attendees of a family business training program at IMD Business School have a family agreement in place (Montemerlo & Ward, 2011). In small- and medium-sized families, it is much less well known.

Every family is different, and so agreements can only be custom-made. The content of the family agreement also depends on the phase in which the family business finds itself, the size of the family, the number of active and passive shareholders, the culture of the family and the business, the degree of harmony within the family, and so forth. The process of forging a family agreement is just as or even more important than the content of the document itself, the process builds family problem-solving and decision-making skills (Botero et al., 2015; Montemerlo & Ward, 2011). Individual family members need to see the value of working with a family constitution and this appreciation can be developed throughout the process of writing a family constitution and via the discussion of the content during family meetings.

Family Constitution Practices in Dutch Family SMEs

In 2012, a survey was held amongst Dutch family business owners to gain more insights on the practice of family constitutions. An online questionnaire was sent to contacts of a center for family businesses and a family business consulting group. 252 questionnaires were returned (13% response rate), which led to 222 useful respondents. From this group of family businesses, 14% have a family constitution in place and 15% are considering developing an agreement in the near future. There were some significant differences between family businesses with a family constitution or with the intention to develop a family constitution and businesses with no constitution to work with. Businesses in the first group were more often multi-generational, larger in size, there was co-leadership and co-ownership, and the businesses have relatively high growth perspectives. There was no

significant difference in the business focus on economic goals but there was a higher focus on family-centered non-economic goals (Chrisman et al., 2012). The respondents mentioned as most important motives for forging an agreement: keeping family harmony; making agreements on how to work together as a family; organizing the upcoming succession process; arranging an effective governance structure and solving conflicts within the family. Respondents were also asked to reflect on how satisfied they are with the agreement. Overall, they are satisfied and the reason that ranked the highest was that it helps to clarify the relationship between the family and the business. The results show a positive correlation between the satisfaction and the number of times the family agreement is used and there is the relation between motives and satisfaction.

5.2. Fair Process Between Family Members and in the Business

Family governance can be viewed as a mechanism to ensure justice (Botero et al., 2015). Interestingly, the application of justice in a family business is typically more complex than in a nonfamily firm. Van der Heyden et al. (2005) explain in their seminal article how a fair process can help to achieve justice in family businesses. Van der Heyden et al. (2005) focus on procedural justice instead of distributive justice. Distributive justice in the family business is “messy and complicated” (Lansberg, 1989). The root cause of this lies in the application of the three principles of distributive justice, namely *need*, *equity* and *equality* (Ayres, 1996) in the family business system. Each of the three family business subsystems has a different principle as a main guidance: need-based inside families, meritocracies among managers, and equality among shareholders (Van der Heyden et al., 2005). The consequence is that family, managers, and shareholders will judge the fairness of particular outcomes with very different criteria and inherently, it is near impossible that the different stakeholders will come to an agreement on a *fully fair distributional outcome*, therefore the focus on procedural justice. This focus can also be explained by the power of the concept. Procedural justice originated from legal settings (Thibaut & Walker, 1975) and from there it has been applied to various social settings and cultures (Lind & Tyler, 1988) where its relevance widely has been proved. Especially the work done by Kim and Mauborgne (1991, 1997) who used the concept in their study of the strategic decision-making in transnational corporations inspired Van der Heyden and colleagues for building the dual characterization of fair process for family businesses.

The dual characterization highlights the different steps in the decision-making and implementation process and five conditions under which this process should take place. The five steps in the process are: (1) Engaging & Framing, (2) Exploring & Eliminating, (3) Deciding & Explaining, (4) Implementing & Executing, (5) Evaluating & Learning. The steps are a combination of generic steps of a decision-making process (Russo & Schoemaker, 2002), combined with

key observations from the fair process literature (engaging, explanation, and expectations) (Kim & Mauborgne, 1997) and the addition by the authors of the “execution” step. Van der Heyden et al. (2005) added execution to extend the framework from decision-making to the actual implementation and execution. Especially in the context of fairness is it important that “people ought to do what they say, and also ought to say what they do.” Engaging is coupled to framing, together form the first step in the process. The authors argue that it is key that the people whom it concerned all feel involved in an active way right from the beginning. This is needed to frame the decision properly and commit people to the resolution of the issue and/or the implementation of the outcome. When the decision is taken it is important that the decision is explained properly, this is also an opportunity to validate the decision. In addition, at this stage, the expectations need to be set with regard to an effective execution and implementation. Next to the steps in the process, Van der Heyden and colleagues formulate five conditions in which the steps should be executed to achieve fairness: (1) communication and voice; (2) clarity of information, process, and expectations; (3) consistency across people, over time, and with agreed values and norms; (4) changeability of decisions, process, goals, and principles, and (5) commitment to fairness. “Consistency” and “changeability” are characteristics that at a first glance seem to be conflicting but that are actually not the case. Changeability acknowledges the family’s need to alter previous agreements to make sure that agreements reflect current family values and interests, as well as changing business needs. The possibility to review past decisions reflects the requirement of correctability (Leventhal, 1980) but this doesn’t intervene with the need of consistency in the application of agreements once they are installed. As a final characteristic, the authors highlight the need for the family’s deep commitment to fairness and to realize that fairness is not a “mechanical” instrument. If it’s treated as a utilitarian exercise, then the risk is that the benefits of a fair process rapidly are replaced with cynicism and resentment (Van der Heyden et al., 2005). The most preferable situation is when the commitment to fairness is embedded in the core values of the family. One remark of Van der Heyden and colleagues which we want to echo here is the realization that fair process is not an *absolute* but a *relative* concept. In practice, its full essence can only be aimed at and never fully attained. Therefore, it is important to view the fair process as a continuous learning process and appreciate the incremental value of every small step that is accomplished.

Above, we described the process of fairness in the family business from the viewpoint of the family. The owning family is a key stakeholder in the family business but not the only one. Samara and Arenas (2017) draw attention toward practicing fairness in the workplace of the family business, namely the employees, another important stakeholder group. Human resource management in a family business has an extra layer of complication because of the different sets of knowledge, skills, capabilities, and sources of motivations between family and non-family employees (e.g., Dawson, 2012). For example, non-family employees come from a larger pool of talent and therefore may have more outside experience and better training than family employees although this latter group may bring to the workplace deep tacit knowledge and a high motivation stemming from a strong alignment with

the business goals. This complexity makes distributive justice hard to accomplish and that's why also here the focus on procedural justice is a valuable instrument to increase job satisfaction of all employees and will help to preserve the business reputation, not in the least as a good place to work (Samara & Arenas, 2017). So, the framework suggested by Van der Heyden et al. (2005) for building a fair process in the family business is not only helpful for family governance decision-making and implementation but is also valuable from the viewpoint toward the fair treatment of non-family employees. Moreover, these are not fully separate processes, some of the decisions will have an impact on the fair process climate created within the family but also toward the non-family employees.

In the next section, we will use Van der Heyden's characterization as a framework for the analysis of the case.

5.3. Family Governance in Practice: Introducing NNZ

5.3.1. Data Collection

The case study of NNZ, a family business located in the northern part of the Netherlands, owned and run by the family Boot since 1922, aims to qualitatively explore the factors that contribute to the trans-generational potential of a family firm and the role of family governance to achieve this. In order to collect rich, high-quality primary and secondary data, the following methodological approach was developed and executed. First, a literature review of the core theoretical concepts was conducted. Then, in order to gather the necessary in-depth primary data, interviews were undertaken with key actors who held strategically relevant positions (Table 5.1). In addition to the CEO, three people in strategic positions, all non-family, were interviewed. Also, the CEO's niece, a member of the 4th generation, who works in the family business as a sales manager, and the CEO's brother, who is a co-owner but doesn't have an active role in the business, were interviewed. The interviews lasted around 90 minutes each. The main goal of the interviews was to collect sufficient data about the family and the company to allow for the development of the case. The interview questions were predominantly process-oriented, and interviewees were asked to provide examples to clarify abstract answers. The transcripts of the interviews were independently analyzed by the authors.

The Company

NNZ is a multinational company located in Groningen, owned and run by the Boot family since 1922. The business is creating packaging solutions for their clients in the agro food and industrial market (www.nnz.com). In 1922, NNZ started trading jute bags from "Pakhuis Libau" in Groningen, the start of a family business with international ambitions. Today, NNZ has grown into an organization with more than 200 employees, serving clients from offices in Austria, BeNeLux, Canada, Denmark, Germany, Italy, Poland, Latvia, Lithuania, Estonia, South Africa, UK, and USA. In close cooperation with partners in 40 other countries, NNZ provides packaging solutions to a worldwide customer base.

Table 5.1. Interviewees.

	Position in the Business	Family
1	CEO	Family 3rd gen
2	Chief Commercial officer	Non-family
3	Chair person supervisory board	Non-family
4	Chair person STAK board	Non-family
5	Sales manager	Family 4th gen
6	Not involved in the business	Family 3rd gen

5.3.2. The Family Boot

1st generation: Rien Boot started NNZ in 1922. The Boot family originally came from the Gouda-region, the Western part of the Netherlands. Rien had experience with Jute and used a grant from the government to start a trading company in Jute-packaging based in Groningen: the Noord Nederlandse Zakkenhandel (NNZ). Rien married Anna Pieffers and they had four children: Leendert, Femmigje, Marinus, and Wim (Fig. 5.1).

2nd generation: Leendert worked for NNZ. Femmigje stayed at home to help her parents in the household. Marinus tragically died in the Second World War: he was a member of the Dutch resistance and was put to work in a prisoner camp in Germany. Wim didn't start working in NNZ, but went to work in Malaysia to work for another company. There, he met his wife Will who was born and raised in the former Dutch colony "Nederlands-Indië." Rien finally asked Wim to come back and work for NNZ. Femmigje always stayed single and Leendert and his wife didn't have children. Wim and Will had four children: Anja (1956), Marco (1957), Len (1959), and Fred (1965).

3rd generation: Len and Marco work for NNZ: Len is the current CEO and Marco is the president of NNZ Inc, the USA branch of the company. Anja has a career in the healthcare sector and Fred started his own business: he is a producer and one of his productions, the musical Soldier of Orange, is a huge success in the Netherlands.

4th generation: all four siblings have two children, so there are eight cousins that form the 4th generation. The oldest, Rachel, was born in 1978, the youngest, Jip, in 2003. Roos (1980) is the first member of the fourth generation who works for NNZ. She started as an account manager for the industrial market for the BeNeLux in January 2016. Since August 2017, she is the Manager of Sales for the BeNeLux in the industrial market.

5.3.3. The Ownership Structure

Today, NNZ is owned by the four members of the 3rd generation: Anja, Marco, Len, and Fred. Their shares are certified via StAK Libau. StAK is an abbreviation

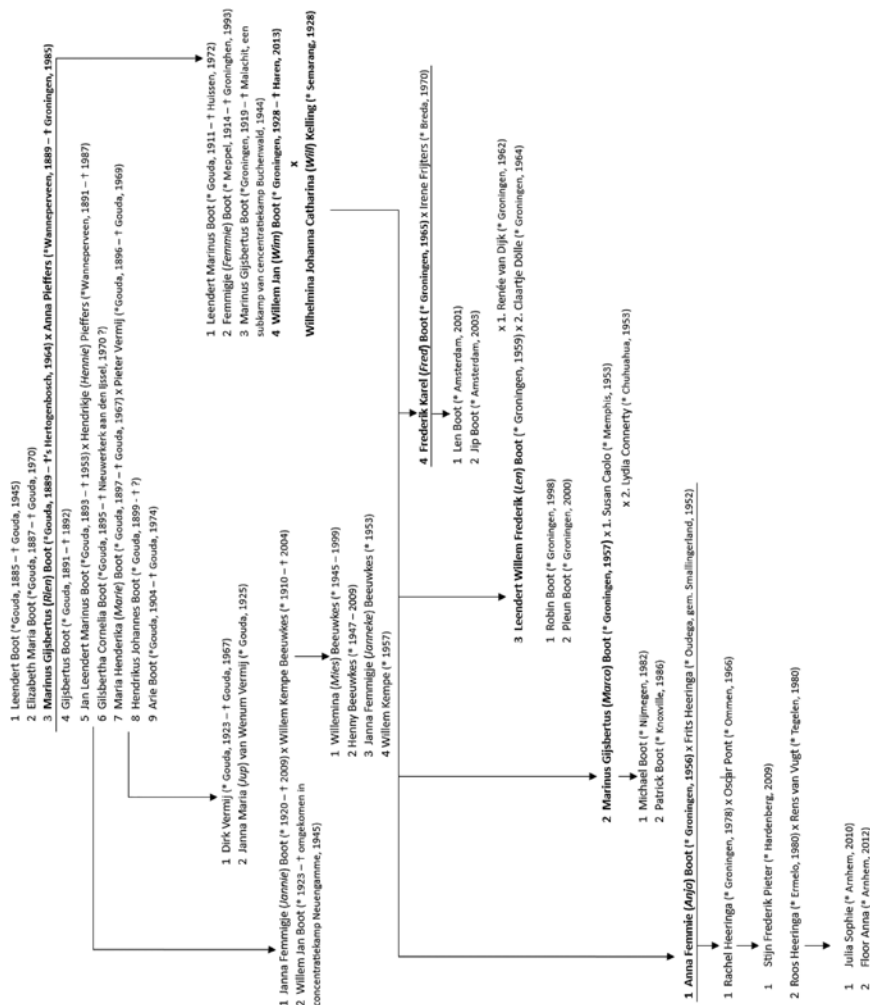


Fig. 5.1. The Family Tree of the Boot Family.

of Stichting administratiekantoor¹ and is an independent foundation that has been set up to acquire shares in NNZ B.V. and, in exchange, to issue depositary receipts. With this, the voting rights have been separated from the economic rights of the ownership. The governance structure of NNZ consists of the board of directors, a supervisory board, and the StAK board. The board of directors is responsible for corporate policy, makes long-term strategy plans and executes them. The supervisory board monitors the board of directors and has to approve certain decisions. In practice, it acts primarily as a sparring partner for the board of directors.

Finally, the StAK executes the legal ownership. This is the place where important decisions such as the long-term strategy as well as important investments suggested by the board of directors and supported by the supervisory board are needed to be approved. The owners have the right to appoint the members of the supervisory board and the board of directors.

NNZ – Ownership and Control – An Overview

The foundation, StAK Libau

In the Netherlands, it is common to work with a two-tier governance system: a board of directors and a supervisory board. This is also the case with the NNZ. The legal ownership of the NNZ B.V. is held by StAK Libau. The general objective of this foundation is the administration and holding of the shares of NNZ, and exercising the voting right and other rights associated with those shares. The foundation has issued certificates to Anja, Marco, Len, and Fred Boot. Both offspring who work in the business and offspring who do not work in the business have acquired shares. It is the family's wish to continue with this principle for the next generation as well. The family constitution describes that certificates can only be transferred to current shareholders, the business and offspring of the current shareholders.

In the constitution, it is explained that concerning the dividend the aim is to invest the major part of the net profit back into the business. In addition, a dividend policy is established and approved in the shareholders meeting.

The StAK Libau board consists of three "types" of board members (A, B, and C). They currently consist of the following: A (one representative of the board of directors), B (one representative of the family), & C (three

¹For Dutch family firms, it is quite common to use the legal construct of stichting administratiekantoor. The possibility it offers to split the economic rights and the voting rights is appreciated by family shareholders. Especially in complex ownership situation, it makes it easier to organize that family shareholders speak in one voice with the business.

independent advisors). A and B both have three votes and each individual type C StAK board member has one vote. Currently, Len has a dual position, he is the CEO and is also StAK board member B. The family members rotate every three years. The independent advisors are appointed for three years and can be re-appointed for a second term.

Rights of certificate holders

Under the articles of association, the certificate holders have only been granted the statutory rights, i.e.: to attend the shareholders' meeting and address the meeting, to see the official financial statements, to challenge any unreasonable treatment, and the right of investigation.

The statutory right to vote lies with StAK, board member B represents the certificate holders in the board. Moreover, the StAK board needs to consult all certificate holders about important decisions before a shareholders' meeting takes place.

Ultimately, the board of StAK can decide on the full or partial conversion of certificates back into shares. This decision has to be taken by unanimous vote in a plenary board meeting, with no board positions vacant.

The Supervisory Board

The certificate holders appoint the supervisory board. In general terms, it is the task of this board to supervise the board of directors with the ultimate goal to assure the continuity of the business. The supervisory board is expected to have a monitoring role in terms of managerial, strategic, and financial matters, and to give unsolicited advice to the board of directors, in particular in financial matters. In terms of management, the board is expected to join the deliberation process and view the business from a different perspective. Finally, it has a role as conflict mediator, also in the unlooked-for event of conflicts between the board of directors and shareholders. All three members of the supervisory board are not members of the family.

Input by family members

All family members are warmly invited to present ideas and plans about the development of the family business to the board of directors and/or the board of StAK, on the basis of the idea that both family and business will benefit from such active input.

5.3.4. The Family Constitution

In 1993, the pre-days of Wim Boot's retirement, Wim started to develop a family constitution, with the help of advisors from an accounting firm. In several sessions facilitated by these advisors Wim and his four children, who would become

the new owners of NNZ, discussed family and business values and all kinds of topics relating to how the family wants to own and manage the company. These discussions were the input for a document that became the blueprint for the cooperation between NNZ and the Boot family. The core motto is: NNZ is a business with a family. The wellbeing of the company and its people come first.

The document, labeled the family constitution, has several chapters. Starting with an introduction to express the purpose of the document: the family, in line with their core motto, wants to be clear on how to act in situations where different interests come together: family interests, the company's interests, and individual interests. After this statement, several paragraphs describe various aspects relevant for a strong cooperation between the family and the business. Paragraphs describe in detail: the family goals and family values; the policy regarding family members working for NNZ; leadership and succession; ownership, control, and the transfer of ownership; the role of the supervisory board; communication practices. The last paragraph describes that every year the constitution will be discussed in the annual family meeting and describes the policy of how individual family members can make suggestions for changes in the document. During the years, some adjustments of the document have been made. For example, in the first draft of the document, a family member was obliged to have working experience in the packaging industry. Nowadays, this is changed to the broader term of "relevant working experience."

The career planning of Roos is a good example of how the constitution plays an active role in prescribing how to act in specific situations. When in 2011 Roos had already some years of working experience, she had a talk with her uncle Len (as CEO) to express her interest in joining the family business. Together they thought of the next career step Roos had to take in order to get the necessary experience. She already had sales-experience, but lacked the experience of working in a large company. She applied for a sales job at Friesland Campina and in a summer vacation she did a short internship at the R&D department of NNZ in order to become more acquainted with the NNZ. Three years later NNZ needed a new salesperson and Roos applied for the job. Being equally good as others, her family membership got her the job. In 2017, she was promoted to a management position. She had to formally apply for this position as well.

When the case was written, the family could reflect on more than two decades of experience with the constitution. It is also the time that some of the younger cousins are turning 18 and are welcomed to the shareholders' meeting and the family meeting.

5.4. Findings

The findings in the interviews are organized with help of the conditions of a fair process as identified by [Van der Heyden et al. \(2005\)](#).

5.4.1. Clarification: Clarity of Information, Process and Expectations

Wim Boot had the vision that it was important to discuss guidelines up front and in addition write them down. When in 1993 he wanted to write a family constitution this was a very uncommon practice, it probably has been one of the first examples

in the Netherlands. Now with more than 20 years of experience all stakeholders agree that the governance structure functions well, and that the constitution plays a significant and active role in this. It is not a document that lays untouched in some drawer but the document is shared with employees, discussed during family meetings and shareholder meetings and when needed checked and used. In its years of application, the document has been adjusted on some specific points.

There is a willingness to professionalize the governance structure, and working with the document has helped to fine-tune the overall governance practice. With the positive outcome that at NNZ there is not a significant difference between the formal and informal organization processes. The chairpersons of the StAK board and supervisory board have both experience with comparable roles in other family businesses. They emphasize that the governance structure of NNZ can be seen as a best practice. A key element in this success is that all actors in the governance arena respect each other's role. This not only counts for the formal decision-making processes but also has a lot to do with informing the different parties. For instance, there is informal contact between the chair of the StAK and the chair of the supervisory board.

5.4.2. Communication and Voice

The core motto of the owning family is that NNZ is a business with a family. This motto influences many aspects of the business. All family members, also the ones who don't work in the company, are well known by the employees. The commercial director expressed that the family supports the business

we have very good contact with them, they really give the impression that they believe in the company, they support us and at the same time they give the freedom to take decisions which we think are necessary. Moreover, they support everything NNZ does as a team.

The family is very open in communicating the governance structure. The family constitution is for example translated in English and in every NNZ office around the world a copy can be found. Non-family coworkers are welcome to read the document to gain a better understanding of what exactly is meant with "a business with a family."

The family has decided that turning 18 is the time for the first invitation to attend the shareholders meeting. The idea is that attending the annual shareholders' meeting and family meeting will help to increase the awareness of what it means to become a shareholder and, in this way, serves as a learning process for their potential future role. The family meeting is followed by a family weekend, here all spouses and younger children join in, and this get-together helps to maintain strong relationships between the siblings and to strengthen the connection between the cousins of the 4th generation and the extended family members. Also, for the young members of the 5th generation, it is a great opportunity to feel welcome and to get to know their extended family.

5.4.3. Consistency Across People, Over Time and with Agreed Values and Norms

A good example of consistency between family members has to do with the hiring policy: when in 2018 in addition to Roos another member of the fourth generation expressed his interest of a career in the family business, Len treated his cousin exactly the same as he did with his niece. Len had an interview and during the interview the policy as stated in the family constitution was explained and discussed. Len expressed that in principle his nephew is welcome but that in addition to his current level of education and experience he needs a couple of more years of experience in a corporate environment.

The family members are all very aware of the importance of “walking the talk.” With the company growing and professionalization being an important focus, the aim is that all coworkers, especially those who work at the head office in Groningen, have to have higher education. This also counts for family members. Moreover, only when a family member is equally good as others, the family membership can finally help to get the job. As a family member working at NNZ there are high expectations and probably even an extra critical eye. This all has to do with the belief that it is crucial to get the best possible people for the business. When Wim wanted to retire, everyone one including Len, agreed that Len didn’t have the experience yet to become the new CEO. Therefore, for a couple of years an outsider stepped in to lead the company and also to act as coach for Len to prepare him for the position. This was a clear signal that the business comes first.

Incidentally, the family doesn’t follow the rules of the constitution. An example is an investment in another company done by the oldest brother. In the family constitution, there is a paragraph that explains that this is forbidden. The reason behind the rule is that investments in other companies could lead to a lack of focus on the family business. The family members discussed this and decided together that this was not the case here so that there is no need to strictly follow the rules of the constitution.

5.4.4. Changeability of Decisions, Process, Goals, and Principles

As the fourth generation finished school and started their careers, subjects like “working for NNZ” were opened. In the first drafts of the constitution, a family member was obliged to have working experience in the packaging industry. Nowadays, this is changed into relevant working experience. In addition to these explicit changes there are also changes that have to do with more general changes in society. For example, Roos explained that for her mother it was not expected that she would have a career in the family business, now this has changed, gender is not an issue anymore. The ownership structure will in the next decade change from a sibling partnership into a cousin consortium. Although this is not a current topic on the agenda, everyone is aware of it and understands that it could mean that additional discussions need to take place in the near future. For instance, with eight potential candidates for leadership positions in the firm, is there a need to discuss the importance of making sure that there is a balance between family

and non-family members in the board? Another topic mentioned is the increased possibility that one of the shareholders will want to sell his or her shares. How can we make arrangements so that the business and the family is ready if something like this would happen?

5.4.5. *Commitment to Fairness*

Throughout the interviews, it became clear that the values of the Boot family have an impact on the business culture and that the governance practice is built on these values as well. So, there is a good match between the family, the business and the governance structure. The family members working in the business feel a strong moral responsibility. The family values (leading by example, openness, taking care of each other, and honesty) are translated to internal firm values. The strong social relationships between the family members are reflected in the business culture, NNZ wants to be a wonderful place to work, coworkers of NNZ are more important than customers: when people are happy at their work, they will help customers better. To give one example for this practice, every workstation has an empty chair, this is to stimulate that colleagues sit down with each other to discuss things together instead of sending emails. The great sense of morality and belief in openness and honesty is also seen by the non-family board members. They feel at home in this family business and are stimulated to improve the current practices. Overall, this has led to a strong commitment to a fair process.

The interview with Fred revealed how the family values and governance practices influence not only NNZ but also Fred's own company. Fred explained how his leadership style of "management by democracy" was influenced by what he learned from his father, the importance of harmony: decision-making takes longer which sometimes is tough, but once the decision is made there is commitment because of the decision is made by consensus. The governance practices of NNZ have been helpful in his role as owner-manager working with external shareholders. The familiarity with the shareholder meetings and the role and tasks of the board of supervisors have helped a lot to gain confidence to fulfill the formal roles that came with the private equity investment.

5.5. Discussion and Conclusions

The case of NNZ is an example of how an entrepreneurial business can flourish with help from a family and vice versa how the business is helpful in maintaining strong relationships in the family, not only between siblings but also between cousins living in different parts of the world. The family governance practices are an important building block for maintaining this strong and synergetic relationship between the family and the business. The family governance practices in this case are an example of how an understanding of and deep commitment to the principles of fair process can be transformed into a solid practice. A practice that is beneficial for the individual family members but also helps in securing that the business has the owners and management it deserves.

The analysis of this successful case reflected the conditions discussed by [Van der Heyden et al. \(2005\)](#). In this example, all conditions were met with a key role for the family values as a strong foundation for the implementation of the concept of fair process. Furthermore, the case makes it clear that the various conditions interact with each other and are not always easy to separate. It is maybe better to see them as different aspects of a multi-layered concept.

In addition to the importance of fair process within the family this case revealed the value of the governance practices for the other stakeholders to perform well in their role. The interviews showed how important the formal governance practices and the commitment to fair process is helpful for the functioning of the non-family board members, the supervisory board, and the non-family members of the StAK board.

More than 20 years of practice with the family constitution and the additional governance practices have evolved into an institute of fair process for this family and the business. It is an important ingredient for creating and realizing transgenerational entrepreneurship potential. The family ownership and family leadership are a strategic resource for this business. Moreover, the governance practices are an example of appropriable resource, it has become a framework for the governance of other entrepreneurial practices of individual family members as well.

This chapter is based on a single case; therefore, it would be helpful to analyze more cases, especially also non-successful cases. To gain a more in-depth understanding of the mechanisms underneath the processes it would be welcome to investigate incidents where the family governance system has to play an active role to maintain a synergetic relationship between the family and the business. Another line of research that is promising is the impact family governance has on the functioning of different stakeholder groups. For instance, more knowledge about the relationship between sound family governance practice and attracting and keeping highly qualified non-family employees is something academics and practitioners would welcome both ([Gersick & Feliu, 2014](#)).

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Chapter 6

Managing Dispersed Ownership Within the Owning Family: The Role of Family Governance

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Abstract

When ownership starts getting dispersed among several individuals, families, branches, and generations, a need for organizing communications and decision-making usually arises to ensure functional relationships within the family. The need for a shared vision and mutually agreed ways of handling the shared ownership emerges, and a process for developing a family governance structure is often initiated. Family governance, hence, appears to be a central topic in family business research, but we still lack a more profound and specific understanding of how the owner family uses different family governance mechanisms to manage specific situations with possible conflicting goals, interests, and opinions, or just to develop the shared ownership further for or together with the next generation. The aim of this chapter is to give an overview and highlight different processes developed by the family within owner families with dispersed ownership to identify and align governance goals. This overview intends to broaden the understanding of what the role of family governance, as a family internal mechanism, can be in owner families with dispersed ownership among several family members.

Keywords: Managing dispersed ownership; family governance; owner family; family constitution; alignment; communication; cohesion; multi-case study

Family Firms and Family Constitution, 101–116



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6.1. Introduction

Family business research aims at improving the functioning of family firms, and one way to do it is by gaining a deeper understanding of the forces that underlie these firms. Understanding the reciprocal relationships between the family and business systems is fundamental (Sharma, 2004). Gallo and Kenyon-Rouvinez (2005) introduce the two different interacting subsystems: the business and the family governance systems. The latter and its different character of governance have been relatively little studied compared to the traditional business system. Family business research has actively explored family governance as a managerial tool used by the family for governing the business (Bauweraerts et al., 2019; Cucculelli et al., 2016; Damiani et al., 2018; De Massis et al., 2016). However, the structures and organizational forms of family governance (Berent-Braun & Uhlaner, 2012; Gedajlovic et al., 2004) and the underpinning power of emotions and intertwined relationships within the owner family, have gained much less attention within family business research. More focus is thus needed on the family and on how the opinions and varying expectations are consolidated into a piece of information that is communicated to the management (Sharma, 2004). In this book chapter, the focus lies on family governance defined as the internal agreements and mechanisms through which the owner family manages its shared ownership.

When the ownership of a family business starts getting dispersed among several individuals, families, branches, and generations, a need for organizing communication and decision-making usually arises to ensure functional relationships and effectiveness (Gersick et al., 1997; Goel et al., 2013). Mustakallio et al. (2002) emphasize that family governance structures are needed in the family to promote cohesion and shared vision and to reduce harmful conflict. Family governance is identified and defined as a system to secure and organize cohesion within the family (Gallo & Kenyon-Rouvinez, 2005; Gersick et al., 1997). The governance structures in the family firm have been studied by, e.g., Mustakallio et al. (2002), Botero et al. (2013), and Suess (2014). Suess (2014) emphasizes the role of family governance by the fact that if the family is able to successfully govern itself to ensure effectiveness and mitigate dysfunctional interference, it has important consequences for the business. Still, knowledge about the concept of family governance is quite scarce and scattered; the empirical insights are few and there are as many versions of family governance systems as there are owner families (Gersick & Feliu, 2014). The role of family governance changes and evolves during generation shifts and changes in the composition and size of the owner family. In an earlier stage, when ownership is still shared between siblings, an unofficial agreement or decisions might be enough to guide the shared ownership, but when ownership gets dispersed, typically in the next stage, a cousin consortium, a need for understanding and incorporating the expectations, needs, wishes, and opinions of several people with possibly very different life situations, backgrounds, and visions emerges (Parada et al., 2020; Randerson & Radu-Lefebvre, 2021).

The aim of this chapter is to give an overview and highlight different processes developed by the family for the family in owner families with dispersed ownership

and an identified need to align the goals of the family. Family governance parallel with family firm governance, appears to be a central topic in family business research, but we still lack a more profound and specific understanding of how the owner family uses different family governance mechanisms to manage specific situations with possible conflicting goals, interests, and opinions, or just for developing the shared ownership further for or together with the next generation. According to [Payne \(2020\)](#), more focus on the inner workings of the owner families will be emerging as the field of family business grows and develops. This overview intends to broaden understanding of what the role of family governance, as a family internal mechanism, can be in owner families with dispersed ownership among several family members.

6.2. Family Governance

Family governance has been studied from different perspectives, of which, e.g., [Suess \(2014\)](#) mainly focuses on the structures, tools, and processes applied to develop a functioning framework. The mappings by [Suess \(2014\)](#) and [Koeberle-Schmid et al. \(2012\)](#) explore the factors that are associated with family governance and emphasize the voluntary character of family governance and the fact that family governance is not legally obligatory. A family governance structure is usually an outcome of, e.g., a family meeting, often facilitated by a consultant, family business expert, etc., guiding a process to find the way of the family to work and own together, to manage the shared ownership. The heterogeneity of family businesses and the owning families naturally proposes a need for as many tailor-made systems as there are families ([Gersick & Feliu, 2014](#)). Features defining the family context, e.g., the stage of generations and the ownership structure, tend to shape the way power is distributed among the owners and how decisions are made within the family simultaneously defining what the needs of the family are ([van Aaken et al., 2017](#)).

When families grow through succession, governance is considered increasingly important as the family complexity also increases ([Lambrecht & Lievens, 2008](#)). When the owner family is at the controlling founder's stage, the need for a specific family governance system is not as explicit. In such a situation, decision-making is clearly in the hands of the majority owner, and at this stage family governance and corporate governance systems are more overlapping. But when ownership is passed on to a sibling stage, quite equally divided from the first generation with no pruning of the family tree, the need for a shared vision and common policies starts to arise ([Mustakallio et al., 2002](#)). The need for a shared vision and mutually agreed code of conduct might then appear at the latest in the next generation, if the next generation shift transforms ownership to a cousin consortium, including fairly equally divided ownership among cousins. According to [Umans et al. \(2020\)](#), the use of family governance practices stimulates the succession planning process. [Gersick and Feliu \(2014\)](#) present the governance tasks in the family circle to be the following: to clarify the demands and rewards of family membership in relation to the business, to define and communicate the opportunities for involvement in the family collaborative ventures, to facilitate information flow,

to establish and oversee non-business aspects of the enterprise, and to enhance a sense of belonging throughout the family.

In this chapter, I attempt to provide an overarching view from the owners' perspective of the different roles family governance can play in an owner family and to add to understanding of the nature of family governance and its diversity. Focus is on exploring the internal, non-legally, but rather morally binding procedures and agreements concerning the conduct of the owner family in relation to the joint ownership, developed by the family for the family. The function of the family governance system is to allow people to discuss in a structured way issues concerning the shared ownership and to form, (hopefully a unified) view of the family, that can be communicated to the company board, the company management and also when needed, to other stakeholders. The chapter is organized as follows. First, the central themes will be presented as parts of the family governance structure, then identified from the interviews and elaborated through theoretical connections and personal discussions within family business networks and forums. Finally, conclusions and implications will be discussed for further development of research on the concept of family governance.

6.2.1. Central Themes on the Role of Family Governance

Through discussions and interviews with knowledgeable family business owners and based on my own experiences as a fourth-generation member of a sixth-generation owner family, the emerging themes describing the role of family governance, were identified. The interviewees all have experience from positions of trust within the family governance structure in their owner families, their firms are in at least their third generation, with dispersed ownership among several branches, families, and individuals in a way that creates a need for the family to function together in relation to their ownership. My own background and roles within a global network for family businesses and family business consulting build on international networking, facilitating of family governance processes and constant learning through interaction with owner families all around the world during the last 25 years. These encounters provided me with data from multiple sources as well as proprietary information from retrospective and real-time accounts by members of owner families of family businesses. Gradually, recurrent topics and patterns started to emerge from the discussions among family business owners (Corley & Gioia, 2004; Gioia et al., 2012). The exchange of experiences and best practices from the families showed that many different forms of family governance are developed and consumed by owner families of family businesses. Building on this background, my aim is to present a realistic picture of how a family governance framework can be seen from different perspectives, according to the special needs of the particular owner family. Although many of the families might have a similar ownership structure, family culture, or values, the individual families still interpret a definition of family governance in their own way.

The prominent themes describing the role of family governance vary from loose systems and agreements to more rigorous sets of rules. The more issues that

are included and the more specific guidelines concerning decision-making, the more complicated the structure becomes. This chapter is an attempt to identify and capture the central themes characterizing the different roles family governance can have in owner families, namely *alignment*, *communication*, *cohesion*, *a code of conduct* and *a set of rules*. When the focus is on how the family builds, develops, and implements a suitable, tailor-made family governance system, these five themes emerged as the most prominent when identifying the role of family governance. According to the respondents and through my experience, the need for *alignment* of the owner family's conduct and goals is considered crucial in order to secure the best possible environment for the management of the company to perform its best. In order to reach alignment, *communication* is key. People have different values, needs, and expectations, and experience things from their specific perspectives, thus working together toward a common goal calls for aligned behavior, built on communication, transparency, and trust. This kind of transparency and trust exist in a best-case scenario in an environment where people naturally internalize reciprocal behavior; and desire to find ways of adjusting possible different opinions and perspectives in order to build and sustain *cohesion* within the family. Cohesion is something that often spurs from a shared value ground, suggesting a shared view on values and norms, or *a code of conduct*. Such a code of conduct can be based on, e.g., the values of the founder, the values and norms of the family or higher values in terms of ethical or religious views. In many cases, the code of conduct or family policy is refined to a *set of rules*, or a family constitution or protocol, regarding certain specific aspects as, e.g., employment policy of family members or nomination of family members to positions of trust.

6.2.1.1. Alignment

As a family grows into a multigenerational cousin consortium and beyond that, it has already become a complex structure with several family branches, diverse interests and stakeholders, and challenges to sustain collaboration and effectiveness. A need to regulate and integrate the interests and concerns of many people typically emerges at this stage (Jaffe & Lane, 2004). The growing complexity over time increases the heterogeneity within the owner family, emphasizing the existence of diverse interests, goals, and preferences among owners. The central assumption on family ownership being that the family acts as a united group of owners is challenged through the identification of the demand for family governance regulations to align these varying interests (Zellweger & Kammerlander, 2015). Alignment of the goals and behavior of the family are thus central objectives for having a family governance structure. In order to have the family add value to the business, it should have a clear and consequent behavior toward the management and other stakeholders. Unclear communication and goals confuse all parties, and in a worst-case scenario cause unnecessary misunderstandings and ambiguity, trouble for the management, and might even harm the brand and the reputation of the family. A clear infrastructure to manage the interrelationships of people is of great importance as the foundation of trust and alignment that may have held for several generations faces challenges of a changing environment

as well in society as within the family. New generations may have different expectations on the future and look at ownership from a different perspective (Jaffe & Lane, 2004).

Agency theory (Jensen & Meckling, 1976) describes the relationships between a principal and an agent who are engaged in cooperative behavior, but have differing goals. Theorists initially suggested that the unification of ownership and control would induce low agency costs for family firms. Jensen and Meckling (1976, p. 310) suggest that this kind of “agency costs also arise in a situation involving cooperative effort by two or more people even though there is no clear-cut principal-agent relationship.” The organizational assumptions for agency theory propose a partial goal conflict among members of an organization (Eisenhardt, 1989). The situation might be similar among the members of the owner family. Even if ownership is divided in such a way that no one owner has decision-making power over the others, there might still be differing goals and tendency to ward opportunism. As one family member described the situation before having developed a family governance structure: “The absence of a structure creates uncertainty and a tense atmosphere. You don’t really know the agenda of the others....”

Agency theory has been seen as one of the leading paradigms for studying issues of family governance (Carney, 2005). Much of the studies on agency-based governance in family firms share a common assumption, namely that the controlling family acts as a unitary actor. However, family members may be aligned in their overall desire to secure and increase the economic value of their stakes, but might still have very different interests concerning, e.g., risk levels, dividends, and non-economic goals (Zellweger & Kammerlander, 2015). The principal-agent conflict, owing to divergent interests between owners, is a typical constellation where family members acting opportunistically and according to their own interests and agenda. Such an agency cost might derive from family members contacting the management for special information or perks, thereby signaling to the management that the family does not have a unified view on managing their shared ownership and thus offers the management a chance to act according to their own interests. Based on agency theory, Arteaga and Menéndez-Requejo (2017) presented, that one of the reasons for a positive relationship between future performance of the firm and a family constitution, might derive from the fact, that constitutions were found to improve alignment among the owners of the firm.

The owner family involves a cooperative effort by several people, including a high probability for different opinions to still exist, despite the aspiration for alignment and therefore the role of family governance might be to exist as a guidance and reminder of the importance of alignment. A chairman of a newly founded family council felt they had been on a mission of the family to find an aligned view, when developing the family constitution. It entailed lots of work and finally ended with a sense of frustration and disbelief, as some people, wanting to keep control and cling to their power positions opposed to all kinds of changes. The situation was described as follows: “We just finalized a family constitution after working for six years, and it seems like people do not respect it, even though they participated in the development process” Eventually, by emphasizing the

value of the family culture and legacy through continued activities bringing family members together, the family constitution was step by step accepted by people as the guideline for the family alignment. Another member of a family holding company board explained the following:

I have basically given up on trying to reach a specific goal or a feeling of complete alignment. There is always somebody taking care of their own ones, fixing jobs, positions and privileges, based on a personal agenda. That is frustrating, but, that is just the way it is, and I am finally learning to live with it. Even if people deviate from the rules, it is important to go on and to keep the dialogue and process alive. The work that has been done is not meaningless. How could you actually ever make people commit to the rules? In large family with more than 100 shareholders, the game is played from different power positions...That is why the existence of a family governance framework is so important.

A chairman for the family council explained their situation:

Being in our fourth generation the need for alignment suddenly struck us. The process has now been going on for two years, seems like two steps forward and one step back....in trying to agree on a code of conduct. We still try to focus on alignment, then see what kind of possible document or set of rules works for us. The family council drafted a family constitution, we worked on it together everybody was content and then...one family member just decided to ignore the policy concerning employment and took power in his own hands, applied for a job and got himself a position in the company, completely disregarding the newly agreed upon guidelines for how family members could work in the company. This creates frustration, mistrust and loss of faith, but at the same time strengthens the need for finding a way of aligning the family at least concerning a basic set of values and a code of conduct.

6.2.1.2. Communication

The role of family governance can also be developing and sustaining functioning and transparent communication within the owner family. Communication between individuals, families, branches, generations and between the family and the company takes different shapes. Communication might be dissemination of facts concerning, e.g., company performance, generation shift processes or ownership structure, etc., and other issues where the personal interpretation of the communicator and the receiver is not relevant. On the other hand, within a family, where more personal matters are dealt with, and might be influenced by cultural factors, family norms, opinions, expectations, personal agendas, etc. of both the communicator and the receiver, thus making interpretation a central aspect, and emphasizing the importance of transparency when conveying messages.

A perspective for understanding the power of a communicating text is presented through the concept of framing, that illuminates the way in which influence over human consciousness is exerted by the communication of information from one location to that consciousness (Entman, 1993).

Framing is understood as the process of selecting some aspects of a perceived reality and making them more salient in a communicating text, in such a way as to promote a particular problem definition, causal interpretation, moral evaluation and/or treatment recommendation for the item described. (Entman, 1993, p. 52)

According to Entman (1993), when deciding what to say, communicators make conscious or unconscious judgments that can be seen as guided by frames that organize their belief system. However, the frames that guide the receivers thinking, might reflect the frames in the text and the framing intention of the communicator differently. The concept of family governance in this overview focuses on what happens within the owner family when trying to find and keep a balance between opinions and expectations of different individuals in heterogeneous multigenerational owner families. Since people interpret messages in different ways and according to Entman (1993) are guided by frames that organize their belief system, shared beliefs or norms play a central role. Brundin et al. (2007) suggest that strategic dialogue among family business members is an important practice to grow and change across generations. According to Brundin et al. (2007), the communication behaviors, values, and norms within the family will impact the firm.

Frames are said to highlight the parts of the item that is communicated, and so making them more salient, i.e., more noticeable, meaningful, or memorable to the receivers (Entman, 1993). In a social grouping as the owner family, the culture is defined as a set of common frames exhibited in the discourse and thinking of most people, usually measured in terms of common cultural values. Many of the owners had experienced situations caused by unclarity in communication that needed solving or guidance. Such guidance could often be found in the family governance system, functioning as a framework for managing different opinions. One family council chairman exemplified how messages can be framed when he explained how a representative of the older generation was unwilling to leave his position on the family holding board, although he had exceeded the age limit that had been agreed upon within the family. His argument was that he still needs to sit one three-year period because his experience is crucially needed in the ongoing strategic work and that it was important and best for the family. The family governance structure offered a possibility to handle the situation constructively through discussions on issues, instead of going to personalities, which in the long run can cause much more problems and suppressed discontent.

Another example of communication guiding the need for a family governance structure could be discovered in the fourth-generation owner family where the family council chairman explained the focus on communication being the most

important thing. The culture of the family is that everything shall be discussed, and people need to feel comfortable with decisions. This way of including everybody can be identified in many larger families, especially when developing new features if the governance system and the need for buying in is big. It emphasizes the importance of communication but at the same time also the role of a family governance system, since, if the family culture happens to be very discussant and consensus seeking, it might sometimes be challenging to get decisions made. And that in turn creates frustration in the long run.

6.2.1.3. Cohesion

One of the most concrete roles of a family governance structure is probably the task of developing and sustaining cohesion within the family. Voluntary family governance practices enhance the cohesiveness and collective goal orientation and facilitate the relationships between the family and the business (Berent-Braun & Uhlaner, 2012). As cohesion is one of the cornerstones of building a shared vision, nurturing and sustaining it is a central task especially in such a heterogeneous group as an owner family. The family forms a social network with many individuals consisting of different kinds of personalities with expectations, needs, resources, future plans, assumptions, etc., thus it is not self-evident that such a group will agree on a shared view, or be apt to follow a common policy, even if the policy would have been developed together. In such a situation a possible outcome is, that the people sharing the feeling of discontent toward a decision, identify each other and try collectively try to find a solution for addressing the issue they perceive as unjust. Collective action is seen as spurring from a sort of collective discontent and a generalized belief, as can be the case within an owner family, if part of the family members do not feel content with a decision made. Social movement theory describes the concept of collective action as follows: “before collective action is possible within a collective, a generalized belief is necessary concerning at least the causes of the discontent and, under certain conditions, the modes of redress” (McCarthy & Zald, 1977, p. 1214).

When a group sharing the same belief and need for action then is mobilized, resources are assembled for the specific purpose of pursuing the group’s interest through collective action. Policies regarding the employment of family members, or the nomination of family members to positions of trust, typically have been sources for causing differing opinions and also individual interpretations. In order to underline that some policy is experienced as unjust, family members might gather collective strength to oppose through mobilizing resources. Resource mobilization theory focuses on how actors develop strategies with their environment in order to pursue their own interests (Canel, 1991). The theory suggests that groups mobilize and manage resources in order to pursue their goals. Resources can be seen as material or non-material, such as legitimacy, loyalty, authority, moral commitment and solidarity, etc. (Canel, 1991). In an owner family it might be a question of gathering a critical number of votes, in case voting is in the culture of the family, or seeing to that, e.g., the opinion of the mobilized group is communicated well enough to several people in positions of power, in order to make a case.

Another perspective on cohesion, by [Long and Mathews \(2011\)](#), suggests that the social cohesion, including a certain norm of reciprocity, leads to specific attributes identified for family firms, such as intentions for transgenerational sustainability, the pursuit of non-economic goals, and strong interpersonal ties. According to [Hechter \(1987\)](#), social group cohesion is a function of the extensiveness of the reciprocal obligations required of members and the extent to which the group can ensure compliance with those obligations. [Long and Mathews \(2011\)](#) conclude that in order to ensure and sustain social cohesion and morality within a group, capacity to control member behavior and to ensure compliance with the norm of reciprocity as well as other norms of the group is needed. Furthermore, according to [Aronoff \(2004\)](#) family members, even if they typically hope to benefit financially from their ownership, are often still primarily motivated by their sense of belonging in a group that possesses the special opportunity to sustain and extend a legacy of values.

The chairman of an owners' council of a seventh-generation owner family described how the family is organized through their family governance structure, focusing on balance and cohesion among the family members. This builds on lots of activities, talking, networking, finding a shared view through cohesion in order to get aligned. The family has a family council for social activities, e.g., next generation programs, owners' council for owner issues and a channel of communication with the board of directors and a written handbook with family policies. All these are considered important tools and features with the main target to keep up the system and to promote cohesion of the owner family. The chairman also emphasized that it is important to see the whole governance structure as a system where the different parts are dependent of each other and support the development of the family governance structure. None of the tools or features function separately by themselves, but need concrete activities and pushing of issues toward common goals that are communicated within the family. The same pattern could be identified in another family in eight generations where the chairman of the family council presented their main task being to organize the big family and to prepare the family for the next generation shift. This calls for respect for family traditions, but as much respect for each other and individual opinions within the family in order to build cohesion. He also explained that even if aiming at cohesion through cooperation is the goal, also use of power exists in a subtle way, sometimes so subtle that you cannot really acknowledge it or criticize it, because it is not visible. The common pattern of balancing in a diplomatic way was visible in both families as well as using the family governance system as a framework to manage things within.

As the examples from the interviews show, alignment and cohesion are closely related to each other in a sense that the goal is to enhance the development and sustaining of a shared direction for the owner family. Yet, there is a difference in the way this is done. Alignment refers to the family having a concrete structure and infrastructure for managing the interrelationships of family members, something that can also be communicated to the management and external stakeholders. Cohesion, in turn, refers to the desire to develop and sustain a diplomatic atmosphere and sense of reciprocity within the family and spurs from the fact

that family members are often motivated by their sense of belonging in a group that possesses the special opportunity to sustain and extend a legacy of values.

6.2.1.4. A Code of Conduct

The role of family governance can mainly be defining a code of conduct or policy for behavior for the family members to guide within the family, but also toward the company and toward external society and stakeholders. It might be a collection of the values of the owner or, e.g., religious values that the family has always followed. These kinds of policies can appear more as recommendations and norms, and may be written as handbook for the joint shared ownership or simply exist, guiding in different situations with differing opinions and difficulties in making joint decisions. Families that are guided by higher values or specific ethical codes seem to have higher resilience and understanding when building a shared vision and implementing it. The values might serve as a sounding board for making the right decisions and also as a roadmap or street sign for showing the right direction. Koironen (2002) identified family values as explicit or implicit conceptions of the desirable in family life and emphasized that the shared beliefs underlie the attitudinal and behavioral processes of family members. The F-PEC scale by Astrachan et al. (2002) presents the cultural dimension in the F-PEC scale including value-related items such as the extent to which the family members share similar values.

In these families, single events of differing opinions may be treated as “business as usual” and managed through the set values the family has decided to stand behind. In two of the interviewed families, the interviewees told that the behavior (conduct) of the family is built on the religious values the family shares. The challenge appears when unpleasant behavior has to be dealt with and the values or norms do not offer any kind of solution. Any kind of “punishment” or sanction seems to be unthinkable, and the only way is to try convincing the actor of the importance of following the family’s code of conduct and in that way contributing to the cohesion of the family. In one case, the frustration toward the family decisions triggered a family member to expose his side of the story publicly in the press. The only thing to be done was to expel him from his positions of trust, but any kind of legal sanction was not feasible. The family had a non-written code of conduct, based on the values of the founder from 100 years ago, according to one family member, a structure was in place but it was difficult to govern. Another large owner family sees the role of family governance to guide the process toward alignment from a perspective of the religious values of the family.

So even if they see themselves as very well organized and structured, there is still some frustration because of being locked in the structures. But because of the foundation, building on the founder’s values, nobody really dares to oppose. Both these families seem to have experienced the same ambivalent situation of building on the founder’s values, making them the guidelines of the family, but at the same time struggling to find a way to develop the policy and be more practical.

Yet another extremely well-organized family presented their way of family governance having all possible documents and structures, because of a rough background between the sibling partners at a time. They build on religious values

and trust people to be honest and respectful, finding having a family governance system calming. They have put in place a charter, policies, and expectations of commitment through a non-legally binding code of conduct. All this is part of the family handbook or the overall structure. And, still, people might not follow the code of conduct, despite all the mechanisms "...then we just realized, that best practises come from someone behaving badly...gives us a reason to adjust and develop continuously."

6.2.1.5. A Set of Rules

In order to explicitly and formally align the behavior of family members, families often experience a need to formalize the family governance structure to that extent that compliance with the rules is expected and agreed upon in writing and maybe even through signing a family constitution, family protocol, family charter, or other document. However, as long as these policies are non-legally binding agreements, the whole structure only functions if there are mutually respected norms of communication and reciprocity that are embedded in the family culture. [Botero et al. \(2015\)](#) provide an understanding of the importance of family governance structures for the success of family firms. According to [Botero et al. \(2015\)](#), a family protocol can be a tool that outlines in advance what procedures to follow in different situations that can occur when managing relationships between family, business, and ownership subsystems. The main purpose with a family protocol is to have the expectations explicitly articulated by family members documented. The protocol can then function as a tool to manage possible conflicts caused by perceptions of inequality between family members. [Suess \(2014\)](#) focuses on three family governance mechanisms; the family meeting, the family council and the family protocol, and the family introduced them as being primarily intended to strengthen the family's relationship with the business. This overview aims to add to knowledge about family firms with a perspective from members of the owner family exemplifying how family governance can be developed, implemented, used, and experienced in different ways depending mainly on the generational stage of the family, the dispersion of ownership, and the cultural context the of the family. The intended contribution of the article is to enhance the understanding of the importance of flexibility in developing, implementing, and monitoring the family governance system, as well as underlining the significance of heterogeneity within and between the families.

As the earlier example with owner families that follow ethical and religious norms as guidelines and a code of conduct facing challenges with an individual not following the family norms, the same challenges appear even in families with a stricter set of rules in the form of, e.g., a family constitution. People might not just be content with the rules and if they don't get understanding for their critique of the system they might decide to decouple from the rules. Even if there had been a feeling of alignment during the process of developing the rules, the same spirit might not be there anymore, if some of the rules do not fit an individual's personal life situation. A family holding company board member from a fifth-generation family explained that the owner family has a very well documented

and “waterproof” set of rules for how family members interact and organize their shared ownership. They see it as the most important task of their family governance structure “to keep people informed and aligned, give them a possibility to talk and to get heard, but in the end, you cannot please them all.” This exemplifies how the themes presented in this chapter can be of different importance in families and give family governance different kinds of roles. In this family alignment is the most important and the means for reaching it is primarily through a set of rules, not through cohesion or communication. Another member of a family holding company board presented as the most important issue for their large owner family to “do things by the book, keep control, educate the family members according to a program and to try to avoid conflict.” This is also an example of focusing on relying on the rules and agreements.

6.3. Conclusions

Through interviews and discussions, emergent themes were identified, representing the different roles a family governance structure can have in an owner family with dispersed ownership. It appears that when ownership gets dispersed and the family identifies a need for organizing itself in relation to the shared ownership, a family governance mechanism is taken into use, or a more detailed governance system is developed. The themes represent different perspectives of owner families, the naturally prioritized way of functioning of the family. From discussions and interviews combined with my own experiences, common patterns show that when ownership gets dispersed in an owner family, the need for a unified view concerning the shared ownership becomes of great importance. Families seem to search for a suitable solution that fits the culture of the family and resonates with the values of the family. My experience is that most families turn to an external expert or facilitator to set the stage for the process of developing the family governance system and also seek for best practices and confirmation from other families of same size, age or with a similar ownership structure with dispersed ownership in several generations and branches.

Family business research on family governance has focused much on individual tools or mechanisms such as the family protocol, the family constitution or the family council, since these are often concrete steps to either start building a family governance system or continue developing an existing one. However, through encounters with owner families from around the world, praxis appears to be finding one mechanism to start from and then adapting and extending the system to suit the own particular ways of the owner family. The identified themes picturing the role of family governance in owner families show that a family governance system is often shaped to serve the family according to its needs and through a process of involving the individual owners on different levels. Respect for earlier generations and a restrained atmosphere seem to characterize especially old, large families with a strong family culture and traditions. The identified themes presented in this chapter are by no means exclusive or unique, but rather examples of how diverse and yet similar the role a family governance system in

an owner family can be. The heterogeneity within the owner family maintains a need for flexibility and adaptability and as experienced by some owners, the most important thing is to have a structure, a framework to process things through, since a very rigid system seldom serves the purposes of a diversified family for a long time and thus calls for an ongoing dialogue among the family members. Building on experiences, episodes, stories, and observations, this overview aspires to broaden understanding of and perspectives on the concept of family governance, from seeing it as one specific tool or mechanism to understanding the diversity of it. The owner families referred to in this study do a lot of benchmarking and attend conferences and workshops to learn more. They seek expertise from consultants and facilitators to find the right model for taking care of their shared ownership. Very seldom, one solution lasts for years, and as the family constitution or protocol is said to be a living document, so is the whole family governance system. It is about managing, not solving, as one family member defined the ongoing process.

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Chapter 7

Analysis of Critical Incidents for the Design of the Governance System

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Abstract

This chapter focuses on governance as a key element of the safeguarding system of the family enterprise. The management is in charge of the company's performance in terms of profit and growth. The governance system is designed to secure value protection by designing a robust leadership system, monitoring and advising management, reviewing critical decisions, and providing fail-safe solutions in case of serious malfunctions of the management system. This chapter develops a typology of critical elements which could endanger the development of the company, including conflicts and disruptions among the owner group. Results of recent research on the root causes of the downfall of family enterprises are presented. Finally, a concept of a three-layer protection system is developed with the aim of providing stability for longevity.

Keywords: Governance; safeguarding system of the family enterprise; root causes of companies' disappearance; cohesion factors; separation factors; separation hurdles

7.1. Introduction

In an experimental reflection, we explore which analytical techniques and tools can improve the design of governance systems in family businesses. The model case for our analysis is the larger, older (third generation), wholly family-owned

Family Firms and Family Constitution, 117–133



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enterprise in the German legal environment. Governance is understood – in a broad sense – as the concepts for leading the leadership institutions (shareholders' group, Top Management Team). Governance serves to ensure the quality of the whole leadership system. It is assumed that the overriding objective is to secure the longevity of the family and its business.

In reality, however, this vision of longevity is the exception rather than the rule. We illustrate below the findings by [Lantelme \(2017\)](#), that within 40 years – little more than one generation – about half of the large family-owned companies disappear. Disappearance means ceased to exist as independent family companies: They were sold or went bankrupt. Although this is less than the rate of two-thirds of public companies which disappear in the same period, it is still a frightening rate of decay.¹

It is therefore of utmost importance to explore ways and means to improve the longevity of companies. In all likelihood, this has to start with improvements in the quality of leadership. The governance system is designed to assist the owners and the organization to cope with disturbances in, and malfunctions of, the leadership system. In order to achieve that, it would be ideal to know which kind of disturbances and malfunctions are to be expected – specifically in areas critical for the survival of the family business.

With this aim in mind, we explore whether it might be useful to apply a concept technique such as Failure Mode and Event Analysis (FMEA) ([VDA Band 14, 2008](#); [VDA Band 4, 2009](#)). Such techniques are standard in the design of mechanical systems today. They are essential in order to achieve a high level of reliability in modern transportation equipment (airplanes, motorcars, cable cars, railways) where failures would be critical for the users. In this effort, I am fully aware that there are limits to the extent one can transfer insights from mechanical systems to social systems. We cannot assume cause–effect relationships, we can only observe the feasibility of certain means for desired purposes. Even with this restriction, any improvement in the longevity of the social system “family business” would justify any effort.

7.2. The Broad Segments of Critical Incidents

In the system of family business, it is an established perspective of research to separate the three subsystems: the family, the ownership, and the business. These are distinct – albeit interacting – segments which in coevolution influence the family and its business.² Following this line of thinking, we distinguish as segments for critical incidents:

¹This rate of downfall is similar to the rate of downfall reported by Ward (2011, p. 2). He counts 33% disappearance within 30 years. However, his sample includes also small businesses.

²As to the different interpretations of this model and its critical evaluation, see von Schlippe et al. (2017, p. 75 et seq.).

- Events concerning the composition of the ownership group by entry into the group, transfer of membership and rights, and exit.
- Events concerning the sustainability of the ownership group. The sustainability depends on
 - factors supporting the cohesion (Pieper, 2007),
 - factors working toward separation (“Trennungskräfte” according to Kalss, 2017), and
 - factors creating hurdles or even barriers to such separation forces (Kormann, 2017).
- Events originating in the spheres of the business which could affect the sustainability in various ways. Most important is the business development itself. A successful development of the business is “an effective glue for the ownership” (Miele & Zinkann, 2012). Conversely, the assessment of executives or assessments of strategies is a frequent source of potential conflicts among the shareholders. Fig. 7.1 illustrates the key critical elements.

7.3. Extant Research

Any research project in the realm of our topic has to be built on the stream of research on root causes leading to a crisis. In Germany, this body of research is connected with the works of Krystek (1987) and Hauschildt et al. (2000, 2006), for a comprehensive literature review, see Schulenburg (2008). Our specific interest is focused on the question of how the governance system should be designed in order to limit the risks resulting from such critical developments. A starting point for this inquiry is research on principles for designing effective contracts as we find it in Heussen and Pischel (2014) or Rehbinder (1993), or the textbooks of Aderhold

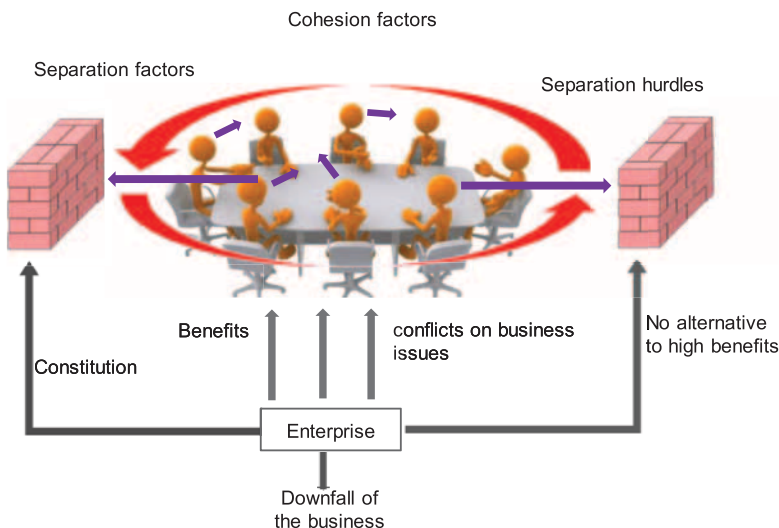


Fig. 7.1. Key Critical Elements.

et al. (2018) and Kunkel (2016). Here, the technique of “Störfallanalyse” (Analysis of disturbances and defaults) is developed. Until now, this research has only looked into procurement contracts, but not into shareholder agreements.

These catalogues of dangerous events which threaten the sustainability are based on the experience of the respective researcher. Complementary to these existing proposals in the relevant literature, we propose the use of a deductive approach to categorize all potentially critical incidents in a “mutually exclusive and comprehensively exhaustive” concept (Minto, 2009; Saunders et al., 2019). In a way, this aims to draw on the aforementioned “FMEA” which is a well-established practice in engineering design.

Standard chapters in the textbooks on corporation statutes and shareholder agreements elaborate on the stipulations which govern the composition of the shareholder group: entry, transfer, or exit of individuals in a shareholder position. In this, we find a variety of standard formulates. However, we seldom find a comprehensive evaluation of the standards according to the criteria of prolonging the longevity of the family business.

The literature on company statutes and shareholder agreements provides a rich source of critical factors which could lead to conflicts and separations among the shareholder group. We refer to Kirchdörfer and Kögel (2000), Lange (2005), Lohse (2005), Wimmer et al. (2018), Lutter (2010), May (2012), Kalss and Probst (2013), Ebel (2014), and Hennerkes and Kirchdörfer (2015). These authors enumerate the most frequent or most dangerous critical events in a shareholder relationship based on the consolidated experience of their professional activity as experts in the field. This stream of research is complemented by growing and well-grounded research on the legal aspects of conflicts in family businesses or – in legal terminology – of “companies with a closed circle of shareholders” (Wedemann, 2013). We refer to Lutz (2021), Bachmann et al. (2012), and Wedemann (2013). In this context, reference is to be made also to the sociological analysis of the typical conflict constellations in family businesses as documented in von Schlippe (2014) and Kormann (2018). An important contribution to the economic analysis of separation factors is the monograph by Redlefsen (2004) on the exit of shareholders from family businesses. He analyses the ramifications of the exit of shareholders from large family companies in Germany: the frequency, the root causes, and the consequences for the owners’ group as well as for the businesses.

In summary, there is a broad basis of research on the negative factors jeopardizing the cohesion of the owners’ group of family businesses. The major contributions are provided by the attorney’s advice to shareholders and their companies.

More recently, there is a growing amount of research on the factors creating cohesion within the owners’ group. Obviously, strengthening the cohesion is also important as a preventive measure for coping with conflicts. Pieper (2007) broke ground with his monograph “Mechanisms to Assure Long-Term Family Business Survival.” Kormann (2018) elaborated on some of the instruments proposed by Pieper. With the research movement on Socioemotional Wealth (Gómez-Mejía et al., 2007), the aspect of cohesion between owners and their businesses as well as among the owners themselves became a central focus of research on family business.

Significant progress has been achieved in the analysis of the root causes for the downfall of companies by the work of Rindfleisch (2011). Rindfleisch does not

focus on family enterprises, but the majority of the analyzed cases are medium-sized businesses which are typical for family enterprises too. A clear focus on the problems of family businesses is provided by [Lantelme \(2017\)](#) who looks at the frequency of downfalls of businesses, and [Greussing \(2017, see Lantelme et al., 2021\)](#) who illuminates the root causes of these downfalls.

We pursue a research project which first consolidates the “Hit-Lists” and other related insight embedded in extant literature. Furthermore, we try to identify those areas where increased research efforts seem promising. The aim is eventually an overarching description of all existence-threatening risks ([Lantelme et al., 2021](#)). This aim needs to be developed using a deductive approach. Ideally, we can construct a grid of relevant critical causes in a mutually exclusive and comprehensively exhaustive system. For this system, it is relevant how critical an effect is rather than how frequent it is, because existence-threatening risks are naturally comparatively rare. Still, it is wise to avoid deadly risks even when they seldom occur.

The relevance and the instruments of hurdles or barriers to separations remain an underresearched segment in the analysis at hand. The susceptibility of the various legal forms or corporations to exit is to be evaluated. For example, the shareholding company (Aktiengesellschaft) is a legal form which provides protection against termination of shareholdings. However, the listing of the shares seems to reduce the separation hurdle significantly. There is convincing empirical evidence that for listed family companies the influence of the founding owner’s family diminishes continually over time ([Klasa, 2007](#); [Kormann & von Schlippe, 2017](#); [Stotmeister, 2022, 2023](#)).

Finally, the research on the downfall of companies due to strategy or management deficiencies is comparatively weak. There are infinitely more publications on “How to become successful....” than on “How to avoid a downfall,” although the latter is more pertinent to a company’s survival than the former.

7.4. Importance of the Factors

Research on family businesses has a certain bias toward the problems originating in the families. This might be a consequence of the fact that the researchers in the early periods came from the professions of psychological family therapy and of legal advisory. Both professions primarily deal with the problems in the owner group. This emphasis underrates the risks of the family business itself. Our research group tried to gain empirical evidence on the relative importance of critical incidents originating in the owners’ group versus those originating in the business sphere – whether it be the management quality in general or specific strategic mistakes. In this quest for a certain population of companies (largest enterprises of 1971), the reasons for their disappearance within the following 40 years were analyzed. The first level of analysis was focused on the form of disappearance ([Lantelme, 2017](#)). [Table 7.1](#) shows the relevant forms and causes of disappearance for family enterprises on the one side and public companies on the other side.³

³This is based on a plausible combination of two different analytical perspectives. This interpretation requires further research.

Table 7.1. Root Causes of Disappearance – Family-Owned Versus Public Enterprises.

	Family Enterprises	Non-Family Enterprises Listed	Non-Family Enterprises Non-listed
Survival	50%	49%	14%
Business-induced downfall	20%	6%	43%
Business-induced sale	–	25%	43%
Owner-induced sale	20%	20%	–
Owner-induced downfall	10%	–	–
Total	100%	100%	100%
	<i>N</i> = 46	<i>N</i> = 35	<i>N</i> = 21

Source: Authors’ own table based on [Lantelme \(2017\)](#), [Greussing \(2017\)](#), and [Frericks \(2019\)](#); see [Lantelme et al. \(2021\)](#).

Note: Details of the break-down in [Lantelme \(2017, p. 68\)](#), and [Lantelme et al. \(2021, p. 165\)](#). The non-listed non-family enterprises include companies such as Aral AG, Edeka, Gedelfi, Bay-wa, Rewe, Ruhrgas, Steag. State-owned companies and subsidiaries of foreign parent companies are not included in this analysis.

In a subsequent analysis, the root causes of the disappearance of the family enterprises were further investigated and categorized ([Greussing, 2017](#)). This allocation indicates that business-related and family-related incidents have about equal importance.

In the context of our proceedings, the family-related issues are of specific relevance. However, the often-quoted conflicts in the family are a fairly rare decisive case. More often, the root causes are not conflicts among various members of the owner group, but just the specific requests of one member of the group. Likewise, it is identified in the survey by [Redlefsen \(2004\)](#) that “personal reasons” of an individual shareholder are the most often quoted reason for an exit.

In order to ensure a comprehensive list of critical factors, a deductive approach is required to complement and cross-check the inductive findings. This is the well-established practice in the critical event analysis in designing technical systems (FEMA).

7.5. Examples of Owner-Induced Critical Incidents

7.5.1. Critical Incidents in the Context of Entry Into and Exit from the System

Entry of new members means a change in the composition of a group and a potentially new allocation of influence. Thus, the regulation of who can join which group under which conditions is a critical element in each shareholder agreement and family constitution ([Kögel & Seemann, 2014](#)).

An even more essential consideration than change is the exit:

- How can we allow that the exiting shareholder makes an auction of his shares? Surely, this would reinforce the rivalry among the remaining shareholders and create inequalities by enabling the acquiring shareholder to strengthen his power. A stipulation that the shares can be sold only to the company provides a safeguard, meaning that the relations among the remaining shareholders are not affected.
- Why do we so often see high discounts on the fair value of shares and rather short payment periods for the compensation of say 3 years? Why not just a 15 or 20% discount and a 7-year-payment period?

7.5.2. Analysis of Cohesion and Separation Factors and Separation Hurdles

As the next frame of critical events, I seek to analyze those factors which either strengthen or jeopardize the cooperation within a given shareholder group. These are the prerequisites for a lasting relationship in a profession or business or association for pursuing certain shared interests. To this end, there must be cohesion factors: separation factors cannot prevail. If these do gain a dangerous intensity, then there should separation barriers be in place. The lack or the destruction of these prerequisites is the critical incidents which need to be taken care of in preventive or at least curative actions or regulations for actions, respectively.

7.5.3. Cohesion Factors

The cohesion factors are described in a convincing concept together with rich examples by [Pieper \(2007\)](#), see [Table 7.2](#) for a summary. [Kormann \(2018\)](#) expands on some aspects further, specifically concerning the financial benefits, the inheritance strategy, and the importance of the family and business history.

The critical factors destroying cohesion are – among others – the following ([Pieper, 2007](#)):

- Inequalities among shareholders create a wide area of principal–principal conflicts. There are numerous potentials for inequalities:
 - Majority rights and insufficient minority rights.
 - Wide differences in the portion of shareholding: 30% and 3%.
 - Unequal benefits between active and passive shareholders.
 - Unfair conditions for exit.
- Refusal of “Voice” for minority shareholders.
- Refusal of financial benefits such as profit distribution.
- Destruction of the good reputation of the enterprise or the owners’ group and thereby diminishing or even destroying Socioemotional Wealth.

Such factors degrade the loyalty to the family business. The latent question “Why should I belong to this group?” cannot be satisfyingly answered any more.

Table 7.2. Summary of the Cohesion Factors as Per [Pieper \(2007, p. 213\)](#).

Cohesion Dimension	Cohesion Enhancing Mechanisms
Dimension 1: Family Emotional Cohesion	Regular meeting Celebrating milestones and accomplishments Luxurious, interesting or exotic settings for family meetings Good parenting and familial relationships Interesting personalities Having fun together Birthday calendars Family history (written or video graphic) Photographic and video graphic albums etc. Family name Philanthropy
Dimension 2: Family Financial Cohesion	Money and other material objects Money for education Trust funds or other spending accounts Elevated lifestyle Intra-family lending Inheritances More explicit rules and precise application about how the resources are distributed (like education policies or family venturing policies)
Dimension 3: Business Financial Cohesion	Dividends Salaries in excess of market wages Perquisites Investing and business opportunities Pool contracts Shareholder agreements
Dimension 4: Business Emotional Cohesion	Newsletters and other regular communication between business and family Corporate news, corporate press releases Governance bodies as mediators for information between family and business Family gatherings around the business Celebration of special corporate anniversaries

Table 7.2. (Continued)

Cohesion Dimension	Cohesion Enhancing Mechanisms
	Next generation training and meetings
	Internships
	Plant tours
	Quality products
	Company name and logo
	Philanthropy
	Corporate Social Responsibility
	Archives, museums (business and other), monuments, portraits, busts, and movies
	Family business legacy

7.5.4. Separation Factors

We term “Separation Factors” (Table 7.3) those elements in the relationship among shareholders themselves and between shareholders and their business which could induce shareholders to exit the owners’ group or to sell the whole business (Kormann & von Schlippe, 2023; Lantelme et al., 2021; von Schlippe & Kormann, 2023). Following Pieper’s categorization of the origin of cohesion factors, we distinguish the following separation factors:

- Family Emotions
- Family Financials
- Business Financials
- Business Emotions

and we add the dimensions of conflicts of interest resulting from:

- principal–principal relation among shareholders
- principal–agent relation with a managing shareholder or even a non-family executive as the agent.

7.5.5. Separation Hurdles

Separation hurdles (Kormann, 2017, pp. 302 et seq., 523–524; Redlefsen, 2004, pp. 30–31) prevent or delay an otherwise intended separation. To these factors belong a wide variety of reasons:

- High taxes connected with a separation.

Table 7.3. List of Separation Factors.

Dimension of Separation Tendency	Exacerbating Factor
Family Emotion	Lack of family identity Personal rivalry Different lifestyles Different values Unequal parental affection
Family Finances	Unequally distributed inheritance Other personal interests (investments, philanthropy) Different perception of the need to grow
Business	No sufficient profit distribution
Financial	Concerns about sustainable strategy
Benefits	Different perception of need to grow
Business Emotion	Refusal of “Voice” Insufficient minority rights Overly restrictive contractual ties Damage to the good reputation of the enterprise = Destruction of Socioemotional Wealth
Principal – Principal Conflicts	Insufficient minority rights Wide difference in percentage of shares held Unfair exit conditions
Principal – Agent Conflicts	Doubts about qualification of agent Doubts about loyalty to family business concept

- High discounts versus the fair value of the shares in the sell-and-buy-agreements governing the exit.
- A legal form which does not provide the exit option such as a SE or AG, as long as the company is not listed.
- Long contract fixed duration periods (30 years).
- Excellent profits of the family business which could not be matched by another income alternative.

There are cases of hot conflicts active over decades where such hurdles prevented a separation. Even in cases where relevant provision could not ultimately

prevent a separation, the hurdles' presence could help to gain time for the orchestration of an exit process favorable for the sustainability of the business.

7.6. Examples for Company-Induced Critical Incidents

Understanding which type of decisions could lead to critical events in the development of the business leads to governance rules which limit the authority of the executive directors of the company. In the context of our chapter, we can only provide examples for the potential approaches to listing the critical events ([Kormann, 2018](#), p. 315 et seq.):

- Rigidity of the organization when adjusting to changing requirements in the environment. This requires the observation of the long-term trends in the development of critical indicators. Ideally, these indicators are not restricted to the end-effect “profitability” or “growth rate” only, but address the root causes of profitability and growth. For example, one could stipulate that the company is evaluated every 5 years to verify a reasonable value of the business and to assess the development versus the last valuation date.
- Decisions which cannot be corrected any more. Relevant examples are: forming Joint Ventures, long-term cooperation contracts, and the acquisition of companies which could not be sold again to other parties. Making a big mistake in these decisions can have existence-threatening consequences as they cannot be corrected any more.
- Decisions which are a “first time” event for the relevant company. Whatever is done first is an area in which the executive team does not yet have experience. This significantly increases the risk of making a wrong decision.
- Decisions which involve the investment of high amounts of money are inherently riskier than decisions about small sums of money.
- Decisions which significantly concern the personal interests of a member of the executive team (agency problem).
- Decisions which could be significantly affected by behavioral deficiencies of the executives, such as overconfidence.

All these categories require certain measures in the governance process to assure the quality of the decision-making process and limit the risk exposure. For the design of such regulations, there are basically two approaches. The conventional approach is to include in the Rules of Order for the executive team a list of transactions where the authority of the executives is limited and a governance institution (board, shareholder committee) must give their approval ([Kormann, 2017](#), p. 225 et seq.). This specific enumeration has some disadvantages. Typically, only steps which are late in the planning phase or even in the implementation phase trigger the approval process. The other approach is simply to specify a general request: Any development or decision situation which can substantially affect the future development potential of the company has to be reported to the supervisory board ([Kormann, 2017](#), p. 228).

7.7. The Downfall Protection Design

7.7.1. First Level: Performance System

Analogous to the design of engineering systems, one can differentiate three levels of damage protection.

The first level is the prevention of problems through a well-designed “Performance System”: A good business strategy and harmonious personal relationships are the basis. The formulation of a family strategy is an important “first line” of protection. These fundaments can only be created by sufficient leadership in the business and/or in the ownership group. In our understanding, the quality of the leadership is based primarily on the structure, the people, and the processes of the leadership institution itself, e.g., the Top Management Team.

7.7.2. Second Level: Monitoring System

The quality of the decision system has various aspects:

- Competence in identifying decision requirements, in analysis of relevant facts and in evaluation of facts, actions, and consequences.
- Alignment to valid targets and decision criteria.
- Decision-making processes and attitudes of the actors which ensure timely decisions. This also helps avoid delays or stalemate situations.
- Decision-making processes and attitudes of the actors which ensure cohesion. This requires avoiding counterproductive conflicts which jeopardize the implementation of any decision.

If one wants to increase the performance, then the quality of the management needs to be increased. This can be achieved by motivation, training, advising, or changing the composition and/or allocation of responsibilities. The quality improvement has to take place where the resources and their steering are located by the management. Deficiencies in the quality of management cannot be compensated for by other institutions in charge of supervision or audits or similar tasks.

Secondary protection comprises regular monitoring or even testing of the proper and safe functioning of the system. This is the realm of Governance.

The monitoring has three perspectives. First, the members of the governance institution may contribute to the monitoring of the business environment based on their involvement in the business activities of other companies. If appropriate they set “early warning signals” (Ansoff, 1975). Second, the monitoring follows variances in the performance of the system. The business development may necessitate additional resources such as a major capital investment program or an increase in the equity base. Such structural adjustments of the resources are typically to be approved by a governance institution (board, shareholder assembly). If dangerous deteriorations are noted, appropriate restructuring programs can be initiated. Such restructuring might include the disposal of an activity which is

“beyond repair.” Third, the monitoring of the activities of the management might lead to initiatives to ensure the quality of the management system:

- Impulses for the self-steering capability of the management, e.g., motivation, value orientation, incentives.
- Impulses for cooperative development of initiatives and decisions by advisory.
- Impulses for setting safeguarding context conditions for the decision process, e.g., rules for decision criteria, setting boundary conditions for limiting risk exposure.
- Limits to the authority of the management.
- Authority to give direct instruction to the management.
- If needed, the monitoring can lead to a removal of the executives and their replacement by new members.

The institution for the business governance, e.g., supervisory board, has a back-up in the form of the shareholders’ assembly which monitors the activities of the business governance. If needed, the shareholders can upgrade the business governance by their own initiatives. Likewise, the shareholders have the right to change the composition of the governance board.

7.7.3. Third Level: Fail-Safe Back-Up System

Tertiary protection avoids a final downfall after the damaging event. This is the area in which the design of contracts is tested. The general protection routes are, for example, a fail-safe design, which secures a reduced but stable functionality for some time – time to develop remedies. Securing some minimum rights for minority shareholders might be an instrument of fail-safe design. The other option is to provide an emergency alternative. A board assuming to some extent the functions of a not-functioning shareholder assembly is a case in point.

In any case, the primary task of damage protection is “to stop the bleeding” and its root causes: The controlled exit of a shareholder might be necessary to stop the bleeding.

The ultimate layer of a fail-safe business system is to ensure the survival even following the downfall of *one* part of the business activity. “Survival” means maintaining the ability to pursue a strategy for business development. In general, this layer is formed by a diversification of wealth:

- Diversification of the activities of one enterprise.
- Ownership of two or more separate and autonomous enterprises in the ownership of one group of owners.
- Diversification of the wealth of the family by financial investments outside the enterprise.

These concepts of diversification are difficult to observe from the outside. Nevertheless, they do exist in many of the multigeneration business families.

Table 7.4 summarizes the important elements in each of the three levels.

Table 7.4. The Three Levels of Failure Protection.

The Three Levels of Failure Protection	
Primary Protection	Good structures, people Processes Good strategy Family strategy
Secondary Protection	Monitoring reliable functioning by Governance
Tertiary Protection	Contractual arrangements • Fail-safe-operation in conflict (at reduced functionality); minimal rights • Redundant design Exit options Diversification

7.8. The Basic Dilemma for Achieving “Ultra-Stability”⁴

In order to gain stability under known circumstances, clear and strict regulations are required in the shareholder agreements. However, the research on safety conditions provides a warning: Too many security measures to protect against disturbances and to secure stability lead to a rigidity which jeopardizes the safety in terms of adaptability. This adaptability is vital for securing sustainability under drastically changed external conditions. Perhaps the agreements under a “family constitution” are the proper place to provide for this flexibility – see [Fig. 7.2](#).

7.9. The Decisive Role of the Legal Advisor in Identifying Critical Incidents

The legal advisor who designs the shareholder agreement has an enormous responsibility. He or she cannot only transfer the set intentions of the shareholders into a contract language. Designing their constitution is for the shareholders a unique decision. They haven’t had the opportunity to accumulate experience. Only the legal advisor can act as a trusted person to transfer the experience of the cause–effect relationships to his or her clients. To accomplish this task, a holistic perspective is required. And there is more research and its consolidation in an interdisciplinary body of experience required in order to enable this holistic view.

⁴Ultrastability as the capability of a system to survive external shocks from arbitrary and unforeseen interferences (Ashby, 1956).

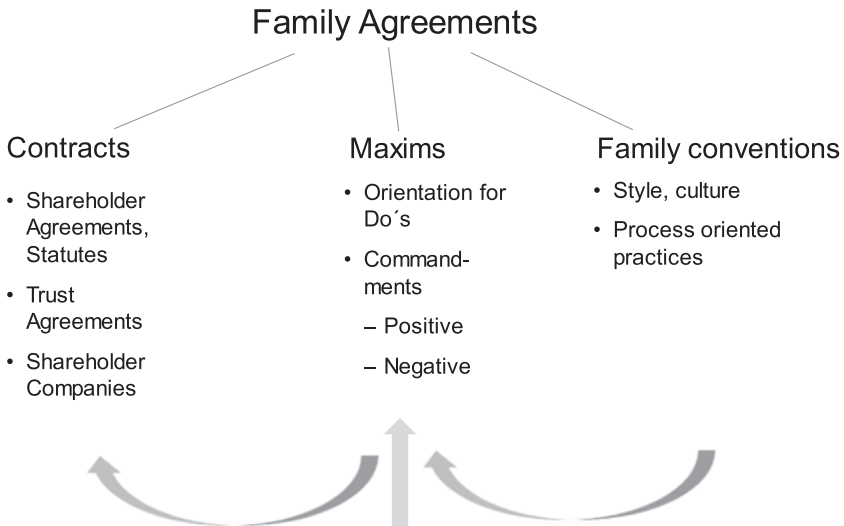


Fig. 7.2. Family Agreements as Elements of Governance.

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Chapter 8

Discussion Report Part 2: Managerial Research I: Conceptual and Qualitative Analyses

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Ilse Matser/Rachel Heeringa/Jan Willem van der Vloot van Vliet: Family Governance in Practice: Lessons Learned from a 100-Year-Old Entrepreneurial Family Firm

Lena Jungell: Managing Dispersed Ownership within the Owing Family: The Role of Family Governance

Hermut Kormann: Analysis of Critical Incidents for the Design of the Governance System¹

The exchange of views about Matser's contribution began with the intervention of a legal scholar who said that Matser had mentioned that the management team in her case consisted of family and external managers. He wanted to know how the family respected the roles of the non-family managers. Matser reported an event that happened a few years ago where the family had decided something urgent overnight and had forgotten their own guidelines, which stated that they had to inform the rest of the management and the supervisory board. That incident was an important learning. Today, they focused more on their own

¹As the chapter by Botero and Fediuk was not presented during the conference, it was not part of the discussions.



rules and followed them strictly. They also recognized the value of the non-family members in management and supervisory board and that their experience could be beneficial for the business. Thus, the non-family members were more involved nowadays.

A managerial academic remarked that Matser had stated that the family constitution documents were only rarely used and that the process had been more important in her case study than the document. She wanted to know whether there had been any non-family members involved in the development of the family constitution. Matser confirmed her former statement; the family constitution had only been used a few times in critical situations. One non-family member had been involved in the development of the family constitution. A management scholar and consultant asked whether any non-family members knew about the family constitution. Matser replied that all non-family members in management and on the supervisory board were aware of the family constitution.

A managerial scholar referred to Matser's presentation where she had mentioned that the family discussed their constitution on an annual basis. He asked what the result of such discussion were. A revision? Matser reported that the family combined a family meeting with the shareholder meeting once a year and that it was in this context in which the family constitution was shortly discussed. Amendments of the constitution during the last 20 years were rare. A legal scholar dwelled upon that subject and asked what the rule for amendments in the family constitution was. Matser answered that such a rule existed, but she was not sure about its exact nature at the moment. In addition to that, the legal scholar was interested in the constitution's association with other documents, whether there were only referrals. Matser answered that an overlap of the constitution with other documents existed and that there were also referrals to other documents in the constitution (and vice versa). The consistency of all links had been checked by a lawyer.

A managerial scholar and practitioner concluded the discussion of Matser's presentation with an anecdotal remark: Some families had rules that no member brought his lawyer to family meetings in order to avoid conflicts. The involvement of lawyers was not always wanted.

The discussion continued with an exchange between Lena Jungell and Hermut Kormann. Reacting to Jungell's presentation, Kormann stated that, regarding family governance, there is yet not enough experience of whether the instructions work at all. In his understanding, the intention of the governance instruments is that the shareholders make a contribution and are involved in the business, but sometimes management is not even happy that everyone is involved. Jungell replied, that, so far, family governance is the best solution. It was about education from the beginning on, to keep the people busy, to get enlightened owners. When people were willing to accept legal rules, they knew the boundaries and how they could participate. Kormann responded that the document itself is the end status. Jungell chose a slightly different emphasis, stating that the document lives parallel to the family.

Next, a legal consultant rose to speak and asked Jungell, firstly, what she does to live family governance, and, secondly, what she does to avoid divergence

between governance and practice? Jungell began her answer by underlining that first you have to define governance and differentiate between owner family and business family. If only two members of a large owning family worked in the business, it was from her perspective an owning and not a business family. Touching directly upon the legal consultant's first question, Jungell recommended behave and try to find ways to clarify how the family can own the company in the best possible way without being a problem for the business. She recounted an experience from her family business that is in the food industry. They made the experience that members of her owning family called the non-family CEO when they saw a TV spot they did not like. This should not happen from her point of view; the family had to let the non-family managers do their work. The legal consultant then added the question of how her family avoids divergence between governance and practice? Jungell reported that their family constitution is more like a code of conduct, and that they have articles of association. Thus, it was very clear, and the rest was more social stuff.

After that, a managerial scholar made an intervention with regard to Jungell's presentation. He said that synthesizing the literature on family governance is a good area for working. Another interesting way to have a look at the literature would be to approach family governance with the questions: what is family governance (form) versus what is the purpose of family governance (objective)? This differentiation would be helpful from his point of view as some researchers in family governance talked about form, some about purpose. He continued that one could visualize this distinction by setting up a 2×2 matrix, in the rows differentiation between narrowly and broadly and in the columns between nature and purpose. He was convinced that it would help all interested in family business, if one pulled the information for the definition of family governance together. The managerial scholar then strongly recommended the booklet of Dennis Jaffe "Governing the family enterprise: The evolution of Family Councils, Assemblies and Constitutions" published in 2017. He stated that he is also fascinated about to know the different views regarding the effectiveness of family governance across different generations; questions to raise are "Why this path? How can we live and breed it?" For him that is the heart of the effectiveness.

A legal scholar stated that all participants know that family and business are interrelated, so there is the question of cohesion, e.g., in case a member of the owning family wanted to extract money and others wanted to invest it. This setting reminded him of the issue of club goods/collective goods from economics. In that area, it was tried to establish social mechanisms to keep public goods working. From his point of view, this structure is similar to family firms and their influencing rights. He suggested that it might be worth to transfer some thoughts from this economics perspective to the family governance research area.

After that, a discussion on family firm heterogeneity began, initiated by a managerial scholar. She said to Jungell that family business research has to think about the context and the complexity of the family. Maybe, one could take the research niche to do research about family shareholders who play no active role in the business while other family members play an active role by working in the

company. More generally, she pointed out that there are different types of groups within owning families and that the employer–employee relationship within the company should also be considered. Another managerial scholar asked how this could look like, whether she recommended orientation to the three-circle model? She replied that the three-circle model most probably would not be rich enough. She said that family members play different roles within the family and within the business. There were a lot of cousins, sisters, etc. to consider. Generations mattered as well. The intervening managerial scholar agreed that this is a good idea to do research on. He added that taking into account heterogeneity more strongly might provide more transparency in which settings family constitutions are particularly valuable. Making the link back to the first intervention, the first managerial scholar concluded this part of the discussion with the hint that this research should be linked to the purpose aspect of family governance.

Closing the discussion of Jungell's presentation, a legal scholar added that, from a legal point of view, the divergence between the written form and the practice always has to be considered as to whether the family did implicit amendments of the written form.

Turning to Kormann's talk, the legal scholar remarked that the Failure Mode and Event Analysis (FMEA) was very close to what lawyers do, trying to anticipate all eventualities. Kormann agreed, but stated that the FMEA is more advanced in malfunctions in performance. The legal scholar continued that in law one knows that there are always incomplete contracts because it is simply too costly to write complete contracts. As a solution, lawyers would include focal principles, e.g., the duty of loyalty (from company law) which shall give orientation how to resolve future conflicts. It was impossible to anticipate all eventualities. The longer the contract, the lesser effective it was; the salience diminished, so there would be reasons for standardization. Kormann countered that from his point of view shareholder contracts must be tailor-made. He could not believe that there is a standard contract for this. In engineering, e.g., it was known that there are a thousand things that can happen to an airplane, however, only six of them bring an airplane down. Therefore, Kormann deemed it very important that there is an exit structure so that the company can survive also if a shareholder exits. Kormann underlined that the shareholders themselves have no experience; they cannot learn or derive a model from a single case. He accepted that there are no complete contracts, and for recurring issues there had to be standards. The legal scholar agreed that it was a plausible way to make use of collective experience to set up a model for the articles and then adapt them accordingly for the specific case.

A legal practitioner stated that he finds Kormann's differentiation between the need of security versus safety very interesting. This was a dilemma and a challenge in contract design as well as that there was on the one hand a closed-shop strategy and on the other hand the flexibility needed to find the best solution for the company. From his perspective, lawyers could be a good support when it comes to the family governance level as they had more experience with crucial exit situations than the owners themselves.

A managerial scholar mentioned to Kormann that the layers he had described for the governance levels reminded his doctoral student and him of the Three-Lines-of-Defence model for the different governance, risk and compliance elements in organizations. The doctoral student added that also with the Three-Lines-of-Defence model there is this difficult balance between security versus safety and flexibility that Kormann mentioned in his presentation. Too strict forms of Governance, Risk Management, Compliance (GRC) elements would hinder the business and slow down processes. Kormann fully agreed with this parallel with the Three-Lines-of-Defence model and appended that especially risk management misses to come down to a concrete operational level.

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Part 3

Managerial Research II: Survey and Quantitative Analyses

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Chapter 9

An Examination of the Relationship Between Governance Mechanisms and Performance: Evidence from the Australian Family Business Context

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Abstract

Prior family business research has been dominated by an agency theory perspective, narrow definitions of what constitutes family wealth, and a preoccupation with business governance mechanisms to the exclusion of family governance mechanisms. This chapter presents the findings of examining the role of a broader range of governance mechanisms (for the business; for the family) in achieving more comprehensive wealth (economic and non-economic) family business goals in the Australian context. Based on survey responses from around 400 family businesses, the findings from this study show that both family and business governance mechanisms contribute significantly to achieving both the business's financial performance and the achievement of family-centered goals that are important to the owning family. The results also suggest that the relationship between governance and performance in the family business context is much more complex than that acknowledged in prior research and has implications for both future research and practice.

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Keywords: Family constitution; family council; family governance; business governance; financial performance; family-oriented performance; quantitative research; Australia

9.1. Introduction

As in most jurisdictions around the world, the corporate governance practices of Australian family businesses are predominately determined by the law (e.g., the Australian Corporations Act). Australia adopted the “Anglo-American model” of governance which is based on principles of agency theory, where company directors (the “agents”) are required to act in the best interests of the organization which has been interpreted in the Australian court of law as maximizing the shareholders’ (the “principals”) wealth. However, we know from prior family business research that theories other than agency theory (e.g., stewardship theory) offer more promise in furthering our understanding of family business behavior and performance, and consequently, advancing the practice and research of governance in the family business context. Despite this, an agency perspective dominates prior research on the governance of family businesses with the use of narrow definitions of what constitutes family wealth and a preoccupation with *business* governance mechanisms to the exclusion of *family* governance mechanisms. Because it is commonly accepted that business families have a broader concept of “wealth,” which incorporates the socioemotional objectives of a family (Gómez-Mejía et al., 2007; Holt et al., 2017), we argue it is important for family businesses to adopt governance mechanisms beyond those that focus on business goals and on the economic returns to its shareholders.

To advance our understanding of what constitutes effective governance in the family business context, this chapter presents the findings of the examination of the role of a broader range of governance mechanisms (for the business; for the family) in achieving broader wealth (economic and non-economic) goals of the family business in the Australian context. The sample used in this study was drawn from Australian family-owned businesses listed on the databases of Family Business Australia (FBA) and KPMG Australia where a survey instrument was completed by the chief decision-maker (the Chief Executive Officer). FBA is a family business membership organization whose role is to provide an education and advocacy service for family businesses in Australia. FBA and KPMG collaborate to conduct a biannual survey of family businesses in Australia that broadly assesses their status in terms of management, operational and performance indicators. Based on usable responses from 396 family businesses, the findings from this study show that both family and business governance mechanisms contribute significantly to achieving the financial performance of the business and the family-centered goals that are important to the owning family. The results also suggest that the relationship between governance and performance in the family business context is much

more complex than that acknowledged in prior research, and has implications for both future research and practice.

The remainder of this chapter is organized as follows. Firstly, the following section outlines the relevant literature on governance and performance in the family business context, and the research questions to be examined in this study. Secondly, the research method used, measurement of variables and statistical method (model specification) employed in this study are presented. This is followed by a presentation of the results where the descriptive statistics and results of the regression analysis are discussed. The last section summarizes the contributions of this study, its limitations and suggestions for future research, and implications for family business owners and their advisors.

9.2. Governance, Wealth, and Performance of Family Businesses

9.2.1. Governance

Although there are a myriad of definitions of corporate governance, in its simplest form, corporate governance can be defined as “the system by which companies are directed and controlled” (Cadbury, 1992, p. 15). Such a system within a firm context often comprises not one but a number of integrated components such as policies and procedures, structures, roles, relationships, and delegated responsibilities. In the past, the purpose of corporate governance has been both narrowly and broadly defined and influenced by the underlying theoretical lens adopted (agency theory, transactional cost economics, stakeholder theory, and social capital theory to name a few). In the narrowest sense, the purpose of corporate governance is ensuring the firm achieves the goal of generating wealth for its investors (Shleifer & Vishny, 1997). However, the purpose of corporate governance is much more than ensuring economic outcomes for its capital providers. In recent times, there has been a shift toward acknowledging broader societal expectation of organizations, other than that of their capital providers, as a result of a number of spectacular cases of corporate collapses and misconduct (Tricker, 2015). In sum, corporate governance involves establishing a system that ensures the goals of the owners are achieved while at the same time meeting expectations from broader stakeholder groups.

Prior family business governance research has been preoccupied with understanding the significance of business governance rather than family governance mechanisms. Furthermore, Pindando and Requejo’s (2015) review of more than 350 research articles on family business performance highlights the bias toward research on publicly-listed firms, economic measures of performance, and therefore not surprisingly, formal *business* (as opposed to *family*) governance mechanisms. Nevertheless, there is a growing interest in research into the role of family governance mechanisms in family businesses. For example, Suess’s (2014) review of published research papers that specifically focused on family governance mechanisms highlighted that mechanisms such as a family council and a family constitution are researched the most while other mechanisms such

as family employment selection criteria and family communication systems are yet to receive little attention. We argue that there is a need for more research on a range of different family governance mechanisms and their effect on family business outcomes such as family wealth (economic and non-economic) as discussed below.

9.2.2. Wealth and Performance of Family Businesses

In the family business literature, it has been acknowledged that the goals of business families vary from family to family and often encompass non-economic as well as economic goals (Basco, 2017; Berrone et al., 2012; Zellweger et al., 2013). The importance of considering non-economic as well as economic wealth goals is not a new phenomenon (Berrone et al., 2012; Gómez-Mejía et al., 2007). The term “wealth” originates from the Old English words “weal” (well-being) and “th” (condition). Literally, wealth means the “condition of being happy and prosperous” (Anielski, 2007, p. 16). As argued by Jensen and Meckling (1994), people care not only about financial wealth but also place value on matters such as respect, honor, power, love, and the welfare of others. Over three decades ago, Chrisman and Carroll (1984) outlined the importance (and compatibility) of organizations achieving both economic and social goals. Chrisman et al. (2003) call for a broader concept of wealth in family business research, one that takes into account both the economic and non-economic goals of business families. Yet, despite this, prior family business research has been preoccupied with research on the determinants of economic performance. As a consequence, attention to how family-centered goals interact with financial goals and influence performance of the family business has received little attention. Thus, it is no surprise to see calls for research into issues surrounding the family-centered goals and performance of family businesses (see Holt et al., 2017; Yu et al., 2012).

The preoccupation with economic goals and outcomes is evident in research on family business governance. Specifically, the majority of prior studies of the effect of governance on family business performance has focused on financial outcomes such as market value or profitability of the family business (see Pinedado & Requejo, 2015 for an extensive review). This has been to the exclusion of examining how family governance mechanisms can assist family businesses in achieving family-centered goals, such as family cohesiveness and identity in the community, in addition to its economic goals. As a consequence, little is known as to whether family governance mechanisms are also important for achieving family-centered goals (in addition to the financial goals) of the family. We argue that given its uniqueness as an organizational form that entwines the family in the business, there needs to be a reorientation toward a broader concept of wealth in family business governance research so that the relationship between family business governance and family business performance can be examined in a more holistic manner (Graves et al., 2016). Through broadening family business research to include achievement of financial and family-centered goals, a

more refined analysis of the influence of different business and family governance mechanisms can be explored.

9.3. Research Questions

In summary, we argue that research on the governance in the family business context has been hindered due to using narrow definitions of what constitutes wealth and a preoccupation with business governance mechanisms. We believe that by broadening measures of wealth to include achievement of financial and family-centered goals, and measures of governance mechanisms to include a broad range of family governance mechanisms, we can advance understanding of how governance (and the types of mechanisms used in combination) affects outcomes experienced by family businesses. As a consequence, in this study, we examine the following research questions:

RQ1. To what extent do *business* governance mechanisms assist family business owners to achieve their financial and family-centered goals?

RQ2. To what extent do *family* governance mechanisms assist family business owners to achieve their financial and family-centered goals?

9.4. Research Method

In this study, data were collected through a survey of firms to examine the influence of different governance mechanisms on family business performance. Drawing on survey instruments developed in previous academic research, a 73-question survey instrument was developed with the assistance of business researchers, business owners, and advisors. The questionnaire contained six sections: key decision-maker profile; aspects of ownership, governance, and management; family issues (family goals and achievement, management and ownership succession); business issues (including goals and performance, strategies, intentions); exit and succession issues; and firm characteristics.

The sample used in this study was drawn from Australian family-owned businesses listed on the FBA and KPMG databases. Over 6,000 Australian privately owned (i.e., unlisted) firms were selected to give a representative sample of the Australian family business sector. In 2013, the questionnaire was sent to the chief decision maker (the Chief Executive Officer) together with a covering letter which explained the purpose of the study. Follow-up correspondence was sent 2 weeks after the initial questionnaire was distributed, resulting in 570 completed questionnaires (response rate of 9.5%). Because this study focuses on the use of formal governance mechanisms, such as the use of a formal board of directors or a shareholders agreement, data from family businesses legally organized as companies were used. After removing questionnaires which did not complete every question required for this study, a total of 396 usable questionnaires from family companies remained.

9.4.1. Measurement of Variables

9.4.1.1. Dependent Variables (*Financial Performance and Family-Oriented Performance*)

As highlighted in the Introduction section, this study focuses on two different measures of performance, namely, achievement of financial goals (financial performance) and achievement of family-oriented goals (family-oriented performance). In a review of family business outcomes which have been used in prior research, [Yu et al. \(2012\)](#) highlight that measures of business and family goals and performance remain underdeveloped and an area for future research. To date, there are no universally accepted instruments to measure financial and non-economic performance of family-owned enterprises. As a consequence, researchers must draw on previous research to develop measures of goals of relevance to family businesses. Thus five items were drawn from the work by [Gupta and Govindarajan \(1984\)](#) and [Richard et al. \(2009\)](#) to measure the financial goals of the business. These included goals relating to net profit, cash flow, return on sales, return on assets, and sales growth. Respondents were asked to indicate the importance of each of the five items using a scale that ranged from one (not important at all) to five (extremely important). Respondents were also asked to assess the business's performance in each of the five items relative to their major competitors using a scale that ranged from one (much worse) to seven (much better). A weighted measure of the performance for each of the five items was calculated by multiplying the importance rating for an item by its performance rating ([Westhead & Howorth, 2006](#)). For example, if a respondent rated the goal "net profit" as extremely important (score of 5) and the business's performance in this goal as the same as others in their industry (score of 4), the business's overall weighted score of performance for the item "net profit" is 20 (5×4).

The work of [Sorenson \(1999, 2000\)](#) was drawn on to measure eight family-oriented goals which families are argued to pursue through their ownership and control of a business. These included goals relating to quality of work life, time to be with family, security for the family, increasing family wealth, independence, family cohesiveness, family respect in the community, and satisfaction/fulfilment. As with the business goals, respondents were asked to indicate the importance of each of the eight family-centric goal items using a scale that ranged from one (not important at all) to five (extremely important). Respondents were also asked to assess how satisfied the owning family was with the level of achievement in each of the eight family-centric goals using a scale that ranged from one (completely dissatisfied) to seven (completely satisfied). A weighted measure of performance for each of the eight family-centric items was calculated by multiplying the importance rating for an item by its satisfaction of achievement rating.

In summary, 13 weighted measures of performance were calculated (five business performance measures, eight family-centric performance measures). Principal Component Analysis (PCA) was used to reduce these 13 measures to two

composite measures of performance of the family business. As discussed later under data analysis, these overall composite measures are related to the following areas of performance: (1) family-oriented performance achieved through the business, and (2) financial performance of the business. This procedure is discussed in more detail in the “validity” section below.

9.4.1.2. Governance Variables

Respondents were presented with 16 different types of governance mechanisms to govern the business and the family. These included:

- a. Business governance mechanisms:
 - Formal board of directors (yes/no)
 - Undertook independent assessment of the formal board performance (yes/no)
 - Formal advisory board (yes/no)
 - Formal evaluation of management performance (yes/no)
 - Policy for the employment, remuneration, and promotion of family members (yes/no)
 - Shareholders' agreement (yes/no)
 - Formal reporting of business matters to shareholders (yes/no)
- b. Family governance mechanisms
 - Family council (yes/no)
 - Family constitution/code of conduct (yes/no)
 - Process for incorporating the family vision/goals into the business planning process (yes/no)
 - Formal reporting of business matters to family members (yes/no)
 - Process for welcoming, educating, inducting family members into the business (yes/no)
 - Documented succession planning for (options included “agreed and documented,” “under development,” and “no”):
 - Unifying strategy for the future of the family business
 - Succession plan for current CEO
 - Succession plan for other family members in senior leadership roles
 - Estate plans (including how ownership will be distributed)

9.4.1.3. Control Variables

Because performance and governance practices may vary according to the lifecycle of the business and the family, the following control variables were used:

- Firm age (from establishment): measured in years.
- Firm size: measured using a seven-item ordinal variable, ranging from one (0–4 employees) to seven (300+ employees).
- Industry: Using ANZIC (Australian and New Zealand Industrial Classification) as a guide, firms were classified according to one of six industry

categories (agriculture, construction, manufacturing, retail, wholesale, other). As the “Other” contained the greatest number of firms, this was used as the reference category when undertaking the statistical analysis. That is, all except the “Other” category were included in the models below ($n - 1 = 5$ categories included).

- Generation in control: to control for firms that had undergone a succession event, firms were classified as either first generation or second and later generation firms.

The following two models were subsequently formulated:

$$\text{Financial performance} = \beta_0 + \beta_{1-16}(\text{governance mechanisms}) + \beta_{17}(\text{firm age}) + \beta_{18}(\text{firm size}) + \beta_{19-24}(\text{firm industry}) + \beta_{25}(\text{generation in control}) + \varepsilon$$

$$\text{Family-oriented performance} = \beta_0 + \beta_{1-16}(\text{governance mechanisms}) + \beta_{17}(\text{firm age}) + \beta_{18}(\text{firm size}) + \beta_{19-24}(\text{firm industry}) + \beta_{25}(\text{generation in control}) + \varepsilon$$

9.4.2. *Validity*

The questionnaire was piloted with family business stakeholders (academics, practitioners, and family business owners), and the feedback received was incorporated into the final questionnaire. Convergent validity was used to assess the reliability of the measures of firm goals. As highlighted above, PCA (utilizing varimax rotation) was used to develop two composite measures of firm performance, financial performance, and family-oriented performance. In total, 2 of the 13 items were removed from the PCA because their communality scores were below the 0.50 cut-off (Hair et al., 2010) (items were sales growth and family control). Component loadings for the different measures were as follows: “family-oriented performance” achieved through the business (7 items with loadings from 0.604 to 0.794) and “financial performance” of the business (4 items with loadings from 0.712 to 0.775). Both measures of performance had Cronbach alphas above the recommended 0.6 (0.870 and 0.811, respectively) for exploratory measures (Hair et al., 2010) and are consistent with levels reported in other studies (see, for example, Koropp et al., 2013).

To ascertain concerns regarding multicollinearity, the Pearson matrix was used. There were no correlation values between explanatory variables that reach 0.5. Furthermore, potential multicollinearity is further examined through the estimation of the Variance Inflation Factor (VIF). VIF values of all of the independent and control variables are below 2. Based on these two tests, there are no concerns regarding the possible effect of multicollinearity on the regression results.

9.5. Results

9.5.1. Descriptive Statistics

Descriptive statistics of the firms included in the quantitative analysis are presented in Table 9.1. With regard to the control variables, the median age of firms was 38 years, and they employed on average between 20 and 49 employees (ordinal variable of 3 = 20–49 employees). Twenty-five percent of firms operated in manufacturing industries, 12% in construction, 10% in retail, 9% in wholesale, and 8% in agriculture. The remaining firms were spread across a range of other smaller industries (classified as “other” and used as the control group for regression analysis). Fifty-nine percent of firms were second or later generation controlled family businesses (that is, 41% were first generation family controlled).

With regard to business governance mechanisms, 45% had a formal board of directors and of these firms, only 3% had undertaken an independent assessment of board performance. Twenty-four percent had a formal advisory board in place. Fifty-one percent undertook a formal assessment of managerial performance while 26% had a formal policy for the selection, remuneration and promotion of family employees. Thirty-six percent had a formal shareholders’ agreement in place, 48% formally reported business matters to all shareholders while 42% formally reported business matters to family members.

With regard to family governance mechanisms, 21% had a family council in place while 16% had developed a family constitution/code of conduct. Twelve percent had a process in place for welcoming, educating and inducting family members into the business while 37% had a process for incorporating the family’s vision and goals into the business planning process. With regard to family governance of management and ownership succession, 18% had documented a unifying strategy for the future of the family business. Thirty-one percent had documented a succession plan for the current CEO while 20% had a documented succession plan in place for other family members in key leadership positions. Thirty percent had an estate plan in place (including how ownership will be distributed).

9.5.2. Effect of Governance Mechanisms on Family-Oriented Performance

Table 9.2 presents the results of the regression analysis of the effect of the 16 different governance mechanisms on family-oriented performance. The composite measure of family-oriented performance included measures of the level of achievement of family-related goals such as increasing family wealth, quality of work life, time to be with family, security for the family, independence, family cohesiveness, family respect in the community, and satisfaction/fulfilment.

Business governance mechanisms: it was found that having a formal advisory board ($p < 0.10$), policy for the employment, remuneration and promotion of family members ($p < 0.10$), and formal reporting of business matters to family members ($p < 0.01$), were all positively and significantly associated with family-oriented performance.

Table 9.1. Descriptive Statistics of Firms Surveyed.

Variable	Mean	Median	Min.	Max.	S.D.
Formal board of directors	0.45	0.00	0.00	1.00	0.50
Formal board x Independent assessment of board	0.03	0.00	0.00	1.00	0.18
Formal advisory board	0.24	0.00	0.00	1.00	0.43
Evaluation of management performance	0.51	1.00	0.00	1.00	0.50
Policy for selection, remuneration & promotion of family employees	0.26	0.00	0.00	1.00	0.44
Shareholders' agreement	0.36	0.00	0.00	1.00	0.48
Formal reporting of business matters to shareholders	0.48	0.00	0.00	1.00	0.50
Formal reporting of business matters to family members	0.42	0.00	0.00	1.00	0.49
Family council	0.21	0.00	0.00	1.00	0.41
Family constitution / code of conduct	0.16	0.00	0.00	1.00	0.36
Process for welcoming, educating, inducting family members into business	0.12	0.00	0.00	1.00	0.33
Process for incorporating family vision / objectives into business planning	0.37	0.00	0.00	1.00	0.48
Succession plan - Unifying strategy for the future of the business	0.18	0.00	0.00	1.00	0.38
Succession plan - CEO	0.31	0.00	0.00	1.00	0.46
Succession plan - Other senior positions held by family members	0.20	0.00	0.00	1.00	0.40
Succession plan - Estate plans (inc. how ownership will be distributed)	0.30	0.00	0.00	1.00	0.46
Firm age	47.09	38.00	1.00	184.00	36.44
Firm size	3.24	3.00	1.00	7.00	1.61
Industry_Agriculture	0.08	0.00	0.00	1.00	0.27
Industry_Construction	0.12	0.00	0.00	1.00	0.33
Industry_Manufacturing	0.25	0.00	0.00	1.00	0.43
Industry_Retail	0.10	0.00	0.00	1.00	0.30
Industry_Wholesale	0.09	0.00	0.00	1.00	0.29
Generation in control: 1st vs. 2nd+	1.59	2.00	1.00	2.00	0.49

Family governance mechanisms: a process for welcoming, educating, inducting family members into the business was positively and significantly associated ($p < 0.10$) with family-oriented performance. All four mechanisms for governing future management and ownership transitions were significantly and positively associated with family-oriented performance (documented unifying strategy for future of family business, $p < 0.01$; documented CEO succession plan, $p < 0.01$; documented succession plan for other family leaders, $p < 0.05$; documented estate plans, $p < 0.01$).

Control variables: family businesses operating in the wholesale industry were significantly more likely to experience higher family-oriented performance ($p < 0.05$ in all cases).

9.5.3. Effect of Governance Mechanisms on Financial Performance

Table 9.3. presents the results of the regression analysis of the effect of the 16 different governance mechanisms on financial performance. The composite measure of financial performance included measures of performance in outcome-based financial goals, namely, profitability, cash flow, return on sales, and return on assets.

Business governance mechanisms: it was found that having a formal board of directors that is independently assessed for effectiveness/performance was positively and significantly ($p < 0.10$) associated with financial performance. Also, having a formal advisory board was positively significant ($p < 0.05$). Formal reporting of business matters to shareholders and family members was positively and significantly associated with financial performance ($p < 0.05$ and $p < 0.01$, respectively).

Family governance mechanisms: having a family council, a family constitution and a process for welcoming, educating, inducting family members into the business were all positively and significantly associated with financial performance (all $p < 0.05$). With regard to governing future management and ownership transitions, having documented succession plans for the CEO and family members in senior leadership roles were both positively and significantly associated with financial performance ($p < 0.05$ and $p < 0.10$, respectively).

Control variables: there is some support for the positive and significant association between firm size and financial performance ($p < 0.10$). Family businesses operating in the manufacturing industry were significantly more likely to experience lower financial performance (min $p < 0.05$ in all cases) and is consistent with the decline of the Australian manufacturing sector due to well-documented poor cost competitiveness.

9.6. Discussion

In the absence of adequate governance mechanisms, business goals can be placed in jeopardy because family goals may not be met. As Moores (2009, p. 8) notes, “The lack of effective governance structure in family business to help sort out

Table 9.2. Regression Analysis of Family-Oriented Performance.

FAMILY-ORIENTED PERFORMANCE	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β
Formal board of directors	0.039																	
Formal board x Independent assessment of board	-0.005																	
Formal advisory board	0.095*																	
Evaluation of management performance	0.023																	
Policy for selection, remuneration & promotion of family employees	0.102*																	
Shareholders' agreement	0.043																	
Formal reporting of business matters to shareholders	0.049																	
Formal reporting of business matters to family members	0.164***																	

(Continued)

Table 9.2. (Continued)

FAMILY-ORIENTED PERFORMANCE	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β
Family council																
Family constitution / code of conduct															0.049	0.051
Process for welcoming, educating, inducting family members into business																0.100*
Process for incorporating family vision / objectives into business planning																0.066
Succession plan - Unifying strategy for the future of the business																0.165***
Succession plan - CEO																0.169***
Succession plan - Other senior positions held by family members																0.135**

(Continued)

Table 9.2. (Continued)

FAMILY- ORIENTED PERFORMANCE	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β
Succession plan - Estate plans (inc. how ownership will be distributed)																			0.163***
Firm age	0.059	0.054	0.039	0.090	0.051	0.027	0.063	0.078	0.082	0.056	0.057	0.056	0.057	0.048	0.065	0.056			
Firm size	0.039	0.048	0.057	0.008	0.056	0.003	0.016	0.029	0.023	0.051	0.043	0.043	0.045	0.038	0.033	0.032			
Industry_ Agriculture	-0.030	-0.043	-0.053	-0.024	-0.048	-0.040	-0.031	-0.044	-0.028	-0.028	-0.027	-0.024	-0.029	-0.026	0.032	-0.034			
Industry_ Construction	-0.014	-0.022	-0.052	-0.034	-0.022	-0.019	-0.019	-0.040	-0.002	-0.013	-0.012	-0.004	-0.009	-0.012	0.014	-0.009			
Industry_ Manufacturing	-0.050	-0.050	-0.045	-0.064	-0.038	-0.076	-0.041	-0.066	-0.034	-0.036	-0.038	-0.033	-0.034	-0.036	-0.060	-0.032			
Industry_Retail	0.042	0.013	0.002	0.008	-0.012	0.024	0.022	0.001	0.004	0.044	0.042	0.050	0.046	0.052	0.033	0.046			
Industry_ Wholesale	0.146***	0.151**	0.143**	0.151**	0.145***	0.148**	0.164***	0.147**	0.167***	0.157***	0.153***	0.148**	0.148**	0.139**	0.135**	0.143**			
Generation in control: 1st vs. 2nd+	-0.059	-0.087	-0.059	-0.111*	-0.076	-0.101	0.094	-0.078	-0.112*	-0.079	-0.080	-0.075	-0.080	-0.077	-0.079	-0.084			
R2	0.036	0.040	0.037	0.051	0.038	0.051	0.042	0.043	0.069	0.040	0.040	0.047	0.042	0.062	0.065	0.061			
F statistic	1.803*	1.477	1.349	1.866*	1.510	1.796*	1.524	1.606	2.601***	1.521	1.669	1.821*	1.597	2.405***	2.570***	2.361**			
Observation	396	331	324	324	327	307	321	329	326	340	340	340	340	337	340	340	337		

*** $p < 0.01$.

** $p < 0.05$.

* $p < 0.10$.

issues over the control and management of the family business can all too easily give rise to unnecessary intra-family conflict.” Family business must therefore be cognisant of the value of the business for both the family and the business. As [Chua et al. \(2003, p. 331\)](#) argue,

For a business to be sustainable as a family firm in the highly competitive global market of the twenty-first century there must be a synergistic and symbiotic relationship between the family and the business. The business must perform in a way that creates value for the family and the family must add value to the business in a manner that is impossible without family involvement.

The findings from this study suggest that both family and business governance mechanisms are associated with both the financial performance of the business as well as the achievement of family-oriented goals which includes aspects such as family cohesiveness, independence, and identity in the community.

On the one hand, and perhaps intuitively, one would have expected the results to indicate that business governance mechanisms are important for financial performance of the business while family governance mechanisms are important for family-oriented performance. However, the findings of this study suggest that some family and business governance mechanisms are positively and significantly associated with both financial and family-oriented performance. For example, establishing a formal advisory board was positively and significantly associated with both financial and family-oriented performance. Also, establishing a succession plan for the CEO and other key family members was positively and significantly associated with both financial and family-oriented performance.

On the other hand, one would have intuitively expected that the two most advocated family governance mechanisms, having a family council and development of a family constitution, would be positively and significantly associated with family-oriented performance. However, these mechanisms were found not to be associated with family-oriented performance. In contrast, a family council and a family constitution were positively and significantly associated with the financial performance of the business.

The above findings suggest that the interrelationship between governance (of the business and of the family) and performance is much more complex than that previously observed. As highlighted in the limitations section of this chapter, one of the challenges with the approach taken in this study is how each governance mechanism is examined in isolation. Such an approach ignores the possibility that effective governance is achieved through the combination of governance mechanisms. The approaches by [Berent-Braun and Uhlener \(2012\)](#) in developing a family governance index represent an interesting development and a possible direction for future research in examining the effect of family governance on family business outcomes.

Table 9.3. Regression Analysis of Financial Performance.

FINANCIAL PERFORMANCE	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β
Formal board of directors		0.052															
Formal board x Independent assessment of board			0.103*														
Formal advisory board				0.123**													
Evaluation of management performance					0.074												
Policy for selection, remuneration & promotion of family employees						-0.010											
Shareholders' agreement							0.012										
Formal reporting of business matters to shareholders								0.129**									
Formal reporting of business matters to family members									0.182***								
Family council										0.126**							
Family constitution / code of conduct											0.138**						

(Continued)

Table 9.3. (Continued)

FINANCIAL PERFORMANCE	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β
Process for welcoming, educating, inducting family members into business															0.131**	
Process for incorporating family vision / objectives into business planning															0.041	
Succession plan - Unifying strategy for the future of the business															0.079	
Succession plan – CEO															0.112**	
Succession plan - Other senior positions held by family members															0.105*	
Succession plan - Estate plans (inc. how ownership will be distributed)																-0.017
Firm age	-0.037	-0.066	-0.052	-0.039	-0.061	-0.057	-0.055	-0.044	-0.053	0.062	-0.059	-0.059	-0.054	-0.050	-0.062	-0.050
Firm size	0.125**	0.094	0.084	0.080	0.056	0.107*	0.103*	0.070	0.056	0.096*	0.074	0.096*	0.107*	0.107*	0.103*	0.096*
Industry_Agriculture	-0.025	-0.054	-0.053	-0.057	-0.051	-0.076	-0.061	-0.056	-0.066	-0.035	-0.034	-0.029	-0.035	-0.035	-0.041	-0.038

(Continued)

Table 9.3. (Continued)

FINANCIAL PERFORMANCE	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β	β
Industry_Construction	-0.030	-0.041	-0.023	-0.043	-0.026	-0.060	-0.040	-0.042	-0.023	-0.020	-0.019	-0.014	-0.026	-0.030	-0.035	-0.028	-0.033
Industry_Manufacturing	-0.135**	-0.179***	-0.141**	-0.187***	-0.160***	-0.198***	-0.179***	-0.190***	-0.187***	-0.152**	-0.159**	-0.153**	-0.158**	-0.159**	-0.167***	-0.177***	-0.160**
Industry_Retail	-0.019	-0.044	-0.032	-0.025	-0.017	-0.031	-0.045	-0.012	-0.011	-0.002	-0.009	-0.003	-0.014	-0.017	-0.022	-0.021	-0.024
Industry_Wholesale	-0.007	-0.001	0.009	0.000	0.004	-0.003	0.005	-0.006	0.003	0.026	0.018	0.005	0.006	0.005	-0.002	0.008	0.008
Generation in control: 1st vs. 2nd+	0.030	0.067	0.069	0.066	0.081	0.085	0.068	0.039	0.077	0.057	0.055	0.066	0.061	0.060	0.063	0.062	0.062
R2	0.029	0.042	0.045	0.056	0.040	0.048	0.041	0.054	0.074	0.053	0.055	0.055	0.040	0.044	0.051	0.049	0.038
F statistic	1.470	1.560	1.787*	2.085**	1.479	1.672*	1.482	2.024**	2.833***	2.070**	2.152**	2.139**	1.533	1.659*	1.956**	1.888*	1.428
Observation	396	331	324	324	327	307	321	329	326	340	340	340	340	337	340	340	337

*** $p < 0.01$.

** $p < 0.05$.

* $p < 0.10$.

9.7. Limitations

Firstly, because this study employed a cross-sectional as opposed to a longitudinal data collection method, we cannot attest to the causal nature of the statistically significant associations between governance mechanisms reported. Secondly, as each governance mechanism was examined in isolation while controlling for firm-level characteristics, we are unable to ascertain whether effective governance is achieved through the combination of governance mechanisms. Finally, as this study was based on Australian family firms, the findings reported may not be generalizable to other geographical contexts which are subject to different governance models and legislation.

9.8. Implications for Practice

There are many implications that emerge from this research. Arguably of greatest importance is the need to value, and hence encourage family businesses to implement, effective family governance mechanisms that assist business families in achieving both their financial and family-oriented goals. The findings from this study highlight that the relationship between governance and family business performance is much more complex than that acknowledged in prior research. Rather than simplistically adopting mechanisms in isolation (e.g., a board or a family council), careful consideration needs to be given by both family business members and their advisors about how a range of business and family governance mechanisms can be used together to drive family business performance. The research here shows that there is an “emotional value” in owning a family firm (Zellweger & Astrachan, 2008) that cannot be disregarded. Thus, education for both family members and their advisors is needed to respond to this challenge, so that family firms are better able to manage these dynamics so that they can further the sustainability and performance of the family business.

9.9. Implications for Future Research

For too long studies of family business governance have been preoccupied with understanding the relationship between corporate governance and financial outcomes. The research shows that scholars need to extend their theoretical lens beyond perspectives such as agency theory and stakeholder theory in analyses of governance. Instead, scholars need to engage not only with theories such as behavioral agency (Gómez-Mejía et al., 2007), but also perspectives that seek to untangle the influence of emotions on family business decision-making. This may include drawing on theoretical insights such as emotional ownership (Björnberg & Nicholson, 2012) and family business ownership (Brundin et al., 2014), both of which seek to conceptualize how decision-making in family business not only reflects financial imperatives of corporate governance but – as we have shown here – the socioemotional goals of the family.

Future research should seek to better untangle how the specific components of family business governance affect family business performance. The findings of

this study suggest that a family council and a family constitution improve financial performance of the business but not the achievement of family-oriented goals. Further research is required to further understand why this might be including whether particular governance mechanisms in combination are more effective in improving family business performance. However, there may be different effects in accordance with different strategies of family council or constitution on family business performance. Importantly, while we have presented the outcomes of quantitative analysis, a longitudinal qualitative approach will help to nuance the aspects of family business governance in terms of the effect on performance. For instance, how conflict is handled and how matters of succession are also embedded in processes of family business governance will affect how mechanisms where family members have to engage with each other (such as in a family council) are affected by these matters, which in turn can affect performance achieved.

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Chapter 10

The Family Constitution as an Instrument of Corporate Governance in Family-Owned Companies*

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Abstract

In recent years, the corporate governance structures of family businesses have become increasingly important to the public. This is due not only to the increasing number of corporate successions but also to the (still) lower degree of formalization of corporate governance in family-owned companies. In this chapter, the authors analyze theoretical and empirical findings on family governance with a focus on family constitution and present the results of their own exploratory empirical survey conducted in 2017.

Keywords: Family constitution; motives for introducing the family constitution; motives for not introducing the family constitution preparation process of the family constitution; survey data; Germany

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10.1. Introduction

In recent years, research and practice in business administration have increasingly been devoted to family businesses, as these have been neglected by business administration in the past decades (Priem & Alfano, 2016). In addition to the special economic and business management features, i.e., corporate management in general, financing, company succession, external management and other business management functions, work on the special features of corporate governance in family-owned companies is also increasingly being published. This is of increasing interest not only in Germany, but also in the international environment (Daspit et al., 2017).

For the German situation of family-owned companies, there is an interesting area of conflict: On the one hand, family-owned companies are regarded by the general public as particularly successful, good employers who operate successfully on a sustainable basis. On the other hand, recent cases such as Aldi, Oetker, and Tönnies have also become known in which disputes within the family have had a negative impact on the respective companies.

In this area, both classic instruments of corporate governance and special instruments of family governance can contribute to the reduction of information asymmetries. One of these mechanisms is the family constitution. This term is used in this chapter as a collective term for documents that can be referred to in practice as a family code or family mission statement, for example, and which can be used as a basis for discussing structures and strategies in the family context. Several studies have already been carried out here on family businesses (Fleischer, 2016; Mengers & Prigge, 2017).

This chapter examines the theoretical and empirical findings about the family constitution. The further progress of the contribution is as follows. First, the mechanisms of corporate governance in family-owned companies are briefly described before an introduction to the family constitution is given. Section 4 contains the empirical findings. The chapter concludes in Section 5 with a summary.

10.2. Mechanisms of Corporate Governance in Family Businesses

In principle, corporate governance functions differently in family-owned companies than in non-family businesses, as the additional “family” system joins the established “company” and “management” systems. As a result, this leads to changed principal-agent-constellations, which depend on the number of persons, but also on the number of generations, family relationships, and the distribution of rights of disposal. In principle, three interest situations can be distinguished (Becker & Ulrich, 2008):

- The owner-managed company, which is managed by a person who holds all shares in the company, does not have any principal-agent conflicts;
- In the family business, in which $n > 1$ persons from the family/several family tribes are involved in ownership and management, there are multiple conflicts of interest between persons within and outside the family;

- In an externally managed company in which the family has withdrawn from operational management, there are not only the “typical” principal-agent conflicts, such as the monitoring of external management, but also the question of which persons from the family or the participating tribes may be represented in the company.

As a result, asymmetries appear in the three configurations mentioned above, which are negative for the company’s added value and therefore have to be “managed.” This can be done by means of a catalogue of governance instruments, which are themselves liable to pay costs but can reduce agency costs.

In general, corporate governance is less formalized in family businesses than in non-family businesses (Klein, 2009). Written or formal mechanisms are partly or completely replaced by the corporate culture and the cohesion of the actors in the company, so that the lower degree of formalization of corporate governance does not pose a major problem for quite simply structured family-owned companies. However, given the increasing complexity caused by the size of the company, the product portfolio, internationalization processes or, above all, the increasing number of, or conflicts of interest between, family members, these informal mechanisms may reach their limits, which is why special instruments such as an advisory board, a shareholders’ committee or other family-related measures (e.g., family office, family activity, and family philanthropy) can be supplemented. These instruments also include the family constitution, which is briefly discussed below.

10.3. Effects of the Family Constitution in Business Practice

The family constitution is a written document that contains the fundamental convictions and principles of the entrepreneurial family. It is an identity-forming model and its principles of action are intended to regulate the relationships between family members and the interaction between family and company. This instrument has its origin in the Anglo-American legal system, where the term “Family Business Protocol” has become established (Brenes et al., 2011). In Germany, the family constitution is often referred to as the “Family Charter,” “Family Protocol,” or “Owner’s or Family Strategy” (Kirchdörfer & Lorz, 2011).

The family constitution is informal. In the first step, it is not legally binding or enforceable and is not formulated in a legally precise manner. It is written in a generally understandable way and can rather be declared as a declaration of intent, with a moral binding effect at most. In its nature and function, it is to be distinguished from the social contract. It precedes other treaties. Thus, many of their rules result in contracts of association, inheritance or marriage, making them legally binding and enforceable. In order to avoid problems with the legal interplay of the rules and regulations with different legal status, the contents of the family constitution should be clearly formulated and, if possible, should appear in identical terms in contractual agreements. In the event of deviations, the family constitution clearly has no legal provisions. However, it often has an indirect influence on the interpretation of other treaties and can thus possibly affect their regulations.

The family constitution is an opportunity for the entrepreneurial family to reach a consensus (Zellweger & Kammerlander, 2015). Raising awareness of matching goals strengthens the family. But also the understanding of conflicting goals can be used to counteract conflicts in a clarifying way and to preventively counteract disputes. All family members are included. Decision autonomies are removed, arbitrariness and abuse of power are reduced (Baus, 2013).

The road to a family constitution entails further risks. There is a danger that the family constitution will be filled in with complex topics that should be reserved for the articles of association and that they will be regarded as a substitute for it. The regulations of the family constitution then run into a void due to their legal non-binding nature and are not necessarily effective. Furthermore, differences between the family constitution and the articles of association may also give rise to legal problems. A further danger lies in the fact that goals are set without reference to the entrepreneurial reality or regulations overshoot goals. As positive as the dismantling of the information asymmetries is, individuals can lose in this process. They may have less power, a different position or less financial support as a result of new regulations.

According to the results of an empirical study by the INTES Institute, older and larger family-owned companies with a diversified shareholder structure and external management as well as supervisory bodies dispose more often of a family constitution (Schween et al., 2011).

10.4. Own Empirical Findings

10.4.1. *Characterization of Survey and Sample*

The quantitative-empirical survey conducted in January 2017 is based on the data of 65 family-owned companies in Germany. In order to obtain the data, a computer-assisted questionnaire was provided in the form of an online survey, enabling a large number of potential participants to be reached. The information on the companies and respondents was completely anonymous, and the standardization of the questionnaire ensures the comparability of the results. The survey was based on the 1,000 largest family-owned companies in Germany according to “DIE DEUTSCHE WIRTSCHAFT.” Here, the addresses of 986 companies could be identified (<http://die-deutsche-wirtschaft.de/die-liste-der-1000-groessten-familienunternehmen-in-deutschland>; last accessed December 7, 2021). The return of 65 completed questionnaires corresponds to a response rate of 6.59%.

For the present study, a family business was defined as follows: The company has more than 20 employees and the founder or a member of the founding family leads the company or has a dominating influence in the supervisory or advisory board.

The economic sector, legal form or turnover do not constitute sound selection criteria within the scope of this survey, as no representativeness was sought. The various structural features of the survey show the diversity and individuality of family businesses. The arithmetic mean of the number of employees and turnover is 3,329 and €730 million, respectively. The majority (57%) of the participating

companies are attributable to the manufacturing industry. Most companies are incorporated as a GmbH (35%) or as GmbH & Co. KG (30%). The youngest companies are run by the first generation whereas the oldest companies are in the hands of the ninth generation. The ownership structure ranges from sole proprietor to stock exchange listing. However, all participating companies have strong family ties, 90% of the companies are wholly owned by a family or an individual and at the same time completely controlled by a family or an individual. For approximately 30% of the companies surveyed, ownership and management are identical (owner-managed), for 45%, at least a part of the owner family represents the management level (family-managed) and for a quarter of the respondents, the family controls the outside management via a supervisory board (family-controlled).

The results of the investigation were evaluated narratively in the sense of [Alveson \(2003\)](#). This means that in the following important statements of respondents by highlighting the citations in double quotation marks.

10.4.2. Characteristics and Management of Family Businesses

The family-owned companies surveyed are characterized by “flat hierarchies” and the associated “short decision-making paths.” A specific behavior is their “long-term orientation” and “thinking in generations.” In addition to the “awareness of tradition,” a “good working atmosphere” and “employee friendliness,” the companies generally perceive themselves as “innovative” and, with regard to the workplace, as “safe.”

The companies have a “reserved, self-confident appearance,” with a “healthy distance to fashion trends.” They are “down-to-earth in their thinking and acting” and they are guided by “strong values,” an “appreciation” and a “focus on the essentials,” “products and customers are at the centre” and “high quality of products and services” come before “return” in their companies. For the employees, there would be a “variety of tasks through broad diversification” with “plenty of scope for new projects.” The family-owned companies frequently have a “strong regional link,” operate “regionally” and “consolidate Germany as a business location.” In this way, they assume a “high level of social responsibility for the people in the region.” All of the above-mentioned characteristics can be described as characteristic for family-owned companies, but they are not unique to them.

The management structure of family-owned companies is often oriented toward the managing (family) partners. The respondents are also characterized by strong personal ties. People talk about a “personal bond,” “close contact with the workforce,” “appreciation,” and “strong values.” The “executives are close to the employees,” the management is “visible and responsive.” There is a “high level of delegation” and a “leadership through trust.” “Humanity in dealing with each other” is also often mentioned. Employees often perceive themselves as “part of the family” who bring in their “skills for the benefit of the company.” However, it also points out possible weaknesses in companies, such as “excessively high fluctuation among managers” or “a fairly high workload because resources are being kept scarce.” Sometimes “decisions in difficult, painful structural decisions are delayed too long, which often discourages top performers.”

10.4.3. Corporate Governance and Family Governance in Family Businesses

For the companies surveyed, the term corporate governance is more commonly used overall and there are more instruments in existence. About 97% are familiar with the term corporate governance in the corporate context and almost three quarters of the companies have professionalized their management and monitoring structures in the form of corporate governance. In concrete terms, this means that bodies such as a shareholders' meeting, an advisory board or a supervisory board are established within the company. On average, the companies surveyed have set up two bodies, with 38% of the respondents representing a combination of shareholders' meeting and advisory board.

Only around 70% are familiar with the concept of family governance, while just under a quarter professionalized organization of the owner's family. A quarter of the companies surveyed with a family governance structure have fixed family values, a partnership agreement or a family meeting. Half of them have further education programmes (family education), common non-profit activities, such as a foundation, or conflict resolution mechanisms. One-third of the respondents have established a Family Council or Family Office. Approximately one-sixth uses a communication platform within the company, such as an app or a newsletter. On average, respondents have established five family governance mechanisms.

10.4.4. Family Constitution as an Element of Family Governance

Within the framework of family governance, many companies adhere to informal rules. They see themselves as a "community of values where the unwritten word counts." Other companies document their values, goals, and rules in a written family constitution.

More than half (57%) of all companies surveyed have drawn up a family constitution. Although this topic is still relatively new in the scientific literature, 72% of companies with a family constitution already have regulations in place for between 1 and 10 years. Companies with a family constitution are not significantly larger or older than those without this set of rules. It is also not possible to establish a correlation with the generation, the age of the company or the number of employees.

The most important motives for the introduction of a family constitution include safeguarding the company's future (28%), conflict prevention (17%), the question of filling positions in the company (17%), and succession planning (14%). Otherwise, determining who is a member of the entrepreneurial family (11%), the qualifications required to fill positions with family members (8%), the withdrawal of (family) shareholders (3%), and the financing (3%) are motivations for drawing up a family constitution. Overall, 97% of the entrepreneurial families hope for an emotional added value through the family constitution. Only 3% of the entrepreneurial families primarily aim for an economic increase in the value of the company. The expectations of the family constitution were fulfilled in all participating companies with a gradation of "rather yes" (50%) and "yes, totally" (50%).

The preparation process itself is important for the family of entrepreneurs. During the preparation of the family constitution, the owners get to know each other better with their interests, expectations, strengths, and weaknesses and have the opportunity to take preventive action against conflicts. Two-thirds (67%) of the participating companies received the impetus for the elaboration from the shareholders themselves. Otherwise, family members on the board of directors (11%), the family tradition (11%), or the advisory board (11%) were decisive for drawing up a family constitution. The process of drafting a family constitution took between six and twelve months for two-thirds of those surveyed (67%).

A family constitution must be filled with life, so that it brings strategic benefits and emotional added value. It is also advisable to adapt it regularly to the individual and constantly changing situation of the entrepreneurial family. In 89% of the companies surveyed who have a family constitution, the values, goals, and regulations of the family constitution are actively exemplified. 11% would like to see even greater compliance. Three-quarters of those surveyed have already reviewed their family constitution and adjusted it if necessary. The first adjustment takes place on average after three to four years.

Less than half (45%) of companies that do not have a family constitution still want to introduce such a set of rules. The instrument of family constitution is also generally considered beneficial for family businesses that do not have such an instrument. As a reason why no regulatory framework has been developed, half of them state a lack of information, with 36% having too little information about the family constitution as an instrument of family governance and 14% having too little information about the preparation process. 21% do not see any relevance for their company, for example “because the company is under patriarchal management in the first generation and the family constitution is not planned until the next generation,” because “the company itself is too small for such an instrument,” or the potential contents of the family constitution are “regulated by the supervisory board.” No relevance is also mentioned because, for example, a “small family” leads and therefore “little potential for conflict” is seen. One participant says: “Paper is patient. Life is always more colourful than you think....” In each case, 7% point to a lack of expertise in drawing up, lack of time or an extensive partnership agreement. For no company surveyed, a high level of effort or the costs associated with the preparation of the survey is a reason against the family constitution.

10.5. Recommendations for Action and Conclusion

This section links this chapter with extant theoretical and empirical findings on family governance and family constitution. The empirical study on which the chapter is based shows that, in contrast to the study conducted by [Schween et al. \(2011\)](#) for example, there are no effects of contextual factors such as company size, industry sector, or the existence of a supervisory board. The family constitution seems to have prevailed at least in the sample.

At the same time, respondents to the study still list the disadvantages of an additional set of rules that may conflict with the existing company agreement.

Certainly, the family constitution is not a panacea, it must always be adapted to the situation and supplemented by other mechanisms such as mediation.

From a theoretical point of view, this contribution shows that the assumption often mentioned in the literature, that stewardship theory prevails over principal-agent theory in family businesses, does not necessarily have to be correct, because the family constitution can also be interpreted as a reaction to an increase in principal-agent conflicts within the family (Siebels & zu Knyphausen-Aufseß, 2012).

The empirical study outlined in this chapter is itself subject to several restrictions: On the one hand, it was only carried out for larger family-owned companies at one time and only one respondent was interviewed for each company. Since the family constitution is an individual issue, a qualitative, long-term field study approach for the assessment of mechanisms of action for the future would also be a promising approach to the further development of theory and empiricism.

In practice, several conclusions can be drawn from the remarks in this chapter: The family constitution has become an established tool for the larger family-owned companies. The participants in the study questioned whether this is also always the case for smaller family-owned companies, since they indicated a high degree of complexity and the existence of several generations as a basic prerequisite for meaningfulness.

Nevertheless, however, the question arises as to whether and to what extent the informal mechanisms of trust in family businesses are affected by the family constitution. In addition to the new theoretical approach of Socioemotional Wealth, this problem area should be one of the focal points for further research work on family governance and family constitution.

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Chapter 11

Discussion Report Part 3: Managerial Research II: Survey and Quantitative Analyses

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Chris Graves/Donella Caspersz/Jill Thomas: An Examination of the Relationship between Governance Mechanisms and Performance: Evidence from the Australian Family Business Context¹

A management scholar and consultant asked Graves who the respondents of the survey were. Graves clarified that there was only a single respondent per firm, ideally the CEO. The management scholar and consultant continued to consider whether that was not biased in those cases in which the CEO was not a family member. Graves answered that their primary goal was to ask key decision makers who did not have to be necessarily family members. He conceded that this was a limitation of the study. But he added that they only asked for the presence of a family constitution, which makes it less severe. A legal scholar wanted to know how Graves and his colleagues defined the term non-economic wealth. Graves explained that they defined it as well-being, particularly the non-financial objectives of well-being. Thus, it was similar to the objectives of the socioemotional wealth approach. A managerial scholar put forward two topics regarding the empirical study: First, whether it made sense to further differentiate between different conflict resolution mechanisms. Second, whether it was an option to

¹As the chapter by Ulrich and Speidel was not presented during the conference, it was not part of the discussions.



place weights on different mechanisms. With respect to the first point, Graves said that he had to check the data again and think about it. Addressing the second point, Graves agreed that this could be an interesting idea, but neither Graves nor the scholar who raised the issue had any ad hoc suggestions for such a weighting scheme.

Part 4

Legal Research

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Chapter 12

Facets of Family Constitutions: Conceptual Origins, Practical Approaches, and Legal Implications

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Abstract

The modern family constitution is a written declaration summarizing a process of agreement and decision-making within an entrepreneurial family regarding the motives, guidelines, and regulations for the family members' cooperation within the family and the family business association. This chapter exposes facets of family constitutions from a historical and a practical point of view. In order to do so, it begins with a review of the predecessors and origins of family constitutions. Subsequently, focusing especially on the interplay between a family constitution and the family business' binding legal agreements, it describes four forms of family constitutions that have evolved from different consulting approaches in practice. The chapter concludes with some legal implications.

Keywords: Family constitution; family business governance; conceptual origins of the family constitution; four types of family constitutions; legal classification of family constitutions

Family Firms and Family Constitution, 179–193



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12.1. Exposing the Family Constitution Chameleon

One of the first German articles to explore family constitutions from a legal perspective conceived the image of a family constitution as a chameleon (Gläßer, 2014, p. 228). This holds true in more than one way: *Verbally*, the phenomenon might also be termed as a family mission statement, family agreement, family charter or protocol (see Suess, 2014, p. 140 Fn. 3; Botero et al., 2015, p. 219; McClain, 2006, p. 835). *Factually*, family constitutions span a broad range: from a concise statement of shared beliefs, for example between the founder and his successor, to an elaborate codification of family business governance mechanisms in a cousin's confederation meant to unify a multitude of divergent shareholders and their relatives – no two family constitutions appear alike (see Fleischer, 2016a, p. 48). *Conceptually*, the idea merges different historical and contemporary origins.¹ *Internationally*, family constitutions have evolved in several legal systems to suit specific needs, for instance, the *patto di famiglia* (Fleischer, 2016a, p. 47; 2016b, p. 1512), which intends to rectify a weakness in Italian succession law. *Legally*, family constitutions and even provisions within the same document might vacillate between enforceable obligations, moral commitments, and social agreements (see Fleischer, 2016b, p. 1515 f.; Uffmann, 2015, p. 2448 ff.). They have thus been described as a governance device of elusive legal nature.²

Rather than providing a clear-cut definition of a family constitution in legal terms, this chapter attempts to expose facets of family constitutions from a historical and a practical point of view.³ In order to do so, it begins with a review of the predecessors and origins of family constitutions (Section 12.2). Subsequently, focusing especially on the interplay between a family constitution and the family business' binding legal agreements, it describes four forms of family constitutions that have evolved from different consulting approaches in practice (Section 12.3). They are not meant as a comprehensive classification, but rather as models or types that highlight certain characteristics and purposes of family constitutions. This part draws on discussions with German and Austrian family business consultants as well as input from a joint interview study conducted by the Max Planck Institute for Comparative and International Private Law, Hamburg, and the HSBA Hamburg School of Business Administration. The chapter concludes with some legal implications (Section 12.4).

¹See below 12.2 and Fleischer (2022) in this volume.

²See Fleischer (2016b). “schillernde[...] Regelungsform” (1509), “chamäleonartiges Regelungsinstrument”(1515).

³This chapter summarizes the preliminary research results of the author's dissertation; for final findings and further details, see Bong (2022).

12.2. Conceptual Origins

12.2.1. House Laws and *fideicommissum* – Preserving the *splendor familiae*

The House Laws of royal families are recognized as the earliest ancestors of modern family constitutions.⁴ Both share some similarities in purpose and content. The House Laws evolved as a means to preserve the power and wealth of royal families in late medieval Europe, especially in German territories of the Holy Roman Empire (see Eckert, 1992, pp. 36 ff., 46 ff., 54 ff.; Schulze, 1851, pp. 69 ff., 229 ff.): The royal families' prerogatives initially depended on an appointment to a royal office by the monarch. But, as the monarch developed a practice of appointing the relatives of the current officeholder as successors, the prerogatives soon became linked to the possession of certain lands and estates (see Pütter, 1786, pp. 163 ff., 165; Schulze, 1871, p. 54 f.). The House Laws' primary purpose was to keep these estates in the possession of the family by preventing their fragmentation over the course of generations.⁵

To this end, multiple legal acts and agreements within the family were necessary to depart from the then contemporary practice of dividing property between multiple heirs.⁶ At first, these legal acts had a consensual, contractual basis. Collectively, they ensured that the family's wealth was passed on to the first male heir in return for compensation payments, annuities, or easements provided to other inheritors.⁷ The sole heir's role was akin to a trustee for all living and future family members, and his restricted rights as trustee or steward contributed to the other inheritors' acceptance of this succession model for the sake of the family's power and splendor (see von Thunen, 2015, pp. 26, 53) – for the sake of the *splendor familiae*,⁸ as it was expressed in contemporary terms. Later, these legal acts, as a whole, matured into traditions and customs, which were eventually codified as House Laws (Brauneder, 2012, p. 805 f.; Dutta, 2014, p. 64; Eckert, 1992, pp. 46 ff., 54 f.; von Salza & Lichtenau, 1838, p. 42; von Thunen, 2015, p. 39). Also, their contractual, consensual origin was soon replaced by the family patriarch's dominance and his legal authority to stipulate the laws of the house (see Brauneder, 2012, p. 806).

⁴One of the first to draw inspiration from House Laws was Hennerkes (1998, p. 55 f.); followed by Iliou (2004, p. 163); Fabis (2007, p. 362); Kögel and Seemann (2014, p. 28); with regard to the *fideicommissum*, Kalss and Probst (2013, p. 44 ff. no. 3/16 ff.).

⁵Eckert (1992, pp. 47, 51); further Rosin (1893, p. 333 f.); Dilcher (1990, p. 85).

⁶With regard to contemporary inheritance practices, see Schulze (1871, pp. 42 ff., 46); for a description of different legal acts, see Eckert (1992, p. 46 ff.); see also Kohler (1832, pp. 208 f., 210 ff.); Schulze (1862, p. IX); Beseler (1885, p. 801 ff.); Brauneder (2012, p. 805); von Thunen (2015, p. 24).

⁷See footnote 13.

⁸In the context of daughters' waivers of their rights to inheritance, Eckert (1992, p. 51).

The House Laws inspired the family *fideicommissum*, which evolved as a European composite, also absorbing Roman, Spanish, and Italian influences.⁹ It enabled a testator to structure his inheritance for future generations and to prevent its fragmentation. As an instrument of ordinary civil law, it was available to all citizens with property, and it served the same purpose as the House Laws: to preserve the family's wealth and splendor.¹⁰ In Germany, both devices existed for several centuries, before they were abolished by the legislature in 1939.¹¹

The modern family constitution still aims to preserve the family's wealth – meaning today the family business – and it still addresses similar issues, such as membership in the family or the eligibility to inherit property. But it breaks with its predecessors in an important way as it employs other means to reach these objectives and to develop its contents: The patriarch's dominance is replaced by a family consensus, forged in a strategic planning process.¹²

12.2.2. Strategic Planning – Promoting the *affectio familiae*

Much more recently, the field of management studies in the United States sparked the rise of the modern family constitution.¹³ Building on the work of others (Beckhard & Dyer, 1983, p. 10), John Ward uncovered the benefits of strategic planning for family firms; he identified relevant topics, conceived a planning process and promoted it as a business concept for consultants.¹⁴ In business families, strategic family planning serves today to address various topics and to reach a common understanding before a sensitive topic becomes personalized, for instance, the issue of management succession or the eligibility to become a shareholder.¹⁵ It aims to strengthen the emotional cohesion within the family and to sustain the family's emotional involvement in the business.¹⁶ Adapting an expression from French corporate law, Sebastian Bong summarizes that the strategic planning

⁹See Dutta (2014, p. 54 ff.); Eckert (1992, pp. 63 f., 65 ff.); for more detail see Bong (2022: Kapitel 2 – A.I.2.).

¹⁰Eckert (1992, p. 23); Luig (1998, p. 375); Bayer (1999, p. 66); Kalss and Probst (2013, p. 30 no. 2/76).

¹¹§ 1 Abs. 1 und § 30 Abs. 1 Gesetz über das Erlöschen der Familienfideikommiss und sonstiger gebundener Vermögen vom 6. 7. 1938 (RGBl I, 825/BGBl III 7811-2).

¹²See also Fleischer (2022) in this volume; for more detail, see Bong (2022: Kapitel 2 – A.I.4., Kapitel 2 – A.IV.).

¹³Tracing these origins, Fleischer (2016b, p. 1511).

¹⁴Ward (1986, pp. 6 ff., 56, 135 ff., 155 ff.); Ward (2011, pp. 6 ff., 61, 143 ff., 164 ff.); Ward (1988, p. 106). “With this paper, I hope to stimulate research exploring the special role of strategic planning in the family firm; to provide professionals who serve family businesses with some insights on how families in business approach strategic planning; and, most important, to outline a strategic planning framework for the family business.”

¹⁵Ward (1986, p. 137); Ward (2011, p. 145); succinct Taylor (2014, p. 30). “de-personalise and de-sensitise.”

¹⁶Ward (1988, p. 117); from a more current perspective, Taylor (2014, p. 4); Suess (2014, p. 140 f.).

process intends to promote the *affectio familiae* (Fleischer, 2016b, p. 1515), the affection within the family and for the business. The family constitution, at first, was no more and no less than the embodiment of the results reached during this process. Its effectiveness and persuasiveness were highly dependent on the involvement of all family members in the planning process. This intrinsic connection between the process and the final declaration persists today and merits being considered in the functional and legal analysis of family constitutions.¹⁷

12.2.3. Corporate Governance – Structuring Institutions

It was not until the wave of corporate governance caught hold of family firms that the family constitution grew into a family business governance document. At the turn of the millennium, the corporate governance debate contributed to the development of family constitutions in two ways:¹⁸

Firstly, it imported an institutional perspective that focused on creating family institutions and structuring their interaction with corporate decision-making bodies.¹⁹ Most academic and practical attention focuses on the family meeting, the family council, the corporate board, and their interaction.²⁰ Other institutions on the sidelines, such as family offices, family education and family philanthropy, have become more popular recently. They seek to engage passive shareholders and outside family members in order to enhance belonging by involvement.²¹ And, in line with the concept of enlightened ownership,²² they aim to instill in the members of business families an attitude of stewardship for generations to come.²³

Secondly, the governance discussion came as a critical catalyst for the family constitution's circulation and popularity.²⁴ Inspired by governance codes for

¹⁷Similarly, Montemerlo and Ward (2005, p. 5); more recently, Gläßer (2014, p. 236); Botero et al. (2015, p. 225). “important to view the protocol as a process.”; Holler (2020: 1667 no. 180); for more detail, see Bong (2022: Kapitel 2 – A.III.2.).

¹⁸For more detail, see (Bong: Kapitel 2 – A.II.2.).

¹⁹Illustrative of this development, Neubauer and Lank (1998, pp. 65 ff., 80 ff.). “A family, like any other organization, must have a governance structure if it is to continue to function as an entity.” (71); Aronoff and Ward (1996, pp. 17 f., 29 ff., 65 ff., 76 ff., 85); Carlock and Ward (2001, p. 140 ff.); drawing on these preparatory works, Koeberle-Schmid and Nützel (2005, pp. 41, 45); Eisenmann-Mittenzwei (2006, pp. 162 ff., 178 ff.); Koeberle-Schmid (2008, p. 149); May (2009, p. 116); Bettermann and Henneric (2009, p. 867); compare further McCahery and Vermeulen (2008, p. 153).

²⁰For instance, Aronoff and Ward (1996, pp. 65 ff., 76 ff., 85); Gersick and Feliu (2014, p. 210 ff.); based on a literature review, Suess (2014, p. 139).

²¹See, for instance, Suess (2014, p. 139); Botero et al. (2015, p. 222).

²²Developed by Neubauer and Lank (1998, p. 247 ff.); for the similar concept of “effective ownership,” see Carlock and Ward (2001, p. 119 ff.); compare also Governance Kodex für Familienunternehmen, 4.9.2004, no. 8.2.4.

²³See Aronoff and Ward (2002, p. 2). “Ownership, at its best, means stewardship [...],” explicated further on pp. 27 ff.

²⁴Compare in a more general context McCahery and Vermeulen (2008, p. 156). “The corporate governance hype creates awareness and encourages parties in non-listed companies to improve the governance structure of their firm.”

public firms, private associations in numerous European countries drafted codes tailored to family firms, most of which recommended drafting a family constitution for the governance of the business family.²⁵ Today, these codes are valued in practice as cataloging issues that help to exert party autonomy deliberately, especially in Germany, Austria, and Belgium.²⁶

12.2.4. Convergence in the Concept of Family Business Governance

These origins converge in the modern concept of family business governance. This concept aims to provide an emotional supplement to typical contractual provisions in family businesses, which evolved to perpetuate the company. Its centerpiece is the planning process. It helps business families to reach a consensus on conflict-laden issues, to build social capital, to foster trusteeship, and to structure a governance framework. In short, it aims to preserve the *splendor familiae* by promoting and institutionalizing the *affectio familiae*. Afterwards, the family constitution may act as a record of this process, as an affirmation, as a guide for contractual implementation and as a layer of relational governance supplementing the contractual governance laid down in the articles of association.

12.3. Practical Approaches

These purposes of a family constitution within the family business governance concept are highlighted by the following four forms, or types, of family constitutions discernible in practice, each emphasizing a particular facet of a family constitution.²⁷

12.3.1. A Collection of Ad-hoc Agreements

The first form is a family constitution that is composed of a collection of separate ad-hoc agreements.²⁸ In some ways, it is an outlier, because it lacks a strategic planning process and a comprehensive document. Nevertheless, this type merits

²⁵See for instance Governance Kodex für Familienunternehmen, 4.9.2004 (Germany); Österreichischer Governance Kodex für Familienunternehmen, 21.7.2005 (Austria); Code Buysee I, 2005 (Belgium); Buen Gobierno en la Empresa Familiar, 2005 (Spain); Governance für Familienunternehmen, 2006 (Switzerland); Corporate Governance Guidance and Principles for Unlisted Companies in the UK, 2010 (United Kingdom).

²⁶From a German point of view, Wicke (2012, p. 458); Fleischer (2016b, p. 1514); for Austria, Kals and Probst (2013, p. 53 no. 3/35); for Belgium, see Code Buysee III, 2017, préface, p. 8.

²⁷For an early typology, compare Montemerlo and Ward (2005, pp. 3, 47 ff.); for a more detailed description of current types of family constitutions see Bong (2022: Kapitel 2 – B.II.).

²⁸Observing comparable informal forms of family constitutions, Carlock and Ward (2001, p. 8).

attention because it shows a basic function and a basic characteristic of family constitutions: To some extent, a family constitution is no more than a factual record of a decision-making process.

One of the first interviews in a joint interview study by the Max Planck Institute for Comparative and International Private Law and the Hamburg School of Business Administration concerned a family firm in transition from the first to the second generation. After the founder's two adult children entered the business' management rather spontaneously due to the founder's sudden bad health, it became apparent that the siblings were not well suited to work as co-leaders and that there was an inclination for the business to be continued by the older son as sole leader. The family worked to resolve the resulting conflicts between son and daughter as well as between the founder and his daughter through various individual talks and group meetings involving the founder, his wife and the siblings, some of them moderated by the founder's advisors and friends.

In this manner and in the course of several years, the family agreed on the firm management, the ownership structure, and other issues that came up one by one or that were suggested by the family's tax consultant. Most of these issues one would expect in a family constitution. However, the family members did not sign a comprehensive document putting these agreements together; instead, there is a compilation of e-mails and discussion summaries written by various family members, which were collected by the family itself as well as by its tax consultant, who also prepared the implementation in legal form when necessary.

In this case, the family discussions served to solve conflicts and to deal with tax or legal issues as they arose. There was no doubt that family members would adhere to the resolutions, regardless of legal considerations, because they participated in the decision-making process; legal implementation was considered a mere formality. The resolutions' written summaries acted only as records of facts. Accordingly, their legal nature was not of interest, neither were sanctions for disregard.

12.3.2. A Family-Focused Approach – The Family Statement

The second form of a family constitution bears greater resemblance to the strategic planning concept as developed by *John Ward*.²⁹ This form may be described as a comprehensive document of family values, policies, and institutions, signed by all family members. Since its distinctive feature is an emphasis on the governance of the family and a deliberate surrender of ownership or business issues to other governance devices (see [Baus, 2016](#), p. 108), it will be called a family statement. It aims to reserve the planning process for family bonding and to shield it from an infringing legal mindset or terminology.³⁰ This approach is favored, for instance, by the *Kirsten Baus Institut für Familienstrategie*, one of the first consulting firms for family businesses in Germany.

²⁹See footnote 25 and accompanying text.

³⁰Compare Baus (2016, p. 108).

Typically, the planning process for a family statement involves all family members, including spouses and adult members of the next generation.³¹ Shareholders are meant to meet each other and their families in their role as family members, not as shareholders (see [Baus, 2016](#), p. 108). The process is usually led and moderated by a family or business consultant; legal advisors are excluded as far as possible. There is a preference to accord votes per person and to make decisions unanimously.³² This approach aims to reach agreements on conflict-laden topics before they surface and to sustain the family's social cohesion.³³ Accordingly, the significance of the planning process outweighs the relevance of the final document. The primary measure to ensure compliance with the final document is the participation in the planning process.³⁴ Therefore, sanctions for the breach of family statements are usually not considered ([Baus, 2016](#), p. 115); the principal compliance mechanisms are intrinsic acceptance and family social pressure.

The consulting approach behind a family statement purposefully reduces to a minimum the interplay between a family statement and other agreements for the governance of the business and its shareholders. Accordingly, it avoids explicit references between a family statement and the articles of association or shareholder agreements. With regard to a revision or adaptation of the articles in light of the family statement, the latter intends no more than to lay the ground for a unified and improved decision-making process (see [Baus, 2016](#), p. 109). For example, the implications of certain family values for the family's rights to distributions or information might be discussed in the process of drafting a family statement, but they will not be put to paper or they will, at the most, be mentioned only in broad terms.³⁵ Nevertheless, certain areas of overlap between a family statement and legal agreements are inevitable, concerning for instance the membership in the family and the eligibility to become a shareholder or manager of the business. To prevent that these topics imprint a legal character on the document, some family statements contain a provision that qualifies the family statement as morally binding but explicitly excludes any enforceable legal effects arising directly or indirectly from the statement.

The family statement thus serves two main purposes³⁶: Similar to the collection of ad-hoc agreements, it acts as a record of facts, in this case for the agreements reached during the planning process. Additionally, the act of signing a comprehensive agreement is primarily symbolic: it inscribes each family member's affirmation of his commitment to family unity and the family business.

³¹ Compare Baus (2016, p. 108 f.).

³² Compare Montemerlo and Ward (2005, p. 41).

³³ Compare Baus (2016, pp. 43, 50, 65 ff.).

³⁴ Compare Baus (2016, pp. 108, 111).

³⁵ Compare the sample constitution in Baus (2013, p. 145 ff.) to Baus (2016, p. 117 ff.), in which some phrases were deleted and others were softened in their wording.

³⁶ Elaborately Bong (2022: Kapitel 2 – B.II.2.).

12.3.3. A Business-Focused Approach – The Governance Protocol

The third form of a family constitution stems from a business-focused approach, as developed by family business consulting pioneer *Peter May* and as practiced today by *Intes Akademie*, one of the leading family business consulting firms in Germany. In contrast to other consulting approaches, this one conceives a family constitution as the last step of the planning process and the first step toward the contractual implementation of its results.³⁷ It acknowledges that a family constitution unavoidably overlaps with the articles of association as well as with other contracts within the business family, and it assumes that a legal insignificance of the family constitution is inconsistent with the parties' expectations (see [Claussen & Waldens, 2017](#), p. 131 f.). Family constitutions of this kind may be described as governance protocols.

Similar to family statements, these governance protocols emerge from a planning process that is typically moderated by a family or business consultant ([May, 2017](#), p. 132; [May & Ebel, 2017](#), p. 102). The process may involve the entire family, but it is not uncommon to limit discussions or decisions on certain business issues to the shareholders.³⁸ Pertaining to these issues, voting rights may not be accorded per person, but may rather be based on share ownership, and majority or supermajority decisions may suffice.³⁹ Most importantly, governance protocols treat a broad set of topics: Since they intend to act as a blueprint for the contractual governance of the family, the business and its owners, they do not shy away from detailing issues which need implementation in the articles of association,⁴⁰ such as the transferability of shares or the rights to a buy-out or dividends. Accordingly, legal advisors may join the process of drafting a governance protocol in order to prepare and facilitate its contractual implementation.⁴¹ At the very least, the coherence between the planning results and their legal implementation is monitored by the consultants who moderated the planning process.

To ensure that family members and shareholders implement the common intentions they forged during the planning process, governance protocols may contain an obligation to make all necessary changes to the family's contracts, which include first and foremost the articles of association, but also shareholder agreements. With regard to wills, inheritance contracts and matrimonial agreements, such an obligation may not be enforceable for legal reasons (see [Lange, 2013](#), p. 42 f.), but sanctions within the articles of association may nevertheless secure compliance indirectly.⁴² With the exception of this obligation of implementation, however, governance protocols exclude any directly enforceable legal effects.

³⁷May (2017), p. 135; compare also Montemerlo and Ward (2005, p. 41 f.).

³⁸Compare May (2017, p. 126 ff.).

³⁹Compare Montemerlo and Ward (2005, p. 41).

⁴⁰May (2017, p. 137); May and Ebel (2017, p. 111 f.); compare also von Au and Strick (2017, p. 120 ff.).

⁴¹Compare May (2017, p. 133).

⁴²For a typical contractual provision to incentivize certain clauses regarding the matrimonial property regime, see Sigle (2012, p. § 20 no. 76).

Nevertheless, they are not meant to be meaningless once they are implemented. Instead, they are intended to be legally significant when viewed in the context of the business family's contractual relationships, for instance as an aid to their interpretation (see [Claussen & Waldens, 2017](#), p. 130 f.). Accordingly, the articles of association may explicitly refer to the governance protocol in their preamble (see [Claussen & Waldens, 2017](#), p. 132).

In sum, the governance protocol adds a third facet to family constitutions⁴³: It serves not only as record of a decision-making process and as affirmation of family commitment, but, additionally, as a guide for and supplement to the business family's contractual governance.

12.3.4. An Ownership-Focused Approach – The Family Ownership Contract

Finally, this integration of the family constitution into the family's contractual relationships is taken a step further by a fourth form of family constitutions, which will be called a family ownership contract. In essence, this type resembles traditional shareholder agreements with additional contents tailored to the themes of business families.⁴⁴

The planning process typically focuses on the shareholders of the family business. Legal advisors are involved from the outset. The form of the final declaration varies (see [Kalss & Probst, 2013](#), p. 50 no. 3/27 f.): As a separate document, it may be akin to a typical family constitution, which is intended to be explicated and implemented contractually, or it may also resemble a classic shareholder agreement supplemented by a lengthy preamble, which discusses softer, family-related topics. In both cases, these contracts are intended to be legally binding as a whole, but certain provisions may not be enforceable (see [Kalss & Probst, 2013](#), p. 48 no. 3/23, 58 no. 3/46), for instance parts pertaining to family values, family goals, or family governance institutions. As a consequence and an indication of their binding nature, family ownership contracts prescribe sanctions in the event of their breach and, at times, include dispute resolution clauses replacing state courts.

Similar to governance protocols, family ownership agreements intend to interact with the articles of association and other contracts by serving as instructions for their implementation and as a guide for interpretation ([Kalss & Probst, 2013](#), pp. 49 f. no. 3/25 f.). Also, this interaction is encouraged by explicit references to the family ownership contract, for instance in the preamble of the articles of association.

In comparison with forms of family constitutions shaped by business advisors, family ownership contracts shift the focus from the planning process to the final declaration and from the documentation of agreements in need of implementation to an interlinked body of contracts. Unlike other forms of family

⁴³Elaborately Bong (2022: Kapitel 2 – B.II.3.).

⁴⁴Elaborately Bong (2022: Kapitel 2 – B.II.4.).

constitutions, they reveal some traits of the family *fideicommissum*, both in purpose and approach.⁴⁵

12.4. Legal Implications

These forms of family constitutions show that such a document has different facets and that it may serve a variety of purposes: it may act as a factual record, as an affirmation of family commitment, and as both a guide for contractual implementation as well as a supplemental layer of relational governance.⁴⁶ Also, some family constitutions may appear in the guise of binding shareholder agreements. This comparison provides some guidance for the legal classification of family constitutions and may help to expose their elusive legal nature.

12.4.1. Classification en bloc

In the first place, if the planning process is monitored by a professional advisor, the final declaration as a whole is aligned to a certain purpose and drafted accordingly. Family business consultants are aware of the debate about the legal nature of family constitutions. They have refined their consultation model to either avoid or encourage ties between the family constitution and the business family's contracts, and they likewise instruct their clients. Therefore, as a rule, the legal classification should conceptualize the family constitution as a whole.⁴⁷ Only in exceptional cases, where such indications predominate, are some phrases to be classified as legally binding and others as inconsequential. However, in and of itself, the fact that some phrases appear sufficiently precise to yield to legal enforcement is not sufficient to merit their partial classification as legally binding.

12.4.2. Legal Facts

Secondly, all formal family constitutions act at least as records of a decision-making process and as affirmation of family commitment. They are consensus-creating devices⁴⁸ and a written reassurance of mutual trust. In this respect, family constitutions are best understood as legally relevant facts, purposefully created by the parties at the intersection of the family and business spheres and with regard to their ongoing contractual relationship.⁴⁹ Unlike legal acts, legal facts do not give rise to enforceable obligations by themselves. But they may become legally significant in the context of an existing legal relationship. Family constitutions may become legally significant in various ways as gap-fillers for the articles

⁴⁵ Compare Kalss and Probst (2013, pp. 40 ff., 49 f. no. 3/4 ff., 3/25).

⁴⁶ For further details on the functions of family constitutions see Bong (2022: Kapitel 2 – C.II.), identifying a contract-related function as well as an interaction-related function and explicating on the concept of relational governance.

⁴⁷ With further arguments Bong (2022: Kapitel 3 – A.II.3.).

⁴⁸ Fleischer (2016a, p. 46); also Bong (2022: Kapitel 2 – A.III.2.). “Einigungsinstrument”.

⁴⁹ Elaborately Bong (2022: Kapitel 3 – A.II.-A.VI.).

of association,⁵⁰ which typically constitute incomplete, relational contracts. To exclude these indirect legal effects runs counter to party intentions, if such exclusion is at all possible from a legal point of view.

12.4.3. *Obligation to Implement*

Thirdly, an obligation to contractually implement the family's consensus as it is recorded in the constitution is in line with the effort and the meaning of the planning process. The process often confronts families with sensitive issues. As *John Ward* observes from his practice, "For most families, the process represents their most significant investment of vulnerability and openness."⁵¹ If a family manages to deal with these issues successfully and to foster family unity, the legal implementation of certain agreements supplements individual commitment. The obligation to do so may be explicitly excluded. Whether such an obligation arises as a matter of construction without there being an express agreement can be answered only on a case-by-case basis.

12.4.4. *Shareholder Agreements*

Finally, some family constitutions may appear in the guise of binding shareholder agreements.⁵² The important question in this case is not their legal nature as such, but the enforceability of individual provisions and their interplay with the company's articles. From a legal point of view, it might be tempting to draft family constitutions as binding shareholder agreements. However, the predominance of legal considerations in the ownership-focused approach may detract from some of the advantages of the strategic planning process.⁵³

12.5. Conclusion

Just like family businesses themselves, the practical approaches to family constitutions and their legal classification alternate between the spheres of family, business, and ownership. The ability to blend in with all of these environments is an advantage of the family constitution as a governance chameleon. The legal classification should take care to uphold this flexibility.

⁵⁰See for a more recent collection of possible indirect effects by Uffmann (2015, p. 2450); Fleischer (2016a, p. 48 f.); Fleischer (2016b, p. 1517); Hueck (2017, p. 240 ff.); also Taylor (2014, p. 23).

⁵¹Montemerlo and Ward (2005, p. 41).

⁵²With this result for the "Family Ownership Contract" see Bong (2022: Kapitel 3 – A.VI.3.); arguing in favor of classifying a family constitution ordinarily as a shareholder agreement by Holler (2020, p. 1673 no. 197-205).

⁵³Compare Montemerlo and Ward (2005, p. 7).

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Chapter 13

Discussion Report Part 4: Legal Research I

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Sebastian Bong: Facets of Family Constitutions: Conceptual Origins, Practical Approaches and Legal Implications

The discussion first revolved around the possibilities and limitations of empirical research on family constitutions. A managerial scholar expressed her view that classifications of family constitutions and evidence from corporate practice are useful and highly welcome. She suggested collecting more originals of family constitutions and comparing their texts. Bong agreed, but at the same time referred to his own experience from previous attempts at obtaining original documents, indicating that families prefer to keep their constitution in the family. A law professor confirmed this and stated that discretion is important for business families and their advisors. Another managerial scholar pointed out to the audience that drafting of family constitutions is a business, too, and that advisors want to keep their business model and their work products to themselves.

Other contributions addressed the growing legal awareness of family constitutions. It was mentioned that a law review article by Holger Fleischer in 2017 was one of the first in Germany to raise this legal awareness and to consider binding direct or indirect legal effects of the family constitutions. However, the legal discussion in Austria predated the German one, with pioneering thoughts by Susanne Kalss and Stefan Probst in their seminal book on family enterprises published in 2013. A managerial scholar and member of a family firm cautioned, however, stating that the act of signing a family constitution blurs the distinction between legal and moral agreement. According to her, family constitutions should be more of a “social thing,” more of a feeling without legal effect. In the case of her family business, the family constitution is not signed in an attempt to

Family Firms and Family Constitution, 195–196



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draw a clear demarcation line between family and business. The family constitution and the articles of association are bound together in a booklet, but the family constitution is not intended to be binding.

A third strand of discussion dealt with the legal effects of the family constitution on corporate agreements. Bong was asked by a legal practitioner whether the family constitution can be used as an aid for the interpretation of a partnership agreement or a corporate statute. He explained that, in line with the case law of German courts, this is indeed possible in the case of partnership agreements. In contrast, corporate statutes, such as the articles of association of a close corporation (GmbH), are to be interpreted objectively on the basis of the statute alone, thus excluding other documents from consideration that are not available to the public. Some participants expressed dissatisfaction with the legal status quo, arguing that the line should not run between legal forms but rather look to the real structure of the company. For family businesses, typical contractual provisions in partnerships and the GmbH ensure that only family members may become partners or shareholders. This may be a good reason for a subjective interpretation of the articles of association with regard to the family constitution in family businesses as well. A law professor from Vienna reported that Austrian courts are beginning to take a more liberal approach, especially if the articles of association refer to a family constitution in their preambles (incorporation by reference). In Germany, however, such a reference would not render the family constitution admissible as an aid for interpretation, since the family constitution is not available to the public in the commercial register.

Eventually, the discussion turned to the institutionalization and standardization of family constitutions. A law professor explained that the legal discourse on new factual phenomena typically develops in three steps. In the first phase of juridification, legal practitioners and scholars become aware that a new factual phenomenon with potential legal implications has emerged. For the family constitution, this awareness has been achieved. In the second phase of institutionalization, legal doctrine has to digest the new phenomenon by discussing its doctrinal classification and legal effects. For the family constitution, this discussion is presently evolving. In the third phase of standardization, different types and forms of the new factual phenomenon are recognized, analyzed, and associated with different legal effects. This leads in the end to legal certainty. For the family constitution, the law professor observed that Bong's presentation took a first step in this direction by suggesting different facets of family constitutions as they developed in practice.

Chapter 14

Succession in Family Businesses – Legal Frameworks

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Abstract

The chapter deals with the interface between the law of succession and corporate law and explains the completely different objects of these two fields of law. Succession law tries to shift and contribute assets to the successors, whereas corporate law focuses on the well-being of the company. However, in a family business, it is necessary to find legal, social, and psychological techniques to combine these two areas and to establish strong and binding relations. This is the function of shareholder agreements and family constitutions.

Keywords: Family constitution; shareholder agreement; succession law; company law; succession; corporate succession

14.1. Family Business

The economic importance of family businesses must not be underestimated in Europe. In the German-speaking world (in particular Germany, Austria, and Switzerland) 80% to 90% of all businesses are family businesses; they employ 70% of the working population. Looking at Europe, about 60% of all businesses can be qualified as family businesses; the global numbers range between 65% and 80%

Family Firms and Family Constitution, 197–213



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(Kalss, 2017a, p. 383; Lieder & Hoffmann, 2020, p. 10 ff.). These figures show the prevalence of family businesses.

However, no clear-cut definition of family businesses exists. For obvious reasons, it is not important how big or small a family business is or how it is legally organized. Conversely, a definition should not focus on quantitative aspects, but rather on the special nature of family businesses, the most characteristic attribute being the connection between a business and a family (Kalss, 2017b, p. 5; Lieder & Hoffmann, 2020, p. 12 f.). According to the European Commission, in a family business, the majority of the decision-making rights remain in the possession of the natural persons who have established the business or at least one representative of the family is involved in the governance of the business. In addition, listed companies can be family businesses when 25% of the decision-making rights are possessed by the persons and their families who have established or acquired the enterprise (European Commission, 2009, p. 9 f.). The European Group of Family Businesses (GEEF) follows this definition of family businesses.¹ Another starting point is the three-circle model, which shows that family, ownership, and business are three respective circles that overlap and in which the common ground is the family business.²

It makes sense to extend these definitions in order to obtain the following wording (Kalss & Probst, 2013a, p. 115):

A family business is a business of any size where

1. *the majority or all family members are authorized to make decisions,*
2. *and are committed to a “family charter” which is*
3. *designed to last for an indefinite period of time and which can only be*
4. *altered with the consent of a qualified majority or by unanimous decision.*

When it comes to succession in family businesses, both company law and succession law are applicable. The interfaces and conflicting goals of these two legal areas become apparent when family businesses are transferred to a new generation.

14.2. Interfaces Between Company and Succession Law

The lifespan of human beings is limited. This is one difference between natural persons and entities with legal personality. The death of a natural person triggers succession law mechanisms. In connection with businesses, succession law issues arise only when a company is held by natural persons and not solely by legal entities (in particular companies, institutions, or foundations). Nevertheless, the death of shareholders or dominant directors entails far-reaching questions regarding succession in family businesses.

Succession law is closely connected to the question of private ownership of businesses or shares in businesses – especially when agreements regarding succession to these assets are linked to the death of the entrepreneur or the owner of shares in a business.

¹ <<http://www.europeanfamilybusinesses.eu/family-businesses/definition>> (16.3.2018).

² <<http://johndavis.com/three-circle-model-family-business-system/>> (16.3.2018).

Recent surveys have revealed that during the period of 2012 to 2021, around 33% of all family businesses (or SMEs) are expected to be passed on to the next generation (Kalss & Probst, 2013a, p. 115; Lieder & Hoffmann, 2020, p. 19). As a result, complicated legal questions will arise in most family businesses. Therefore, the transfer is the crucial point in securing the survival of family businesses. This insight is important not only for the individual businesses, but also for the economy as a whole.

The succession law-based inheritance of shares in businesses or of corporate assets is marked by some special features. Several fundamental considerations support treating corporate assets differently in the context of succession. Thus, when the assets are transferred to the legal successors, the enterprise or the shares in a business should not simply be equated with other assets. The considerations supporting special treatment of corporate succession apply from the perspective of company law in the case of succession by intestacy, by will, or when the relevant affairs are arranged by contract in advance. Alongside these typical forms of succession law transfer, also other – company law – transfer mechanisms exist and thus take effect parallel to succession law or even circumvent it.

Four material aspects ought to be mentioned here (Kalss, 2017b, p. 8 ff.; Kalss & Maier, 2020, p. 203 ff.):

1. Succession law is the law of *passing* on and of *distributing* assets – company law is the law of *organizing* and keeping assets together;
2. Ownership of corporate shares not only involves property but also property rights and rights of control;
3. Corporate succession not only affects the heirs and by-passed heirs but also other groups of persons;
4. Corporate property is different than other property; it constitutes special property.

14.2.1. The Respective Tasks of Succession Law and Company Law

Company law and succession law are not in a hierarchical relationship with one another. Neither succession law nor company law has precedence over the other field of law (Schauer, 1999, p.339 f.; 2010, p.990 f.; Wiedemann, 1999, p. 1310). Rather, they exist side by side and rank equally. They also fulfill different regulatory tasks (Kalss, 2010, p. 1036):

The law of succession has the *function of transfer and distribution*. It determines who ought to receive the property of the testator (Schauer, 2010, p. 991; Wiedemann, 1999, p. 1310 f.). Company law, on the other hand, has the task of governing, in accordance with the law and the respective company articles, which rights and legal relationships can be passed on in the first place, i.e., determining whether membership can be inherited at all and be passed on (Kalss & Probst, 2013b: no 20/8; Schauer, 2010, p. 991). Company law is the law of organization, which is directed at the efficient cooperation of the shareholders. Company law aims to secure the existence of the enterprise and to regulate, first, the legal relationships amongst members (vis-à-vis the company) and, second, the legal position of members in relation to third parties. It is about ensuring effective cooperation and a balancing of interests

(Goetz & Windbichler, 2013, p. 1 f.; Kalss et al., 2008: no 1/3). This can obviously result in tension between the principle of distribution (succession law) and the principle of concentration and predominance of business (company law).

14.2.1.1. Distribution and Equality

In a nutshell: Succession law is the law of **distribution** (Kalss, 2017b, p. 12), whereas company law is aimed at the continued existence of the enterprise and its efficient management. The **distributive effect** of succession law is demonstrated in intestacy rules, in which typically family members, divided according to circles of relationships or *parentelae*, are invoked as the fundamental statutory model. People within the same generation are treated equally, which is how the distributive effect comes about. Ultimately, each family member of the same generation should get the same amount according to these dispositive intestacy rules. Succession law does not distinguish in terms of age, qualifications, or interests of the individual in relation to the property transferred; each receives the same per head. The pertinent qualification is the relationship. Each child receives the same portion. Often, however, talents and interests are not divided equally among all heirs – especially when it comes to corporate property. This, however, leads to unqualified and non-professional ownership and, as a result, may endanger the equilibrium of power and influence in a company.

Succession law is therefore characterized by “distributive equality.” This can be justified by the principle of the equality of every human being, but at the same time, this can be quite harmful to a business. The distributive effect increases over time, because every death of a natural person triggers the same consequences and – over time – leads to an increasing fragmentation of ownership. This can be shown by the following graphic (Fig. 14.1):

14.2.1.2. Reserved Portion

This distributive effect is even more obvious when it comes to the reserved portion requirements, above all, regarding the provisions entitling certain individuals to compulsory reserved shares. The progeny of the testator is typically entitled to such. This means that claims of certain persons must be fulfilled in any case, even if the testator does not mention them in his will. The law of the reserved portion, therefore, restricts testamentary freedom. Under Austrian

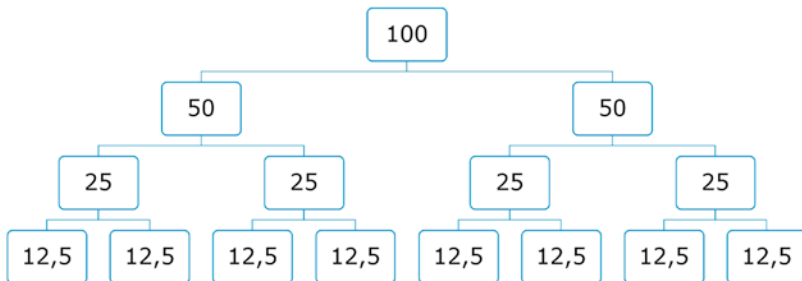


Fig. 14.1. Fragmentation of Ownership.

law and in many other legal systems, the testator's progeny and spouse have a mandatory right to at least half of the succession. Except for England and the USA, almost every national legal system provides for a reserved portion (Kalss, 2015a, at footnote 58; Schauer & Baldovini, 2020, p. 214 ff.). In general, as for instance in Germany, the Netherlands, Poland, Switzerland, Greece, and Austria, the marital spouse and the children get half of the succession. The special nature of this portion lies in the fact that it often consists of a right under the law of obligations, measured in money against the legacy or the succeeding heirs. The necessity to pay out the cash often means that enterprises or shares must be sold so that the heir is in a position to fulfill this entitlement. In addition, only limited possibilities to disinherit a beneficiary exist. While the enterprise or company is not directly affected, the corporate property is often the only or at least the material property of the testator, so that the heir is obliged to take recourse to this business property in order to satisfy his obligations. The simple distribution of dividends is usually insufficient for this purpose.

Frequently, enterprises must be – at least partially – sold in order to be able to pay out the reserved portion, or the enterprise itself must pay out a substantial special dividend so that the shareholder can actually satisfy his succession law obligations.

While company law is thus generally aimed at the continued existence and efficient functioning of the company, succession law has a restricted transfer function with a distributive effect, resulting in an ongoing tension between succession law and company law. Given these two different legal influences and the fact that distribution can endanger the necessary financial and personnel conditions for the continued existence of the company, company law is deployed in order to secure the financial basis of the company. However, also the personnel-related qualifications and manageability of the enterprise can hold back this distributive effect of succession law to a certain extent – regardless of whether the effect is achieved by direct transfer to certain persons or by mechanisms having the same function.

14.2.1.3. Communities of Heirs

An important consequence of the principle of distributive equality is the promotion and existence of communities of heirs. Communities of heirs are of particular importance, such as the community of heirs (*Erbengemeinschaft*) under the German Civil Code (BGB) or the joint ownership community (*Miteigentumsgemeinschaft*) under the Austrian Civil Code (ABGB). Both are characterized by the fact that a legal act by just one member can break up the community. The respective instrument is an action for annulment or partition.

The successors of a person have the same right to joint ownership regarding each physical object, but also in respect of rights such as shares or other memberships of companies. They are obliged to exercise their shareholder rights or partnership rights together. Consequently, they must find a way to agree upon different measures and find a common position. The law requires unanimity for important measures. Therefore, the danger arises that one single member will block all the others. In the second step, it becomes clear that the community is then unstable and permanently endangered.

The community of heirs exists regarding each physical object – as long as it is not annulled by a partitioning of the inheritance. Each co-heir can seek annulment before or after the transfer of the property to the heirs; however, it will not be effective in rem before the transfer. The partition of the inheritance, like the division of a community of joint ownership in general, is carried out in accordance with § 841 ABGB either by an agreement on partition of inheritance (*Erbteilungsübereinkommen*) or – if no agreement is reached – by action for partition (*Erbteilungsklage*) along with the resulting judgment.

14.2.2. Ownership Involves Controlling Rights and Property Rights

Ownership of an enterprise or of corporate shares not only involves property rights but also rights of control and influence (Dutta, 2014:34 ff.; Kalss, 2017b, p. 10; Kormann, 2017, p. 271 ff.). These two aspects must be distinguished clearly. They may in general be exercised or held by different people and may thus also be transferred and allocated separately in the course of passing on and distributing in the context of legal succession. Although they can and must be distinguished, it must be clear that these two aspects influence each other. The more influence a shareholder has, the higher the value and the price of the share become (e.g., double-voting rights, shareholder agreements).

Property rights are economic claims and include, for example, the simple ownership of a stake and thus the benefit deriving from added value. However, above all, they also include the right to dividends; the right to settlement in the case of transfer, merger, or change of legal form; or the yields of the sale if such a share is sold. Rights of control or influence, in other words, the option of exercising power in a company and over its assets, include for instance a voting right at the shareholders' meeting (general meeting or assembly) and the taking on of a management function or office in the supervisory board as the fundamental supervisory committee of an enterprise.

As property rights and rights of control can be separated, they may also be transferred separately in cases of legal succession upon the death of the holder. The separate, but nonetheless proportionate, transfer of these different components of the share secures the succession law participation of all successors in the company. This means that, on the one hand, the succession law principle of distribution and, on the other, the necessity for a concentration of the decision-making processes within a company in order to safeguard efficient management, which is the object of company law, can both be achieved. Property rights can be allocated to particular heirs or legal successors, likewise the rights of influence at the shareholders' meeting or the entitlement to take part in certain executive bodies of the company. The option of separating rights of control and influence is often the key to legal succession in an enterprise in accordance with the corporate need for concentration of influence and efficient management. As a rule, only the invocation of the law of succession and the acceptance of the inheritance and subsequent takeover are necessary for the transfer of property rights. The allocation and takeover of rights of control requires somewhat more, specifically suitability and in many cases qualifications which allow the individual to manage and

control the enterprise in a sustainable and successful manner (Cf. Kalss & Probst, 2013b, p. 672 ff.). Apart from a person's individual qualifications, it is necessary to ensure that the decision-making processes are run efficiently both at the operative management level and at the supervisory and ownership level.

14.2.3. *Different Interests Affected*

When it comes to the succession to corporate property, it is not only the heirs and legal successors (as well as the bypassed heirs, i.e., the non-inheriting children) that are affected. In fact, multiple other groups of people are also impacted. The following interests may be at issue after the death of a shareholder or owner (Kalss & Probst, 2013b, p. 655; Schauer, 2010, p. 989 ff.):

- The interest of the *testator* in preserving his freedom of testation and his unhindered ability to dispose over his own property including shares;
- The interest of the heir(s) in receiving and freely disposing over the property inherited;
- The interest of those entitled to reserved portions in receiving at least a certain part of the value of the net inheritance;
- The interest of the other shareholders in being able to acquire the share of the deceased party or at least to be able to influence the selection of any new shareholder(s); since they may wish to continue the company either alone or with the new shareholders;
- The interest of the enterprise in efficient, decisive management processes and administration; this refers to, on the one hand, the management of the company, but on the other hand, all employees of the company.

The other shareholders have an interest in knowing and influencing who will take the place of the deceased shareholder, i.e., with whom and with how many new shareholders they will have to collaborate in the future. The company itself, represented by the management and the employees, is directly affected. Both groups are interested in the continued existence of the company under reasonable conditions feasible for them. The public, in turn, is interested in the company continuing to exist and continuing to offer people work so that the region profits and value can be achieved in the country. Thus, there is overall public financial interest in the continued existence of the company under feasible conditions in the case of succession. Therefore, not only must there be a balancing of interests between heirs and non-heirs of the deceased party, but it is, moreover, also necessary to balance the interests of a far greater number of people. This is a much wider-ranging task.

14.2.4. *Corporate Property as Special Property*

“Property” is not “property.” Rather, different types of property can be distinguished. These range from money and jewellery, to real estate, to a picture or an art collection, and on to companies. In respect of these different types of

property, different needs and justifications may be elaborated for different forms of transfer. At this point, it makes sense to highlight the difference between a simple sum of money and corporate property.

- Corporate property, i.e., companies or corresponding corporate stakes in companies, differs from other property as its value is more *volatile* – it can change more easily and quickly (Dauner-Lieb, 1998, p. 29 f.). This is a marked difference to a sum of money, for example, which only changes due to reasons such as inflation.
- Enterprises, which are *divided up* are often worth less than the original entire enterprise. While a sum of money even if divided up still totals the original sum (e.g., $30 + 30 + 30 = 90$), this is not necessarily the case when corporate property is split up. Typically, the value depends on the entire enterprise. Divisions and split-offs may increase a company's value, but this is not the typical consequence of distribution.
- The value of corporate property changes – almost daily – due to the *market environment*. For instance, a company may lose buyer segments because another enterprise has used technology that is more efficient or has recognized a new trend sooner and implemented a new business model faster.
- Ultimately, the value of an individual enterprise depends significantly on *people's management* of the enterprise and thus the entrepreneurial performance of the owner (Fleischer, 2015, p. 728 f.). The development of a company, therefore, largely depends on the individuals acting on behalf of the company.

The continued operation of the enterprise also involves substantial entrepreneurial risks, including the risk of total loss or at least the loss of a material part of the inherited asset after the takeover. Someone who had his reserved portion paid out in cash is no longer exposed to this risk as soon as he has received the money. Insofar, this person clearly has a privileged position compared to the heir taking over the company in terms of risks. This means that this person is entitled to a sum of money either immediately or due very soon, without being exposed to any risk of a change in value and earnings on the part of the enterprise or risks of generating the amount to be paid out. Thus, the notion of compensating risk would support a different and special succession rule regarding corporate property.

These different special features of enterprises, even more particularly of corporate assets organized as companies, show why it makes sense – and is sometimes necessary – that corporate assets should not be subject to the same general rules of succession law. By contrast, other alternative means of transfer should be investigated, both within and outside the boundaries of succession law.

14.3. Special Rules for Agricultural Enterprises

In several countries, such as Poland, Germany, and Austria, there are special rules for corporate succession regarding farming and forestry enterprises (Kalss, 2015a, Fn. 303; Probst, 2018, p. 123 ff.; Schauer & Baldovini, 2021, p. 2020).

The justification for establishing special rules in the area of farming and forestry enterprises is macroeconomic in nature and thus founded in the public interest. The existence of farming and forestry enterprises ought not to be jeopardized by simplistic distribution, especially as a certain size is essential in order to secure the feasibility of the enterprise. At the same time, it ought to be ensured that only the most qualified successor obtains and continues the farming enterprise. This is the only way to safeguard the existence of such enterprises and in consequence the supply of food. Therefore, these farming or forestry enterprises ought not to be distributed and split into too many small sub-enterprises.

- Since the aim is that the substance of farming and forestry enterprises should not be hollowed disproportionately, the legal rules for farming and forestry enterprises strongly undermine the entitlement to a reserved portion. The reserved portion, therefore, does not correspond as usual to half of the succession; rather, when it comes to corporate succession in a farming or forestry enterprise, the person entitled to a reserved portion receives only a share which measured against the earnings of the enterprise does not in any way endanger the functioning of the enterprise.
- The continued existence and efficient management of a farming or forestry enterprise are secured by the rule that only one heir of several possible heirs comes into the inheritance, specifically the best qualified heir and thus the one who has the necessary training or in some other way the best qualifications. This is not automatically the oldest son or the oldest daughter. The primary overall consideration is that the existence of the enterprise ought to be secured because a country needs a certain number of feasible farming and forestry enterprises in order to supply the public with food (Probst, 2010, p. 114 ff., 2018, p. 123 ff.).
- Finally, an incentive is provided for long-term continuance as the special succession law rule applies only when the enterprise is continued for 10 years; if it is sold prior to this, the proceeds from the sale must be divided and are subject to the general succession law rules.

14.4. Replication of These Rules by Contract

The macroeconomic importance of appropriate rules for corporate succession is not limited to farming and forestry enterprises. For instance, an empirical study for Austria shows that about 6,800 corporate successions are implemented each year (KMU Austria, 2014; Lieder & Hoffmann, 2020, p. 19 ff.). Therefore, a value of macroeconomic proportions is certainly at issue when it comes to the continued existence of these enterprises. Not only farming and forestry enterprises have significant macroeconomic value; in general, enterprises offer jobs, create value, secure livelihoods, and thus, are extremely important when it comes to securing the lives of a country's population. Hence, there is a macroeconomic interest in securing the existence of such enterprises and making sure they are not broken up when it comes to succession because of the distribution provided for under the rules on intestacy or the necessity to satisfy heirs' entitlements. The continuance of the enterprise means creation of value beyond the enterprise.

Above all, the jobs dependent on the enterprise can be preserved, not only in economically strong regions and in urban areas but also in regions where jobs are more rare. The importance of enterprises in such regions is even greater in macroeconomic terms.

In practice, appropriate solutions balancing the interests of all stakeholders involved, from the entrepreneur, to the person handing over the business, his children, and the enterprise itself, are found in accordance with the applicable law on the basis of an analysis of all these interests and by means of contractual arrangements. These arrangements aim at securing the existence of the enterprise and affordability for the entrepreneur who continues the enterprise. They also aim at providing an appropriate financial settlement for those entitled to a reserved portion. It is vital to ensure that the parents handing over are provided for. In practice, therefore, various arrangements often supply solutions. Nonetheless, a statutory rule is desirable and advisable, as accidents and other unforeseen events often occur where there is as yet no will or contractual arrangement.

The notion of special rules and the justification for special succession rules for farming and forestry enterprises can be applied to other fields of enterprises as well. The issue here is recognizing the feasibility of the enterprise by concentrating the inheritance on one suitable successor and by determining the reserved portions according to the earnings of the enterprise and by determining the affordability out of the corporate earnings. Thus, it would certainly be reasonable from a legal policy perspective not only to open up the option but also to provide for a general special law for corporate succession (Probst quoted in [Kalss, 2015b](#), p. 52). From today's perspective, this is legitimate not only in securing the farming and forestry enterprises which supply the population's needs but also as regards service enterprises, for instance in the tourism sector or in respect of industrial manufacturing enterprises. The total lack of special rules regarding succession in family businesses other than farming and forestry enterprises leads to tensions between the distributing effect of succession law on the one hand and the interest in the continued and stable existence of the business as a whole.

In any case, the existence of enterprises should be secured in order to secure the economic power exercised in the macroeconomic interest. This should make it possible to concentrate the inheritance of a business in one person. In the case of corporate succession, the reserved portions should not be determined according to the market value at the time of the testator's death but instead in relation to the earnings over the last ten years. If the earnings turn out to be unexpectedly higher, then there should be a retrospective duty to make payment to the other heirs if – within the 10 years following the inheritance – the enterprise is sold for a higher price. Thus, when the value of the enterprise is subsequently higher, the heirs who were already paid a sum can participate and profit once again. This model would provide incentives and also secure the continued existence of the enterprise in order to continue creating value within the family, for the workforce of the enterprise, and for its business partners. Alongside civil law considerations arising out of the law of succession, tax law provisions must be introduced. For example, reserved portions paid out by an entrepreneur must be recognized as business expenses; conversely, the entitlement to reserved portions should be taxed at half the rate of other incomes in order to balance the interests involved from a tax law perspective.

Finally, the organization of succession in family businesses might also include the creation of foundations or trusts in order to secure payment of family maintenance by family-owned businesses. Such foundations exist in various jurisdictions, including Austria, the Netherlands, Greece, Finland, Italy, and Switzerland.

14.5. Succession Law Arrangements Already Possible Under the Applicable Law

Under the applicable law, it is already possible to find suitable arrangements. It must, however, be borne in mind that due to company law, a company's statutes can usually only be amended unanimously, i.e., with the consent of all other shareholders. Last wills and testaments, on the other hand, can be made by the testator acting alone and can also be changed unilaterally at any time up to his death. Thus, from a succession law point of view, the freedom to organize one's affairs (testamentary freedom) is greater than under company law.

Firstly, one very important flexible aspect of succession law is the ability to render only one person the corporate successor, either by will or by anticipated succession, thus securing efficient corporate management and continuance tailored to this one person (Holler, 2020, p. 1195 ff.; Kalss & Maier, 2020, p. 206 ff.; Oberhumer, 2020, p. 760 ff.). Many laws of succession allow for not having to pay out the reserved portions in cash straight away, instead delaying this for several years. Even more important is the option of being able to grant other assets in lieu, particularly shares in the enterprise that only grant dividend rights but no influence, e.g., preferred shares without voting rights, profit participation rights (*Genussrechte*), sub-shares, or other rights based on the earnings of the enterprise. In this respect, it is necessary to make both contractual and company law arrangements in order to bring about a supplementary or necessary succession law transfer of assets as intended. Thus, for instance, the future Austrian law of succession allows participation rights (*Genussrechte*), silent partnerships, and other stakes in companies without rights of influence – precisely for the purpose of securing efficient decision-making structures in enterprises (Kalss & Cach, 2015c, p. 675 ff.). Dutch law makes it possible to issue special certificates to satisfy reserved portion rights (Burgerhart & Verstappen, 2015). Deviating from statutory succession law always requires certain legal dispositions and usually consensual settlements.

Another – and rather old fashioned – model is the *fideicommissum* for real estate and industrial assets, allowing the testator to determine the heirs to his estate for generations in advance. However, the general attitude toward binding property for more than one generation is rather hesitant – mainly because of the lack of freedom of disposition and the exclusion of market forces.

14.6. Possible Company Law Arrangements

14.6.1. Partnerships

When considering the special nature of corporate assets, the macroeconomic justification for special rules, and the effectiveness of arrangements, it becomes clear that in company law there are some legally recognized arrangements which

organize succession in an enterprise differently from other types of succession. It may be said that will substitutes play a much more significant role in the company law context than in the case of other assets. The law on partnerships in Germany and Austria, for instance, already offers numerous ways and means via company law to decide on material issues as regards corporate succession.

In this context, it is important to distinguish between (a) gaining the status of partner and (b) the entitlement to be compensated for value. In any case, there are company law options that aim at not including heirs or particular legal successors as members of the company. Thus, these heirs are refused succession to the real corporate value of the enterprise or a share therein, and they are instead granted compensation for value. Sometimes, there are even company law options going beyond this, actually reducing this compensation for value or even excluding it, for example excluding the settlement in favor of the other shareholders and at the expense of the heirs (see on this [Kalss & Probst, 2013b](#), p. 662; [Oberhumer, 2020](#), p. 763 ff.; [Schauer, 2010](#), p. 999 ff., 2018, p. 1221 ff.).

In what follows, specific company law options are presented. The statutory starting point is the dissolution of the company with the possibility of continuing the enterprise with the heirs. Arrangements deviating from this must be provided for in the company statutes accordingly.

- A *continuation clause* sets out that upon the death of one of the partners, the other partners in a partnership can continue the company together. The company is simply continued – without being dissolved. The heirs of the deceased partner are neither entitled nor obligated to take his place in the company. In lieu of a share in the company, the entitlement to a settlement is inherited. Due to the continuation clause, therefore, the partners can prevent unwanted or unsuitable people from entering the company. Thus, certain people are excluded by company law from taking a share in the business, but they at least have a succession law right to compensation for the value. These include both heirs by intestacy rules and heirs by will, as well as those entitled to a reserved portion. As a right to a settlement in principle falls due in place of a share in the company, there is a risk related to capital flow in favor of the heirs of the deceased shareholder. In principle, the right to a settlement must be estimated according to the value of the enterprise, and on this basis, the deceased shareholder's share should be calculated as one piece of a whole cake. According to this mechanism, the real value is calculated according to the relevant substance or earnings value which is not the book value.³
- It is also permissible to combine a *continuation clause* with a *settlement exclusion clause*. Such contractual arrangements are also binding for the heirs, for instance, an agreement to use an evaluation method provided for by company law, e.g., a book value clause. In particular, the right to a settlement on the

³ Kalss and Probst (2013b: 662); Schauer (2010: 1002); Schauer (2018: 1221 ff.); on the aspects of the piece of cake, Fleischer (2015: 728 f.).

part of a partner in a general partnership or of a general partner (*Komplementär*) can, in the event of his leaving the company due to death, not only be reduced but also completely excluded in the company statutes. Such a clause is admissible because the interests of the heirs play no role from a company law perspective. The testator can, after all, freely dispose over his property during his lifetime. The continuation clause with exclusion of settlement must apply mutually among all partners. Therefore, this is a donative transaction involving a monetary interest, and it is effective vis-à-vis all partners and their heirs. Hence, it is not only the continued existence of the company that can be secured using just such a continuation clause working in favor of the other partners and prohibiting other undesired partners from entering; the financial substance of the company can also be fully secured in favor of the other partners.

- A *successor clause* is a provision in the company statutes according to which the company is not dissolved upon the death of one of the partners but is instead continued with the heirs of the deceased partner. This means the legal consequence of dissolution is inhibited and the flow of assets due to the right to a settlement is prevented. The problem with this, however, is that a simple successor clause allows each heir to enter the company; thus, undesired and unsuitable heirs could also become partners. It is merely their status as heir that is decisive. Preventive measures can and should be taken by corresponding provisions in the company statutes, for example by extinguishing certain management or representation rights or by admitting only one statutory heir. However, it is also permissible to draft a contractual combination with a termination clause to eliminate shareholders (*Hinauskündigungsklausel*). This means that the other partners have the right to terminate the membership of the heir(s) within a certain time or if certain circumstances occur. The company law admissibility of this unilateral exclusion clause, which can be exercised by the other partners, derives from the special case of succession by inheritance (Kalss & Probst, 2013b, p. 736).
- The *qualified successor clause* is a rule in the company statutes providing that only individuals who fulfill certain requirements can be admitted as partners. The company statutes can even name a particular person or set out detailed qualification criteria, such as previous education or being part of the family. The qualified successor clause ensures that people also desired by the other partners take the place of the deceased among the partners. Nonetheless, the new partners and successors must have the status of heirs – there needs to be an interplay of company law rules and succession law dispositions (Kalss & Probst, 2013b, p. 664; Oberhumer, 2020, p. 763 ff.; Schauer, 2010, p. 1018, 2018, p. 1221 ff.).
- An *entry clause* in the company statutes grants a third party the right to take the place of a deceased partner in the company upon the death of this partner. This third-party right is based upon the company statutes, not on succession law. The right of entry offers the entitled party a particularly strong position since it takes effect regardless of succession. The company and the

other partners are dependent on the decision of the entitled party in the case of this company law arrangement. Thus, if there are doubts regarding this clause, it is to be construed as a successor clause. This strengthens the position of the partners and is in the interest of the continued existence of the company and its partners. If the entitled party decides not to enter into the company, the planned corporate succession is frustrated. Therefore, drafting an entry clause must be carefully considered. Moreover, if the entry right is not exercised by the entitled party, the settlement amount must be paid out by the company in favor of the deceased partner's estate. In the case of an entry clause, the legal position of those entitled to a reserved portion is thus dependent, firstly, on whether the entitled party enters the company and, secondly, when the person desists from entering the company, on how the settlement amount is calculated. From a company law perspective, an entry clause makes sense only if already known candidates are to be admitted into the company and the continued existence of the company can thus be secured. The material difference between an entry clause and a successor clause is that entry based on an entry clause depends solely on the company statutes and is in general independent of the succession law position (Oberhumer, 2020, p. 763 ff.; Schauer, 1999, p. 618 f.; 2010, p. 1022; 2018, p. 1224). The entitled party acquires the right to membership upon the death of the deceased partner not by inheritance under succession law and thus not on the basis of a title under succession law, but directly from the other partners on the basis of the contractual provision (Schauer, 1999, p. 630). By contrast, the successor clause requires that a successor and that certain persons, whether on the basis of intestacy rules or testamentary succession, do in fact succeed. Specifically, if a person is not ultimately an heir in the case of a successor clause, its succession law effect, namely the *ex lege* transfer of the right to the named successor, cannot ensue with the devolution of the property.

This shows that company law and succession law, depending on the choice of a clause and the wording of the clause in the company statutes, interact in different ways and that company law can completely set aside the succession law transfer of property or can coordinate it with succession law dispositions. This depends on the specific contractual provisions.

14.6.2. Law on Corporations

Within the field of the law on corporations, there are less far-ranging pre-formed contractual arrangements. Unlike the law on partnerships, it is not possible to provide in advance in the company statutes that an heir is not allowed to participate at all in the corporation, but that the relevant share falls directly to other shareholders or other third parties. Within the field of corporation law, the interface between company law and succession law is even clearer. Nevertheless, it is also possible within the field of corporation law to make far-reaching arrangements in order to replicate mechanisms in the company statutes similar

to those in partnerships. This is true especially when combined with an obliging “putting” clause in the company statutes, i.e., a clause setting out a duty of the heir to transfer the share to the other shareholders or a third person as soon as he has acquired it *de lege* by universal succession or by another succession law inheritance. At the same time, the share price can also be significantly reduced in respect of the inheritance. Finally, the heir does not acquire membership in the company or at most only temporarily. Under the law of corporations, it is also possible to substantially reduce compensation for the value of the shares in question. Depending on the specific provision, such contractual rules affect not only the position of the direct heir and temporary shareholder but also the legal position of other bypassed children and legal successors of the deceased shareholder – because their reserved portions are also determined by such provision in relation to the company successors. While this means the transfer cannot be governed by the company statutes alone under the law of corporations, the same function is accomplished through a combination of succession law transfer and the company law duty to transfer along with corresponding valuation rules.

Very often shareholders’ agreements are used in order to organize a family’s role in the family business. These multilateral contracts may include rules regarding the transfer of shares or parts in a company, but they may also govern the family’s stake in the management of the company. Additionally, the voting behavior of family members may be restricted and the distribution of profits organized in an efficient manner. Such contractual agreements are especially useful when the family business is owned by more than one family or family line. However, shareholders’ agreements can only be concluded within the boundaries of mandatory rules of company law as well as the company’s statutes.

14.7. Summary

The special nature of corporate property justifies separate succession rules that secure the efficient continuation of the company and the existence of the enterprise. This position is supported by the various interests affected, the volatility of the enterprise’s value, the difficulty in measuring it and the risks assumed, the lack of feasible divisibility, and ultimately the necessity for long-term creation of value. The necessity for long-term creation of value forms the core of the macroeconomic argument and represents the public interest in special rules for corporate succession. Under the applicable law, provisions can, to a large extent, already be constructed in the company statutes, so that only certain persons can become members of a company; other than that it is possible to substantively determine and to usually reduce the amounts of compensation for value and thus any reserved portions. The above-mentioned legal instruments aim to balance the long-term continuation and development of the business with the claims of the business owner and other descendants. Insofar, the provisions in the company statutes can affect the testamentary freedom of disposition substantially and materially influence it.

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Chapter 15

Family Firms and Family Constitutions in France – A General Overview

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Abstract

Ah la famille ...! We tend to say that we do not choose it. But there are beautiful family stories, even in business, and particularly in France. Indeed, when it comes to business, the French take family as a serious matter – with about 80% of all companies in the country family controlled. Whether big or small, French family businesses are particularly noticeable in sectors such as food and beverages, as well as luxury.

The chapter gives a general overview of family firms in France, considering in particular their main legal structures, how diverse they are in reality, and finally their governance rules, and notably their family constitutions. It concludes that business and family stories often prove to be a good match, at least in France.

Keywords: Family constitution; shareholder agreement; legal forms; France; French family firms; corporate governance codes

Family Firms and Family Constitution, 215–224



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15.1. Introduction

Ah la famille ...! We tend to say that we do not choose it. But there are beautiful family stories, even in business, and particularly in France.¹

Indeed, when it comes to business, the French take family as a serious matter – with as many as 80% of all companies in the country family controlled (see also Kitsou, 2013, p. 10 ff.). Whether big or small, French family businesses are particularly noticeable in sectors such as food and beverages. Large ones include Lactalis, the world's biggest dairy company. Much of France's wine industry is also family controlled – many are small family businesses, even though family-owned Rémy Cointreau is one of the world's leading producers and distributors of cognac, *spirits*, and liqueurs. And then there is the country's famous luxury sector, which remains almost completely linked with family: whether it is the big luxury holding companies like LVMH and Kering, or iconic brands like Hermès and Chanel, family is everything.

Some evidence shows the prevalence of family businesses in France, even if figures may vary: about 15% of companies on the CAC 40, a benchmark French stock market index, are family businesses; more than 11 family businesses in France were established more than 200 years ago;² about 83% of French businesses are family businesses; about half of all French employees work for family businesses.

This chapter gives a general overview of family firms in France, considering in particular their main legal structures (Section 15.2), how diverse they are in reality (Section 15.3), and finally their governance rules, and notably their family constitutions (Section 15.4).

15.2. Main Types of Legal Structures for Family Firms

There are numerous types of company structures (i.e., types of companies that can be formed) provided by French law, but most family firms take one of the following forms (even though the European Company is increasingly appreciated by families that want their company to be listed). (https://www.legifrance.gouv.fr/codes/texte_lc/LEGITEXT000005634379/)

¹For a definition of *société familiale* or *entreprise familiale*, see Kitsou (2013, p. 15 ff.), Champaud (2009, p. 6 ff.), and Poulain-Rehm (2006, p. 77 ff). For a general presentation of family firms in France, see Daumas (2012, p. 33 ff.) and Tandeau de Marsac (2011, 2014 [L'entreprise familiale]).

²The oldest family business is, as it seems, the luxury jeweler MELLERIO called MELLER, whose first traces of activity date back to 1613; the company has been located near Place Vendôme, in Paris, for more than 200 years. Among the oldest companies in France, we find also one of the largest producers of Alsatian wines: Hugel & Fils, which was founded in 1639.

15.2.1 *Société à responsabilité limitée*

The *société à responsabilité limitée* (SARL), which corresponds to the German *Gesellschaft mit beschränkter Haftung* (GmbH), the UK private limited company and the US limited liability company, is in general the most attractive and widespread structure for companies in France, and in particular for family companies.

A key advantage of this structure is the relatively simple administration and the liability limited to the joint capital of the company. French law does not impose a minimum share capital (*capital social*). At least two shareholders are required to form this form of company; if there is only one shareholder, it is an *entreprise unipersonnelle à responsabilité limitée* (EURL), a single-owner limited liability company. However, not more than 100 individuals or legal entities can form a SARL. The SARL is managed by one or more managing directors (*gérant*), who may also be shareholders. The French legislature has recently further simplified and liberalized the legal framework for the SARL.

15.2.2. *Société anonyme*

The French *société anonyme* (SA) most closely corresponds to the German *Aktiengesellschaft*, the Public Limited Company in the UK and the US corporation. It is the structure often adopted by large (family) companies.

The *société anonyme* requires at least two shareholders (or seven if listed) and a total share capital of €37,000. It is often run by a president (of the *conseil d'administration*) and a general director (*directeur général*) (in the one-tier system), who can be the same person; the two-tier system featuring a supervisory board (*conseil de surveillance*) and a management board (*directoire*) is less widespread in France, in particular since the last financial crisis, but it nonetheless exists, even among family firms. In any case, shareholders have a liability that is limited to the extent of their share contribution.

15.2.3. *Société par actions simplifiée*

The *société par actions simplifiée* (SAS), which can be translated as a simplified stock company, is extremely popular in France, notably among family firms. Despite the great popularity of this structure, there are only few rules governing it.

This means that its organization can be relatively freely and flexibly designed in the articles of association (*statuts*). No legal minimum capital requirement is defined by the law. At least two shareholders are required; if only one shareholder exists, the structure is a *société par actions simplifiée unipersonnelle* (SASU). A chairman or president must be appointed by the shareholders. Financial liability is limited to the share capital.

15.2.4. *Société en nom collectif*

The *société en nom collectif* (SNC), what we can translate as a general partnership, is relatively rare in France for family businesses as compared to the other company types, but it can still apply to some of them.

An SNC has legal personality and holds the assets placed in it by the partners. The latter must all be merchants (*commerçant*). They are jointly and severally liable for the company's debts to an unlimited extent. At least two partners are required to form the company. No minimum capital is required for setting up a general partnership. The company is represented by one or more managing directors.

15.2.5. *Société en commandite simple and société en commandite par actions*

The *société en commandite simple* (SCS), which may be translated as a limited partnership, and the *société en commandite par actions* (SCA), in English a partnership limited by shares, are also interesting for family businesses.

Indeed, both of these business forms have legal personality and in both forms the company holds the assets placed in it by the partners. Above all, some of the partners (*commandité*) are jointly and severally liable for the company's debts to an unlimited extent, while other partners (*commanditaire*) benefit from a limited liability protection according to the size of their contribution.

To sum up, the *société par actions simplifiée* (SAS), the *société à responsabilité limitée* (SARL), the *société en nom collectif* (SNC), and the *société en commandite simple* (SCS) appear particularly suitable and very convenient for small and medium-sized family businesses which are set up in France. For large (family) businesses, the *société anonyme* (SA) and the *société en commandite par actions* (SCA) are usually preferred.

15.3. Diversity of Family Firms

Five iconic family companies holding a major position on both the French and international markets will be briefly presented, allowing an illustration of the wide diversity of French family firms and their complex reality in practice.³

15.3.1. *Lactalis*

Founded by André Besnier at the beginning of the 20th century (1933), the Lactalis Group is currently one of the world leaders in the dairy industry.⁴ It owns brands such as Galbani, Société, Bridel, Président, Rachel's Organic, and Valmont.

From its creation, the company has remained for three generations under the control of the Besnier family, with growing success. Today, it markets a large number of dairy products (butter, milk, cheese, etc.) around the world, with more than 85,000 employees working in 84 countries and 266 production sites in 51 countries. The Besnier family controls 100% of the company's capital, which has recorded a yearly turnover of more than €20 billion. Lactalis is one of the largest family businesses in France.

³For a non-legal presentation of some specific family businesses, see <https://lentreprise.lexpress.fr/entreprises-familiales/>.

⁴For more information about Lactalis, see <http://www.lactalis.fr/en/>.

The entire capital of the company, a *société anonyme* (with a two-tier system) is held by the Besnier family (via the Belgium-based holding company Besnier SA [BSA] International). The company was created by André Besnier, and later headed by his son Michel (1928–2000). Today, Emmanuel Besnier, the younger son of Michel, presides the supervisory board whereas his elder brother Jean-Michel holds the function of CEO of Lactalis France (their sister Marie, although without operational responsibility in the group, is consulted on the strategy of the family business). Since June 2020, the company is run by Philippe Palazzi, who is more precisely the Chairman & CEO Lactalis Group.

15.3.2. SEB

The group SEB (*Société d'Emboutissage de Bourgogne*) is a large French consortium that produces small appliances.⁵ The history of SEB began in 1857 when Antoine Lescure founded his first tinware workshop (*atelier de ferblanterie*). Over the years, the company expanded into the manufacturing and distribution sector, becoming the world's leading small appliance company. SEB has indeed managed to grow, notably through numerous acquisitions, and now owns many well-known brands, such as Moulinex, Rowenta, Tefal, WMF, or Calor. Its turnover was about €7 billion, and it presently employs nearly 33,000 people worldwide.

Today, SEB is headed by its founding family; the Lescure family owns 31.9% of the group's capital, with a company capitalization of about €7 billion. It is a *société anonyme* with a *conseil d'administration* (one-tier-system) listed on Euronext.

15.3.3. Roquette Frères

Roquette Frères is a family-owned company which produces more than 650 products derived from the starch extracted from corn, wheat, potatoes, and peas.⁶ Founded in 1933 by the brothers Dominique and Germain Roquette, Roquette has grown to become the leader in starch production in Europe and the fourth largest producer of starch worldwide; it is also the world leader in the production of polyols.

Today, the company, a *société anonyme* which is not publicly traded, is owned by over 300 family shareholders from the second to the fifth generation. Its turnover of around €3.5 billion currently relies on its 8,360 employees worldwide.

15.3.4. Bonduelle

The Bonduelle Group is at present the world's leading canned vegetable company.⁷ It was founded by Louis Bonduelle-Dalle and Louis Lesaffre Roussel in 1853. With 11,000 employees, it has been run since 2001 by Christophe Bonduelle, a

⁵<https://www.groupeseb.com/en>.

⁶<https://www.roquette.com/>.

⁷<https://www.bonduelle.com/en/>.

member of the fifth generation. Its activity in canned, frozen, and bagged vegetables has enabled it to become a worldwide leader with a turnover of about €2.8 billion.

The Bonduelle Group is formed as a *société en commandite par actions*, a partnership limited by shares. It is listed on the Euronext Paris stock exchange.

It includes two categories of associates. The Pierre et Benoît Bonduelle SAS (held by three Bonduelle family branches) is the general partner (*commandité*) (32.4%); a board of directors composed of eight members is responsible for approving the strategic choices made by the family general partners; its members are in fact directors of Bonduelle SAS. The limited partners (*commanditaire*) are other family members (23.46%), free float (38.37%) and employees and treasury stock (5.87%). Consequently, the Bonduelle family owns the majority of its capital up until today (55.8%).

15.3.5. *Hermès*

Hermès Paris, or Hermès International, is a French high-fashion luxury goods manufacturer. It was established by Thierry Hermès in Paris in 1837. It has experienced growing success and is now renowned internationally. The company records a yearly turnover of more than €6 billion and has about 13,000 employees worldwide.

The company, a partnership limited by shares (*société en commandite par actions*), is listed on Euronext. But it still belongs mainly to its heirs, and the Hermès family also controls the company (Hermès is owned mainly by three families, all heirs of the founder Thierry Hermès: Guerrand, Dumas, and Puech). More precisely, the Hermès family collectively owns the majority of the share capital of Hermès International through a number of asset-holding companies and direct ownerships.⁸

15.4. Rules for the Governance of Family Firms, in Particular Family Constitutions

Regarding the governance of family businesses, three aspects have to be taken into consideration and coordinated: business, family, and ownership. Therefore, different kinds of rules, more or less legally constraining, can be observed.

15.4.1. *Legislation*

Legislation is the first element subject to regulation in the governance framework for family firms. However, there are generally no specific rules regarding family businesses in particular; they depend mainly on which type of company they belong to. In addition, as opposed to other company types, French limited

⁸See https://assets-finance.hermes.com/s3fs-public/node/pdf_file/2021-04/1619013896/hermes_2021_organisation_fr.pdf.

liability companies (SARL) and simplified stock companies (SAS) are granted much party autonomy. Consequently, only little legislation exists, and the most important governance rules are found in the company's articles of association.

15.4.2. Shareholder Agreements

Shareholder agreements also often contain rules about the governance of family firms (voting rights agreements, transfer restrictions and pre-emptory purchase rights, etc.).⁹ However, those agreements – made between all or only a few shareholders – only bind those who signed them.

15.4.3. Corporate Governance Codes

Concerning corporate governance codes, there is no specific code for family firms in France. The Afep-Medef Code,¹⁰ which is considered as the code of reference in France, applies to all companies listed on a regulated market, whether they are a family business or not.

It should however be noted that a second corporate governance code exists in France: the MiddleNext Code.¹¹ The latter is better suited for medium or smaller listed companies. It also sometimes refers specifically to family firms.

15.4.4. Family Constitutions

Last but not least, there is also the family constitution, taking different forms and being without a unique terminology: *protocole familial*, *pacte de famille*, and *charte familiale*.

A family business does not necessarily require a family constitution to be successful. Indeed, the majority of family firms in France can do without. However, the family constitution is currently used by 35% of family firms (Saubiez, 2016).

Legal discussion is rare on this topic.¹² There is also only very limited litigation and even less case law.

To summarize, a family constitution is a document that provides a framework for intra-family relationships and for relationships between the family and their business.¹³ It defines the common values and objectives of the family, which characterize the *affectio familiae*, but also the family's vision of the future and the main principles governing the company's internal functioning.

⁹For more details, see Champaud (2009, p. 5, and in part. 31 ff.).

¹⁰See https://afep.com/wp-content/uploads/2020/01/Afep_Medef-Code-revision-2020-EN-.pdf.

¹¹See https://www.middlenext.com/IMG/pdf/c17_-_cahier_14_middlenext_code_de_gouvernance_2021-2.pdf.

¹²For a short, non-legal presentation with examples, see Daumas (2012, p. 41 ff.) and Danet (2009, p. 85 ff.).

¹³Tandeau de Marsac (2014 [La charte familiale]).

The exact content of a family constitution varies from one company to another, it's being specifically adapted to the concerns and history of each family. However, four main themes may be identified: (1) the philosophy of the family (values and objectives), their visions, and sometimes even their history, (2) the rules of governance, (3) the role of everyone within the family business, and (4) the rules for the integration of new members.

A family constitution is usually signed by all family members, whether they are shareholders or not. The drafting of this document is also collective; it arises from several (face-to-face) meetings. Indeed, as with any family governance process, a family constitution cannot be imposed. Finally, some families perform regular reviews of their constitutions, considering that it is a document in progress.

The family constitution is widely regarded as having no legal value, and more precisely as a gentleman's agreement carrying exclusively moral significance, even if it can sometimes contain elements of a shareholder agreement, and be binding as such. But above all, practitioners are increasingly defending the idea that family constitutions have a kind of contractual value, that is to say, dismissing the idea that the document has no legal value.¹⁴ Indeed, since it entails commitments borne by those who sign it, it has a contractual value as with any commitment freely made by a legally capable person. In other words, considering it is a document signed by legally capable persons that contains commitments, it therefore falls within the scope of a contract, and thus within the framework of civil law.

Of course, sanctions for non-compliance with these commitments are rarely clearly announced or detailed in family constitutions, and the drafting is often vague, as the protagonists are unlikely to consider the circumstances that might prevent the application of such family constitutions. In addition, the family is generally reluctant to take into account such painful issues. In any case, the practice of family constitutions is still too recent to know of their actual legal use by families.

However, hypothetically, it would be possible to take legal action against family members who did not comply with the family constitution and who acted in a way that led to direct damage to another member of the family (for example, a family member could seek compensation if they were refused a job in the family business while meeting the criteria set out in the constitution).

In any event, even if family constitutions do not have the "force of law" between the parties, the judge may take them into account, according to French law. And practice has shown that judges sometimes do so, whether they were invited by law or not.

For example, even if this provision does not concern the family constitutions of companies, Art. 373-2-11 of the French Civil Code (*Code civil*) states that

When deciding on the modes of exercising parental authority, the judge shall notably take into account: 1° the way in which the parents were previously acting, or the agreements which they may have

¹⁴Tandeu de Marsac (2014 [La charte familiale]).

previously concluded [...]. (« lorsqu'il se prononce sur les modalités d'exercice de l'autorité parentale, le juge prend notamment en considération: 1° la pratique que les parents avaient précédemment suivie ou les accords qu'ils avaient pu antérieurement conclure [...] »).

Moreover, judges may refer to such documents – in particular family constitutions – and even take them into consideration, notably in order to interpret some other document. That was evidenced in a court decision issued by the Court of Appeal of Paris (ch. 5&9, 19 June 2015, n° 14/19462, S. c/S).¹⁵ In that decision, the judges based their interpretation of the company's articles of association and the reconstitution of the shareholders' will on the family constitution signed by all of the latter.

Finally, it should also be noted that French courts have sometimes recognized that a solemn commitment (*engagement sur l'honneur*) is mandatory (see, for example, Cass. com., 23 December 1968, no. 67-13.046, Bull. IV, no. 374, D. 1969, somm., p. 71, regarding a commitment taken by a person toward a bank to repay the debit balance of an account). In another court decision, the judges considered that a “commitment to take some action” (*engagement de « faire un geste »*) which appears to be a moral commitment is null because of its “indeterminate purpose” (“*indétermination de l'objet*”); this suggests that the solution to that problem would be different if the “action” was specified (Cass. com., 28 February 1983, no. 81-14.921, Bull. civ. IV, no. 86).

15.5. Conclusion

To conclude, as shown by the French example, family businesses can take a variety of forms. In any case, business and family stories often prove to be a good match, at least in France.

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¹⁵For a deeper analysis, see Masset (2015, p. 734).

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Chapter 16

Discussion Report Part 4: Legal Research II

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Susanne Kalss: Succession in Family Businesses – Legal Frameworks

Katrin Deckert: Family Firms and Family Constitutions in France – A General Overview

At the beginning of the discussion, Kalss was asked about the debate on family constitutions and their legal effects in Austria. She replied that the legal classification as a binding agreement or a moral obligation depends on the specific document. Types of family constitutions as they are increasingly worked out in legal literature may be helpful as a first step to assess their legal nature in the case at hand. At least, a family constitution would be considered as an aid for the interpretation of the company statutes. It may even have the legal effect of restricting the rights of shareholders, for example when they agreed to accept share prices for a buy-out below the fair value. Tailor-made family constitutions also contain provisions for a way out, such as an internal buy-sell arrangement. Often, the core parts of a family constitution in Austria, Kalss explained, are similar to a typical shareholder agreement.

A second part of the discussion was devoted to the legal infrastructure between succession law and company law, following the presentation by Susanne Kalss. A German law professor stated that the role and responsibility of the legislature are to offer legal rules suited to the needs of family firms, especially with regard to the doctrinal reconciliation of succession law and company law. It seems that romanistic legal orders (France, Italy, Spain) have difficulties in this respect, he

Family Firms and Family Constitution, 225–226



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explained. For instance, some of them do not acknowledge the validity of inheritance contracts. The family constitution may help as a remedy to overcome some of these deficiencies of succession law. Kalss added that in Austria the right to a compulsory portion (“Pflichtteilrecht”) in succession law gives rise to further problems. They may be overcome in later generations by making use of the civil-law foundation (“Privatstiftung”), but in the first generation the compulsory portion regime remains a stumbling block for lawyers. Asked about current reform proposals to improve the interplay of company and succession law on the European level, Kalss responded that there are no such plans. In this context, a German law professor reminded the audience of the fact that company law is similar across jurisdictions, whereas the law of succession differs in many respects, reflecting path dependences and cultural differences.

Finally, the discussion on Austrian law turned to legal forms for family businesses, in particular the partnership limited by shares (“Kommanditgesellschaft auf Aktien”) which has become increasingly popular in Germany. Kalss explained that this type of business organization was eliminated from the menu of legal forms in Austria in the 1960s due to its practical irrelevance. From today’s point of view, this loss of flexibility for family businesses is regrettable.

Moving on to family constitutions in France, Deckert explained that their development is a rather recent phenomenon, having emerged more broadly over the last 10–15 years. The Mulliez family’s constitution is considered a role model. It was drafted after the patriarch had died intestate in the 1950s. His heirs worked together with a Belgian business professor and the family notary to create an agreement for their future cooperation. Looking more globally, an Australian management scholar and a German law professor shared the observation that modern family constitutions differ from their early predecessors in the way their content is shaped: today, family consensus has replaced the patriarch’s dictatorship.

The last part of the discussion revolved around a decision by the Paris Court of Appeal of 2015 which considered the family constitution as an aid for interpreting the company charter. Since then, Deckert reported, that practitioners are well aware of the fact that a family constitution may have legal significance. However, this decision did not receive much attention from legal scholars. A possible explanation for the dearth of legal scholarship in this respect is that most disputes within family businesses in France are resolved by mediation or arbitration.

Chapter 17

Family Constitutions and the Complexity of Family Businesses from a Counsel's Point of View¹

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Abstract

Family constitutions are relatively new to the law of family companies, although there might have been forerunners in the history of entrepreneur families. The practical importance and the proliferation of family constitutions in German family companies are increasing, along with the discussion of family constitutions in legal literature. This new instrument of family governance is not law driven but business driven, it has been designed by business advisors. Its analysis and classification are still at the very beginning in academic research and practice. Even though family constitutions are generally deemed to be without any legal effect and not legally binding, from a legal point of view, this assumption is at least highly questionable.

Keywords: Family constitution; family governance; legal analysis of the family constitution; family business counsel; conflicts; Germany

¹The following chapter is based on a lecture given by the author at the Hamburg Conference: Law and Management of Family Firms on 14 and 15 September 2017 at the Max Planck Institute for Comparative and International Private Law in Hamburg – the form of presentation has been maintained.



17.1. Introduction – Managing Complexity and Managing Conflicts

Family businesses are often faced with various conflicts: conflicts between shareholders, between members of the family or between family branches. Conflicts in family businesses are part of the daily business. Of course, these sorts of conflicts are very delicate. But families are very discrete, being aware of the public perception and negative effects on both the family and the family business. The public in general never hears of such conflicts (Holler, 2020, § 75 para. 4). Therefore, advising family businesses often means not only giving legal advice; in addition, it demands managing complexity and managing conflicts – in each case in a very diverse and individual structure of both the family and the family business.

17.2. The Law of Family Businesses

Complexity starts with the absence of any legal codification in respect of family businesses (Holler, 2018, p. 557). Every family business is different. This explains why there are hardly any systematic presentations in corporate law literature.² The law of family companies has not been codified. It is a law of individual contracts and regulations (Holler, 2020, § 75 paras. 5 and 84 et seq.).

17.2.1. Law of Individual Contracts and Regulations

The special and characteristic aims of a family business and its owners must therefore be individually regulated on the basis of tailor-made drafting, especially in the areas of corporate law, succession law, and family law.³ Interface problems are typical and a challenge, especially in the design of contracts.

17.2.2. Typical Characteristics and Regulation Requirements

Although each family company has its individual design, there are typical characteristics and regulation requirements, such as (i) the typical limitation on the group of possible shareholders and the restriction of share transfer only to descendants of the founder (closed shop), (ii) the increasing number of shareholders from generation to generation, (iii) the corporate structure being divided into management, advisory council and the shareholder meeting with the shareholders being organized and divided into groups of families and family branches, (iv) the special importance of internal shareholder financing for the existence and growth of the family business, (v) restrictions on the right to terminate the company and

²Holler (2018); Holler (2020), Hennerkes and Kirchdörfer (1998); Scherer et al. (2012); Ulmer (2010a); Ulmer (2010b); Bochmann and Scheller and Prütting (2021); Vogt et al. (2017); for Austrian law Kalss and Probst (2013).

³Holler (2018, p. 557); Holler (2020, § 75 para. 5 and 84 et seq.); focusing on succession law and planning in family businesses Holler (2021a, 2021b).

reduction of shareholder compensation claims in order to avoid liquidity outflow relating to crucial exit occasions.⁴

These various regulations on different legal levels must be well coordinated. They must fit together and mesh. Inadequate regulation and a lack of interlocking of such regulation can endanger the family business and is one of the typical reasons for conflicts (Holler, 2018, p. 558; Sigle 1994, p. 459).

There are various legal limitations in German corporate law, making an adequate and legally certain design with regard to these typical family businesses characteristics such a challenge that there has been a call for a “special law” (*Sonderrecht*) for family businesses comparable to the “special law for public partnership companies.”⁵

17.2.3. Tradition of the Family Business, Values, and Goals

These typical characteristics are the mission to preserve the company and its character as a family business in the long run. They can be summarized as the tradition of the family business, including its values and goals (Holler, 2019a, p. 883). They are an expression and consequence of the tradition of the family business as determined by the founder and the values and goals that this individual has designated to be the “program” for the following generations (Holler, 2018, p. 558 et seq.).

17.2.3.1. The Founder's Will and Tradition

The founder's will and tradition are the origin and basis of the family business and its legal statutes as provided by the founder, which is relevant and at least in partnership law can even be decisive for both the content and the interpretation of a partnership agreement (Holler, 2018, p. 558 et seq.).

17.2.3.2. Legal Significance for Interpretation and Content of Family Business Statutes

The founder's will is the very beginning of every family business. In jurisprudence, the visions of the founders have been summarized as the “tradition of the family business” based on the founder's will.⁶ Courts have determined such tradition of the founder to be responsible for the content and interpretation of the partnership agreement. It is therefore the founder's will and tradition as incorporated in the corporate membership that is to be passed from one generation to the next (Fig. 17.1).

⁴Ulmer (2010, p. 552); Holler (2018, p. 558); pointing out the specific effect of corporate law on family businesses Habersack (2020, p. 2093).

⁵See Holler (2019a, p. 882); Holler (2018, p. 558); Ulmer (2010, p. 549); Ulmer (2010, p. 805); Binz and Sorg (2018, § 6 para. 178); see for discussion and ample references Holler (2020, § 75 paras. 25 and 79 et seq.); critical Lieder (2017, p. 59); Holler (2012, p. 719ff.); Lieder (2021, § 3 paras. 115ff.); Fleischer (2017, p.1201); explicitly against any special law (*Sonderrecht*) Bochmann and Scheller and Prütting (2021, Einf. Vor § 1 paras. 6 et seq.) (“Kein Sonderrecht der Familienunternehmen”).

⁶Cf. Higher Regional Court of Hamm (OLG Hamm), decision of 3 November 1999 in case 8 U 220/98, NJOZ 2001, 170 and decision of January 17, 1991 in case 15 W 428/90, NJW-RR 1991, 837, 840; Holler (2018, p. 559).

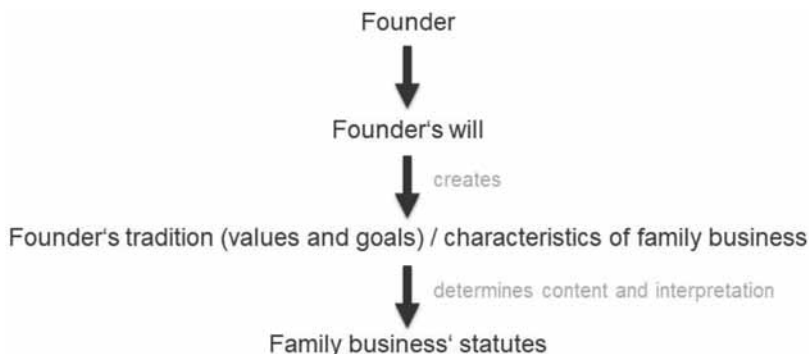


Fig. 17.1. The Link Between the Founder's Will and the Family Business Statutes.

17.2.4. Great Diversity of Legal Forms of Companies

There is a great diversity of company legal forms that the family can choose for their family business (Holler, 2020, § 75 paras. 56 et seq. and 64). And there is not solely one suitable legal form. The selection in the individual case depends not only on the business demands of the company, but especially on the succession situation within the family (Holler, 2020, § 75 paras. 72 et seq.; Lieder, 2017, p. 62).

17.2.5. Architecture of Family Business Providing for Different Corporate Levels and Statutes

17.2.5.1. Not Only Articles of Association, But Different Corporate Levels

Quite often, the internal corporate organization is not limited to the articles of association of the family business itself, although such articles are in general the fundamental place where this organization is stipulated (Holler, 2020, § 75 para. 87 et seq.). The architecture can be rather complex and eclectic. It has been compared with the structure of an onion, thus having different layers ("Zwiebelschalenmodell") (Fleischer, 2016). Such an image, as accurately defined by Fleischer, is attractive also because the corporate structure of a family business in the individual case is a "grown structure" – with the family business usually providing for a closed shop of family shareholders only (Holler, 2020, § 75 paras. 20 and 38 et seq.); it has grown with the family from generation to generation and therefore is multilayered and complex in many respects.

The corporate structure of a family business frequently provides for different corporate levels and statutes for different purposes.

17.2.5.2. Shareholder Agreements

Family shareholders often agree upon a shareholder agreement for different reasons (Holler, 2018, p. 559, 2020, § 75 paras. 86 et seq. and 132 et seq.; Kalss & Probst, 2013: paras. 4/2 et seq.). One important motive is that these agreements, in contrast to the content of the company's articles of association, do not have to be disclosed to the public or filed with the commercial register

(Holler (2020, § 75 para. 87). Additionally, shareholder agreements are more flexible than the articles, as their content, changes or amendments do not have to comply with form requirements or the formal strictness of the articles in stock corporation law.⁷

Individual and versatile content. The content of shareholder agreements of family businesses is individualized and versatile.⁸ Shareholder agreements often contain pooling agreements in which a group of shareholders (for example, a family branch⁹) concentrate their votes to maintain a certain influence on the family business either in general or regarding specific matters and affairs. Families often provide regulations with regard to the composition of the management and advisory boards as well as profile requirements for their members. The definition is one of the crucial issues, and regulation requirements in family businesses are vulnerable to internal conflicts since the family must determine (i) whether or not family members are to be members of the management or supervisory board and (ii) the social and professional qualities required. Other clauses typically provided in shareholder agreements are regulations governing the transfer of shares (for example, transfer restrictions, exit regulation and – in large companies – regulations for an internal share transfer market).

Legal qualification – company under civil law. As far as the legal qualification is concerned, such shareholder agreements themselves usually serve under German law to constitute companies under civil law pursuant to section 705 German Civil Code.¹⁰ Therefore, there often exist other company statutes and other corporate levels beyond the corporate entity of the actual family business, each with its own corporate life and decision-making processes that need to be well coordinated in practice.

Consequences for corporate design practice. The parallel coexistence of various corporate levels requires careful design and drafting so as to achieve an interlocking regulation that meshes and fits together smoothly. Various designs for these companies within the family business structure are possible.

The relatively easiest variation is where the participants and shareholders of both companies – family company and civil law company – are identical. We call this an omnilateral shareholder agreement.¹¹ If the family shareholders only partly become parties, we speak of a fractional shareholder agreement.¹²

⁷Sec. 23 para. 5 German Stock Corporation Act (AktG).

⁸Wicke (2021, § 18 para. 4) ; Wicke (2022, para. 132); in detail Hoffmann-Becking (1994, p. 444); Holler (2018, 559 et seq.).

⁹For more detail on the organization of family branches and their legal implications, Holler (2020, § 75 paras. 91 et seq.); Fleischer (2019); on the criticism of the family branch principle, Kormann (2012, chapter 6 paras. 4 et seq.).

¹⁰Ulmer and Löbbecke (2013, § 3 paras. 119 and 123); Holler (2020, § 75 para. 137 and in more detail paras. 132 et seq.); Holler (2018, p. 560); Wicke (2021, § 18 para. 6).

¹¹See in detail, Noack (1994, p. 33); for the Limited Liability Company (GmbH) Ulmer and Löbbecke (2013, § 3 para. 120); Holler (2018, p. 560).

¹²Noack (1994, p. 33); for the Limited Liability Company (GmbH) Ulmer and Löbbecke (2013, § 3 para. 120) Holler (2018, p. 560).

Rather often, not all of the family shareholders are parties to the shareholder agreement for different reasons. If the family is divided into family branches and the internal relationship between the members of such family branches is not regulated within the partnership agreement or articles of associations, each branch will conclude its own shareholder agreement (family branch statute).¹³ If there are third-party shareholders who are not members of the family, the family often will conclude a shareholder agreement in order to bundle family influence on the family business, thereby providing restrictions on voting rights in the shareholder meeting, which is called a pooling agreement or protective association agreement (*Schutzgemeinschaftsvertrag*).¹⁴ Sometimes there are two or more families who do the same. Together they conclude a multi-family shareholder agreement.

17.2.5.3. Shareholder Resolutions

Another level of regulation is established by shareholder resolutions (Holler, 2018, p. 560). Typical subjects of shareholder resolutions – as in usual, non-family businesses – are rules of procedure for the board of directors, the advisory council, and/or the shareholders' committee. But families can also decide to agree upon sensitive issues not being regulated in the articles of associations but in a shareholder resolution, especially with regard to family issues in relation to the company (Holler, 2018, p. 560).

Example: There was a member of the family who was a shareholder who wanted to buy a product manufactured by the family company. As a legal transaction with a shareholder, the transaction required a shareholder resolution with a majority of 75% of the voting capital as provided by the articles of association. The shareholder concerned by the transaction had no voting right.¹⁵ Since there was a severe conflict in the family as well as a shareholder dispute, the respective shareholder of the other family branch – in protest and on principle – did not agree. The legal transaction had to remain uncompleted. Some months later, this purchase-seeking member of the family discovered a long-forgotten shareholder resolution buried in oblivion that had been passed 20 years earlier and that provided detailed regulations stipulating specific conditions for product sales to family members and family shareholders. The management was entitled to execute the transaction on the basis of such shareholder resolution.

As this practical example illustrates, families can regulate their tradition and interests in relation to the company by means of shareholder resolutions, which are insofar an appropriate instrument.

¹³For more details, see Holler (2020, § 75 paras. 91 et seq.).

¹⁴For further details, see Hoffmann-Becking (1994, p. 442ff.); for a sample pool agreement among shareholders of a listed stock corporation, see Löbbe (2012, chapter 5.01 paras. 1 et seq., pp. 463 et seq. and chapter 5.02, pp. 494 et seq.); Holler (2018, p. 559f.).

¹⁵Sec. 47 para. 4 s. 2 German Limited Liability Company Act (GmbHG).

17.2.6. Other Levels of Regulations – Inheritance and Family Law

There are other levels of regulation for family businesses and their members, such as inheritance and family law. Each family shareholder must ensure that his testament or contract of inheritance complies with requirements for the succession of shares to members of the family as provided by the family business statutes.¹⁶ Since the situation of succession within the family varies over the course of time and therefore constitutes a dynamic process, such compliance can be a challenge and requires continuous and careful monitoring in fact and law.¹⁷

Additionally, claims on the reserved portion of an estate (*Pflichtteil*), in the event of the death of a family shareholder, as well as claims on equal distribution of surplus (*Zugewinnausgleich*), in cases of divorce, can force the family shareholder to exercise the right to terminate the company and to claim compensation. Liquidity outflow caused by a claim of compensation can overstrain the financial means of the company and must be avoided (Holler, 2020, § 75 para. 312). Therefore, claims on the reserved portion of an estate as well as claims on equal distribution of surplus must be excluded by contract in each individual case by every single family shareholder.

Since such claims can endanger the existence of a family business,¹⁸ corporate statutes often provide clauses authorizing the shareholder meeting to decide on the exclusion of a shareholder that has neglected to exclude such claims by contract with his marriage partner and to provide evidence of having done so within a fixed time limit.¹⁹

Last but not least, precautionary powers of attorney are part of the law of family businesses.²⁰ These are important precautionary measures for cases of mental illness or emotional, mental, or physical disability in which a family shareholder is no longer able to manage his or her affairs, especially the exercise of shareholder rights. Precautionary powers of attorney avoid legal guardianship, which is especially important to family businesses because any influence of third parties is often excluded by all means. Apart from that, guardianship can cause severe problems for the functioning of the family company, for the decision-making procedure in the shareholder meeting of the family business and for the exercise of shareholder rights.²¹

¹⁶Holler (2020, § 75 paras. 70 and 220 et seq.) ; see for the design of succession clause (Nachfolgeklausel) in corporate statutes of family businesses, Holler (2021a).

¹⁷Holler (2020, § 75 para. 70); regarding succession clauses (Nachfolgeklauseln) in corporate statutes of family businesses in detail, Holler (2021a).

¹⁸On the problem of the strain on liquidity in the context of corporate succession, see Mayer (2013, p. 75).

¹⁹Explaining such matrimonial property clauses in articles of association, Wenckstern (2014, pp. 1, 12f et seq.); for further detail, see Sanders and Rolfes and Hawickenbrauck (2021: 1797ff.).

²⁰On guardianship and particular challenges, Langenfeld (2005, p. 52).

²¹Generally and for ample references, see Schäfer (2020, § 705 paras. 126 et seq.).

17.3. Complexity in Law and Fact

Complexity often is underestimated. Dealing with family businesses demands an awareness of complexity as regards each person involved. The complexity in terms of legal advice is multilayered and eclectic in law and fact (Holler, 2020, § 75 paras. 1 et seq. and 5 et seq.).

17.3.1. Juxtaposition of Family and Family Business

Family and the family business stand side by side in business reality. You cannot deal with the one without the other. In order to understand the business and its structure, you must know the family as well as the family tradition, including the family history, family conflicts, and family moral values.

17.3.2. Emotions

There often are emotions – and family members sometimes let them run free in the exchange of letters, shareholder meetings or negotiations. Emotions place high demands on each person involved, especially third parties, these including management who are not part of the family and professional advisors (Holler, 2020, § 75 para. 69).

In normal companies, such emotional and not exclusively rational behavior would be regarded as inappropriate or out of place. It may occur that family shareholders will start to cry or shout at each other during a shareholder meeting. However, if a sister shareholder insults her brother shareholder and acts in an offensive manner, this behavior will not necessarily have the same quality as the equivalent behavior among usual shareholders in normal and non-family business. Imagine the addressee of such behavior being the representative of a third party, e.g., a financial investor. In a family business, there are different standards, but no schematic solutions as far as the legal consequences where such behavior is concerned. Rightly, in the case law of the German Federal Court of Justice, fiduciary duties (*gesellschaftsrechtliche Treuepflichten*) of the family shareholder can be either more or less intensive, something which must be determined on a case-by-case basis.²² Specific characteristics of family businesses lead to specific standards for fiduciary duties of the family shareholder as well as the legal consequences in the event of their violation (Holler, 2012, p. 719ff., 2020, § 75 paras. 355 et seq. and 384 et seq.; Holler & Mann, 2021, p. 404 et seq.).

17.4. Conflicts Are Typical and Dangerous for Family Businesses

Conflicts are both typical and dangerous for family business (Holler, 2020, § 75 paras. 67 et seq.).

²²German Federal Court of Justice (BGH), decision of 9 December 1968 in case II ZR 42/67, NJW 1969, 793, 794, and the decision of December 12, 1994 in case II ZR 206/93, NJW 1995, 597; Schmidt (2016, § 140 para. 35).

17.4.1. Special and Individual Characteristics

Family thinking and family feelings, including emotional behavior, can prevail so much over family members that they are not able to make rational decisions in the affairs of the family business (Holler, 2020, § 75 para. 69). Such conflicts between family members or family branches are dangerous (Holler, 2020, § 75 para. 93). It is common sense that experience in corporate litigation outside family businesses suggests that shareholder disputes can even endanger the existence of a company. This is true for family businesses, too. Nevertheless, there are different rules for conflict resolution and (corporate) litigation at least in most of the entrepreneur families. This is a question of (dispute) culture and tradition and therefore – once again – very individual.²³

Shareholders are not just business partners, but family. Whereas shareholders in normal, non-family businesses only see each other in shareholder meetings – and after their exit from the company they go their separate ways – this does not hold true for a family business. The family comes together outside of shareholder meetings and is connected by family ties (*Familienband*).²⁴ The family ties will survive any business partnership or shareholder exit in the long term.

17.4.2. Typical Reasons for Conflicts

17.4.2.1. Unanimous Votes and Individual Consent Requirements

Unanimous votes and the individual consent of shareholders are often required in the structures of family businesses. Although a corporate adviser may try to avoid requirements of unanimous voting and individual consent because they can result in standstills and the blockage of necessary decisions, these crucial and challenging situations are typical in family businesses for different legal reasons:

Section 709 German Civil Code. As pointed out above, we often have to deal with civil law companies in a different regulatory context and on different corporate levels. Even if the family business does not itself have the legal form of a civil law company, often typical shareholder agreements as described above themselves might constitute each in their own right a civil law company pursuant to sections 705 ff. German Civil Code (BGB). Therefore, the law governing civil law companies plays a decisive role within the law of family businesses (Holler, 2020, § 75 paras. 316 et seq.). Unless otherwise stipulated, shareholder resolutions require a unanimous vote pursuant to section 709 German Civil Code.

Special Rights (Section 35 German Civil Code). Special rights (*Sonderrechte*) pursuant to section 35 German Civil Code as well as preference rights (*Vorzugsrechte*) are typical for family businesses and are frequently provided in favor of an individual family shareholder, a group of family shareholders or family branches (Holler, 2020, § 75 paras. 292 et seq.). These special rights, such as a multiple voting right or a presentation right for a member of the management or supervisory board, cannot be restricted or withdrawn without the

²³For ample references, see Holler (2018, p. 559).

²⁴In detail with regard to family connectedness constituting family businesses' DNA, Holler (2019b, p. 931); Holler (2020, § 75 para. 27).

individual consent of the shareholder or the group of shareholders concerned pursuant to [section 35](#) German Civil Code. This statutory rule provides for a general principle valid for all kinds of legal forms, although there are of course particularities to be considered.²⁵ Once such a special right has been granted, it can make a change of the partnership agreement, articles of association or shareholder agreement very difficult or even impossible in fact ([Holler, 2020](#), § 75 para. 308). Furthermore, conflicts arise with regard to the continuity of special and preference rights in cases of succession ([Holler, 2020](#), § 75 para. 309).

The Core of the Membership (*Kernbereich der Mitgliedschaft*). The core of the membership (*Kernbereich der Mitgliedschaft*)²⁶ constitutes another crucial limitation for the design of agreements or decisions in family businesses ([Holler, 2018](#), p. 558; [Holler, 2020](#), § 75 paras. 249 et seq.). There are certain fundamental shareholder rights that cannot be restricted or withdrawn without the individual consent of the shareholder concerned. It is a dilemma for family businesses that elementary regulation encompasses interference with the core of membership of the shareholders (*Eingriff in den Kernbereich der Mitgliedschaft*) and therefore requires the individual consent of each family shareholder concerned. For example, in order to avoid liquidity outflow, the right to terminate the partnership must be excluded ([Holler, 2019b](#), p. 941f., 2020, § 75 paras. 312 et seq.) and compensation claims must be reduced.²⁷ Both of these shareholder rights are part of the core of the membership at least in general and on the basis of the statutory structure of the company. There can be great uncertainty whether a particular shareholder right or position belongs to the core of membership or not in the individual case, depending on the individual design of the family company and its actual or effective shape (*Realstatut*) ([Holler, 2020](#), § 75 paras. 252 et seq.).

17.4.2.2. *Obligation to Consent Due to Shareholder's Fiduciary Duty*

Since unanimous voting and individual consent often cannot be achieved, a frequent shareholder dispute relates to the question of whether the dissenting shareholder has an obligation to consent as a result of the fiduciary duty owed by a shareholder ([Holler, 2020](#), § 75 paras. 371 et seq.; [Holler & Mann, 2021](#): 407 et seq.). But here as well, the German Federal High Court places strict demands in evaluating the individual case.²⁸ That is why blockades of essential corporate measures are often a challenge in family businesses.

²⁵On the particularities of the law governing German Limited Liability Companies (GmbH), partnerships and German Stock Corporations (AG), [Holler \(2020, § 75 paras. 300 et seq.\)](#).

²⁶About this in general and about the term, [Roth \(2021, § 119 para. 36 et seq.\)](#).

²⁷In detail recently, [Holler \(2019b, p. 940f.\)](#) and [Fleischer and Bong \(2017, p. 1957\)](#); [Hamburger Kreis Recht der Familienunternehmen \(2020\)](#).

²⁸Cf. the recent German Federal Court of Justice (BGH) decision of August 14, 2014 in case 23 U 4744/13, NZG 2015, 66 – Media-Saturn.

17.4.2.3. Intergenerational Conflict

Another typical reason for dispute in family businesses is intergenerational conflict. If the founder, for example, appoints one of his children as his successor and after a couple of years regrets this decision and removes the child from the position of director, a severe intergenerational conflict can be the consequence, affecting both the family and the business. Such generational conflict can be momentous not only because the child may have chosen a particular education, career or profession specifically because of having been designated as successor; wounds that children suffer often cannot be healed with financial compensation, and they burden family and shareholder relationships in the long run (Holler, 2021b, § 33 para.33).

17.4.2.4. Juxtaposition of Corporate and Succession Law

The juxtaposition of corporate law and succession law in a particular case is complex and a source of conflict. Quite often, we have to deal with interface problems, for example in the law of executorship (*Recht der Testamentsvollstreckung*),²⁹ which is an indispensable instrument of succession and succession planning from a legal point of view.³⁰ In general, under German succession law the executor of a will is exclusively entitled to exercise the shareholder rights of shares being part of the estate, and the heirs are insofar excluded – but details and exceptions are highly disputed.³¹ Whether there are exceptions to be made with regard to a particular situation – for example in cases of a conflict of interest or an interference with the core of the membership (Holler, 2020, § 75 para. 273a, 2021b, § 33 para. 187 et seq.) – can be hard to determine in the individual case; equally challenging is determining the consequences for the shareholder decision-making process.³² The interplay between corporate law and succession law in particular is complex.

17.5. Family Constitutions

How does a family constitution fit in the law of family businesses, especially with regard to the complex challenges routinely faced by practitioners in designing contracts as well as in resolving or managing conflicts between members of the family, family shareholders, and family branches?

17.5.1. A Novelty in Corporate Law

Family constitutions are relatively new to the law of family companies, although there might have been forerunner in the history of entrepreneur families.³³

²⁹Sec. 2197 et seq. German Civil Code (BGB).

³⁰In detail, Holler (2021b).

³¹For an overview, see Zimmermann (2017, § 2205 paras. 14 et seq.); in detail with regard to family businesses, see Holler (2021b, § 33 para.185 et seq.).

³²Cf. German Federal Court of Justice (BGH), decision of March 13, 2014 in case II ZR 250/12, NZG 2014, 945; Wicke (2015); Holler (2021b, § 33 para. 185 et seq.).

³³For detailed historical and comparative legal classification of family constitutions, see Fleischer (2017); Holler (2020, § 75 para. 164 et seq.).

The practical importance and the proliferation of family constitutions in German family companies are increasing, along with the discussion of family constitutions in legal literature.³⁴ This new instrument of family governance is not law driven but business driven, it has been designed by business advisors. Its analysis and classification are still at the very beginning in academic research and practice. (Fleischer, 2017; Holler, 2020, § 75 para. 167; Hueck, 2017; Uffmann, 2015).

17.5.2. Family Governance Instrument

One main reason for the rising emergence of family constitutions is probably that family companies have become increasingly aware that for the long-term success of the family company, not only good corporate governance but also good family governance is essential.³⁵ Following the example of the German Corporate Governance Kodex, in 2004 a commission of leading professionals and family entrepreneurs was established and subsequently developed a Governance Code for Family Businesses (*Governance Kodex für Familienunternehmen* [GKFU]), which proposes guidelines for the responsible management of family companies.³⁶ An essential part of the Code is the recommendation to create a family constitution (May & Koeberle-Schmid, 2011, p. 488f.).

17.5.3. Name, Definition, Purpose, and Content of the Family Constitution

Just as there is hardly a uniform name or definition of a family constitution, there is no uniform standard for the content and aim of family constitutions (Fleischer, 2019, p. 2823; Holler, 2018, p. 554, 2020, § 75 para. 168; Hueck, 2021, § 50 para. 1). A family constitution is supposed to define the goals and values of the family and the family shareholders in relation to the company. The aim of a family constitution is to secure the success of the company in the long run, to keep the company in the hands of the family, and to strengthen the coherence of the family (Fleischer, 2019, p. 2823; Holler, 2018, p. 555; Kalss, 2014, p. 350; Lange, 2009, p. 147).

Possible topics and the material content of a family constitution are as diverse as the different forms and designs of family constitutions which can be found in practice (Holler, 2018, p. 555; 2020, § 75 para. 173; Hueck, 2017, p. 9f.). Considering that essential aspects like corporate governance and the financing of the company are typically regulated by either the corporate statutes of the family business or by

³⁴Holler (2018); Fleischer (2017); Fleischer (2016); Holler (2020, § 75 paras. 164 et seq.); Uffmann (2015); Reich and Bode (2018); Hueck (2017); Bong (2022); Kalss (2022); for Austrian law, Kalss and Probst (2013, chapter 3).

³⁵Holler (2020, § 75 para. 165); cf. on the development of family governance, Kirchdörfer and Breyer (2014).

³⁶INTES, FBN Deutschland, ASU Die Familienunternehmer: Governance Kodex für Familienunternehmen. „Kodex.“ www.kodex-fuer-familienunternehmen.de/kodex.

means of shareholder agreements or shareholder resolutions, as outlined above, the family constitution must not compete with these corporate documents, which would pose a risk for conflicts between the different provisions.³⁷ Furthermore, the *process* of developing and formulating a family constitution is deemed to be as important as – and for some experts even more important than – the actual content of the family constitution with regard to its conflict-avoiding effect.³⁸

17.5.4. Parties, Language, and Versions of a Family Constitution

It is recommended that a family constitution be commonly developed by all family members, not only family shareholders, in understandable language and that it be signed by all family members, so that all family members, including those who might not be legally or economically educated, accept and understand the instrument.³⁹ Furthermore, different versions are recommended – one for the family (family version) and another one for the management company (company version).⁴⁰

17.5.5. Legal Quality and Relevance of Family Constitutions

The legal basis for family constitutions is still not clear and for the most part has never been discussed, especially with respect to the legal effect of family constitutions.⁴¹ Therefore, the family constitution has properly been qualified as a mystery (*Rätsel*).⁴² It is a common opinion that a family constitution is merely a memorandum of understanding, being only morally binding and legally non-existent and thus unenforceable.⁴³ These views are, however, in their generality at least questionable and need to be examined carefully on the basis of the relevant legal and especially corporate law standards.⁴⁴ With regard to the purpose and qualification of the document as a “constitution”, it is rather questionable that the family constitution is only a morally binding document without any legal effects. The term “constitution” already implies a certain commitment with legal effect.⁴⁵

³⁷Holler (2018, p. 557); Holler (2020, § 75 para. 173); critical as well Lange (2013, pp. 33, 40); Kirchdörfer and Lorz (2011, p. 105); Graf and Bisle (2010, p. 2409ff.).

³⁸For a detailed description of this process and the procedural regulatory tasks for conflict avoidance and resolution, see Holler (2018, p. 555f.); Holler (2020, § 75 para. 174 et seq.); Hueck (2021, § 50 para. 5); Kalss (2022: 37ff.).

³⁹May and Koeberle-Schmid (2011: 489f.); Baus (2016: 108); Lange (2009: 148); Kirchdörfer and Lorz (2011: 101); Holler (2020: § 75 para. 193); Oertzen and Reich (2017: 1123).

⁴⁰Baus (2016: 110); Holler (2018: 561).

⁴¹Holler (2020: § 75 para. 167); Hueck (2017: 335).

⁴²Fleischer (2016).

⁴³Kirchdörfer and Lorz (2011: 101); Koeberle-Schmid, Schween and May (2011: 2500).

⁴⁴Holler (2018: 557, 560ff.); Holler (2020: § 75 paras. 196 et seq.).

⁴⁵Holler (2020: § 75 para. 195).

17.6. Classification of Family Constitutions in the Law of Family Businesses

17.6.1. General Approach to Legal Effects and Legal Characterization

Let us have a closer look at the moment of adoption of a family constitution and its effect: What actually happens, and what exactly is the family doing (Fig. 17.2)?



Fig. 17.2. The Link Between the Founder's and the Family's Will, resp., and the Family Business Statutes.

The owner family draws up the values and goals for the family and the family business (Holler, 2018, p. 559). In fact, the family is setting up a new tradition and thereby a new design of the characteristics of the family business.

How does this relate to the founder's will, the founder's tradition, and the founder's design of the family business?

The family touches upon the founder's will, which is – as outlined above⁴⁶ – relevant and decisive for the determination of content and the interpretation of the family business statutes (Holler, 2018, pp. 559, 562). Ultimately, the family either amends, modifies, or even replaces the founder's will and tradition, which – until this moment – had been the DNA of the family business and had determined the content and interpretation of the family business statutes; it is to some extent an *emancipation process* of the family and the following generation(s) in relation to the founder generation (Holler, 2018, pp. 559, 562). This event illustrates that the family constitution, with its adoption, is not without legal effect in relation to the law of family business (Holler, 2018, p. 562). Therefore, it cannot be generally stated that a family constitution is legally non-binding.⁴⁷ As pointed out, this assumption represents a contradiction in relation to family business law principles.

As an interim result, it can be stated that family constitutions may have legal effects on determining the content and interpretation of the corporate statutes of

⁴⁶See above under point 10.2.3.2.

⁴⁷However in this sense, Hueck (2021, § 50 paras. 22ff.).

the family business, which – of course – in each individual case must be examined carefully. These principles apply at least to partnerships. The question of whether they are valid also for corporations cannot be answered at this point – for corporations these principles are at least valid for typical shareholder agreements such as pooling agreements or protective association agreements (*Schutzgemeinschaftsverträge*) (Holler, 2018, p. 561). If the family business is a closed shop and therefore a pure family business with the shares having been transferred only to family members since its foundation, they should also be applicable to private limited companies.⁴⁸

17.6.2. The Family Constitution Can Constitute Another Corporate Level

17.6.2.1. Partnership Under Civil Law

Furthermore, a family constitution can constitute – depending on the particular design and formulation in the individual case – a partnership under civil law among the family members.⁴⁹ As a consequence, sections 705 ff. German Civil Code are applicable for the internal relationship of the family members that are part of the family constitution.

I have outlined the typical internal corporate structure of family businesses, often divided by shareholder groups and family branches each having their own statutes and shareholder agreements. Similar and corresponding to this, different levels of civil law companies within the owner family are possible, since – in general – there will be two groups within the family: the shareholding family members and the non-shareholding family members (e.g., marriage partners or future shareholders) who directly support the coherence of the family and who indirectly support the family business.

The purpose of a family constitution will regularly be supporting the family business company purpose (*Gesellschaftszweck*)⁵⁰ required for the existence of a civil law company. Such purpose includes the common will of all members of the family to secure the success of the family business in the long run, keeping the company in the hands of the family and strengthening the coherence of the family (Holler, 2018, p. 561).

In practice, a large number of families will have followed and implemented the rules recommended by the Governance Code for Family Companies (*Governance Kodex für Familienunternehmen* (GKFU)). This includes the recommendation to agree on a fixed term for the validity of the family constitution and to allow

⁴⁸On the subjective and objective interpretation of articles of association, Holler (2020, § 75 paras. 225 et seq.); Prütting and Schirmacher (2017, 839 et seq.).

⁴⁹Holler (2016, § 75 para. 111); Holler (2018, p. 561); Holler (2020, § 75 para. 198); In this sense, Fleischer (2016, p. 1515); Prütting and Schirmacher (2017, p. 837); Reich and Bode (2018, p. 307); Kindler (2019, § 105 para. 2); for Austrian Law Kalss (2022, 46). critical of this classification Hamburger Kreis Recht der Familienunternehmen (2018, M26).

⁵⁰On the special company purpose of family businesses and its momentous legal consequences, Holler (2019b, p. 936ff.).

amendment of the family constitution by a qualified majority decision of the family.⁵¹ The recommendation of the Code is, therefore, based on the idea of a company relationship between the family members, which meets all the requirements for a partnership under civil law.⁵²

As a consequence, the family constitution must comply with the law of civil law partnership, meaning regulation and design requirements with regard to issues such as the right of termination (sec. 723 para. 1) or the death of a family member (sec. 727 para. 1), since a civil law partnership – if not otherwise agreed – ends automatically with the death of one of its members.⁵³

17.6.2.2. Shareholder Resolutions

Finally, a family constitution can include a valid shareholder resolution possessing potential regulatory content in relation to the family business (Holler, 2018, p. 561). Pursuant to general corporate principles, this is conceivable if within the family constitution all family shareholders agree upon a particular earnings retention rate in order to strengthen the internal financing of the company; also required is that such agreement is disclosed to the management of the family business, for example, where a “company version” of the family constitution is provided to management.

17.6.2.3. Impact on a Shareholder's Fiduciary Duties

Last but not least, a family constitution can have an impact on shareholders' fiduciary duties (Fleischer, 2016, p. 1518f.; Hamburger Kreis Recht der Familienunternehmen, 2018: M 27; Holler, 2018, p. 561; Holler, 2020, § 75 paras. 206 et seq., 232 et seq. and 241; Holler & Mann, 2021, p. 409; Reich & Bode, 2018, p. 307), especially if it provides include terms regarding shareholder issues of the family business, for example, the requirement that a family member be a member of the board of directors. In such a case there might even arise an approval obligation depending on the design and substance of the family constitution.

17.7. Conclusions

1. Family constitutions are generally deemed to be without any legal effect and not legally binding. From a legal point of view, this assumption is at least highly questionable.
2. The founder's will and his values and goals (tradition) are legally relevant and can be decisive for the content and interpretation of a family business' corporate statutes. The family's will – as unanimously incorporated and manifested

⁵¹Cf. Sec. 8.3 Governance Kodex für Familienunternehmen (GKFU); Kirchdörfer and Lorz (2011, p. 101); Hueck (2017, p. 123f.).

⁵²Holler (2018, p. 562); Holler (2020, § 75 paras. 205 and 202 et seq.); approving Fleischer (2016, p. 1515); Prütting and Schirrmacher (2017, p. 837).

⁵³Holler (2018, p. 562); Holler (2020, § 75 para. 217); in this sense, Reich and Bode (2018, p. 308f.).

- in the family constitution – touches upon such “corporate DNA” of the family business if it provides for a material regulation of values and goals (tradition).⁵⁴
3. Therefore, even if otherwise stipulated, family constitutions – in the individual case – can have material legal effects on the content and interpretation of corporate statutes as well as on shareholders’ fiduciary duties. Especially where it is disclosed to the management of the family business (business version), the family constitution might also have the quality of a shareholder resolution providing for management instructions. But each potential legal effect of a family constitution must be examined carefully on a case-by-case basis.
 4. The interpretation of corporate statutes is a common basis for shareholder conflicts and corporate litigation. In order to avoid family disputes on this corporate level – which can disturb or even endanger operational business and the family business itself – the material regulation of tradition (aims and goals) should rather *not* be stipulated in a family constitution, being covered instead in the traditional legal documentation for family businesses (such as corporate statutes, shareholder agreements and resolutions, inheritance and marriage contracts, etc.). By all means, a family constitution must avoid any regulation that is (potentially) contrary to the regulation set forth in the corporate statutes, including shareholder agreements, articles of association, shareholder agreements, and shareholder resolutions.
 5. Since the procedure of family governance is placed center stage within the family governance discussion, a family constitution – as an acknowledged instrument of family governance – should be reduced to procedural rules only, providing for clear, well-balanced, and fair procedure regulation with regard to the decision-making processes within (i) the family as a whole, (ii) particular groups of the family (for example, family branches) and (iii) individual family members (Holler, 2018, p. 563 et seq.). Corporate statutes of family businesses should provide for regulation to harmonize corporate governance and family governance in order to avoid conflicting rules and shareholder conflict (family business clause⁵⁵).
 6. A family constitution may have the effect of forming civil law companies between family members on different levels such that it will need to be carefully examined on a case-by-case basis with regard to its regulatory content as well as the potential legal effects within the family, groups or individual members of the family. The applicability of sections 705 ff. German Civil Code (BGB) lead to particular regulation requirements, for example with regard to the death (sec. 727) of a family member and termination rights (sec. 723).
 7. The (potential) legal effects of a family constitution can result in severe family conflicts and family shareholder disputes. Since one of the main purposes of the family constitution is to avoid conflicts, its proper legal design is of capital importance.

⁵⁴On the corporate DNA of family businesses characterized by their special company purpose, Holler (2019b, p. 937ff.).

⁵⁵See for terminus Holler (2018, p. 563); in detail with regard to legal design and typical family governance elements in corporate statutes of family businesses Holler (2020, § 75 para. 185 et seq.); Fleischer (2019).

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Chapter 18

Discussion Report Part 4: Legal Research III

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Lorenz Holler: Family Constitutions and the Complexity of Family Businesses from a Counsel's Point of View

The discussion first revolved around the relationship between the family constitution and the founder's intention. A practitioner said that in family businesses, the founder's intentions and values typically shape family traditions as well as the company charter. In later generations, his intentions may be replaced by the family's intentions and values, which in turn shape tradition and the company charter. The family constitution serves as a vehicle to shape the family's intentions. A law professor added that this role of the family constitution fits nicely with the historical development of family constitutions as modern forms of house laws, in which the patriarch's dominance is replaced by a family consensus. According to another legal scholar, German courts acknowledge that the founder's intentions may play a role in the interpretation of partnership agreements and even corporate statutes if they find an expression in the document. Since the founder's intentions can fade over time and the family constitution is constantly revised, this may speak in favor of considering the family constitution as an aid for interpretation. Holler admonished that, in practice, it is very dangerous to touch the founder's intentions and replace them with a family constitution without making sure that all agreements within the family business are properly coordinated. A managerial scholar explained that, from a governance perspective, the first-generation business is entirely different from the following generations. After the

Family Firms and Family Constitution, 249–250



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first generation, the governance framework needs to be revised and adapted for the future. Founders cannot anticipate all future contingencies and they cannot imagine a business 10 times the size of their initial business. To emancipate the company from its founder is of enormous importance. If the next generations run the company like the founder, it will collapse within two generations. Nature invented succession as an incentive to adapt. It is hard to eliminate structures that the founder implemented.

A second strand of discussion dealt with the pros and cons of a branch structure (family lines, “Stammesprinzip”) in family firms. A managerial scholar said that not one researcher would recommend a branch structure. From a governance perspective, a branch structure has only disadvantages. Inherent in a branch structure is the logic “branch first” instead of “business first.” In a branch structure, discussion is taking place only within the branches. On company level, only positions of the branches will be exchanged, rather than arguments. A branch structure therefore creates conflicts. And it is very difficult to abolish a branch structure because every branch has to waive its special rights. Usually, unanimity is necessary. In 30 years, the managerial scholar predicted, it will no longer be *legis artis* to draft contracts which follow a branch logic. Without a branch logic, there will be shifting alliances between the shareholders; everybody will be the winner sometimes. This is necessary for decision-making bodies to function. Holler added that a branch structure can lead to conflict of interest. It may also encourage vote-buying and tit-for-tat. A management consultant cautioned, however, that one must examine whether a branch structure is a question of design or a given fact. A branch structure typically evolves naturally from the first in the second generation, especially if there is a reluctance to involve legal advisors. A law professor added that a branch structure might be advantageous because it helps to overcome collective action problems and it facilitates decision-making. As an alternative, a management consultant suggested to appoint multiple representatives based on various interests instead of family relationships, such as a representative of the next generation.

Finally, there was an exchange of ideas about the role of legal advisors in family firms. A law professor stated that they serve an important precautionary function in family firms. They gain experience with sensitive topics such as powers of attorney in the case of legal incapacity. Following up on that, Holler explained that every shareholder should designate a representative beforehand to ensure that the company remains able to act and make decisions. The obligation to have such a power of attorney may be enforced indirectly in the articles of association by stipulating that the right to vote rests until the shareholder has complied with this obligation.

Part 5

Conclusion

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Chapter 19

Directions for Future Research

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Abstract

This chapter focuses on the ideas and proposals of the “conference,” i.e., suggestions for future research put forward by the conference participants as a group, working for two days on this subject. These research proposals include inter alia: the potential difference between the family constitution in its written form and the constitution in its practiced form; heterogeneity versus standardization of family constitution content (because of some dominating consulting approaches); the effect of national legal frameworks and traditions on the prevalence of the family constitution and its content in different countries; opportunities in large sample quantitative studies.

Keywords: Family constitution; development stage of the family constitution; application stage of the family constitution; gap between practice and written family constitution; revising the family constitution; heterogeneity versus standardization of family constitutions; national legal framework’s effect on the family constitution; intra-family conflicts as club/public goods problem

Family Firms and Family Constitution, 253–256



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The Hamburg Conference: Law and Management of Family Firms is a *research* conference. So, what are the main findings of the conference in terms of recommendations for future research? In this short chapter, we would like to highlight the *specific* contributions of this *conference*. “Specific” meaning that we do not want to develop the broad, encompassing picture of research opportunities in the field of family constitutions in general. Those ideas developed in extant literature are covered to a large extent in the surveying chapters by Fleischer, and Prigge and Mengers. Instead, this chapter focuses on the ideas and proposals of the “conference,” i.e., suggestions put forward by the conference participants as a group, working for two days on this subject. Thus, our role in this chapter is only that of clerks, documenting what originated from the joint work of the participants.

There was great consensus that the family constitution as an object of analysis has to be understood as a phenomenon consisting of two stages: the development stage and the application stage. Moreover, during the second stage, actual practice might diverge from the written form, thus, a further distinction between written form (document) and practice might be necessary. To be sure, these are by far not brand-new findings, however, they have major implications for any analysis of the effects or the determinants of a family constitution. (From here on, the term “family constitution” is used to designate the complete phenomenon, including all stages; if only a certain stage or aspect of the family constitution is discussed, it will be explicitly indicated.) Some of these implications matter for the research topics discussed in what follows.

There was also great unity, that the development stage is of huge importance; it was even speculated that it might be as important or even more important than the application stage. That points to a highly relevant research field: What is the relative significance of development and application stage? Is it possible to separate the effects of the development stage on family and business from those of the application period? Another item in this research field is whether, and if so, how, the process for the initial family constitution differs from that for the revised family constitution.

Discussions often returned to the question of what extent the written rules of the family constitution are practiced. This issue implies that the document does not necessarily reflect the reality in the owner family. This is another area offering interesting research opportunities: To begin with an inventory topic, more information would be welcomed on whether this gap actually exists. Furthermore, it is of great interest how families deal with behavior diverging from the written rules. To name just two possibilities: Do they accept or even welcome it as flexible handling of rules in a complex and changing environment, or do they acquiesce grudgingly the rule violation by some family members simply because of a lack of enforcement options? In addition to that, if we know more about the gap between practice and written rules, it is easier to evaluate the informative value of document analyses of family constitutions.

Heterogeneity versus standardization was another major topic in our discussions. Heterogeneity among owner families and among family businesses is a major issue in current family firm management research. The conference added a new ingredient to this discussion stream as it explored the hypothesis that there

is a trend toward the standardization of family constitutions. (This part of our discussions based mainly on experiences from Germany.) The argument rests on the observation that there are only a few major players in the market for family constitution advisory services. Concentration is even stronger as former employees of these significant players more or less follow their old employer's approach when they offer family constitution services on their own. In the development stage and in the written document, the assumed standardized approach of the consultants meets family heterogeneity. Ex ante it is an open question whether and to what extent this assumed homogenizing effect indeed leads to more homogeneous development processes and documents. For the practiced family constitution in the application period, there are only the (heterogeneous) families acting, the potentially homogenizing effect of the consultants works only indirectly via their influence on the development process and document. Thus, it could be questioned whether the assumed standardization really goes beyond the structures of development process and document, resp., if it exists at all. In any case, this is another research field that could contribute valuable knowledge about family constitutions.

The degree of family constitutions' (understood in the very broad meaning) homogeneity is also seriously linked to large sample empirical studies. Graves et al. with the very first or one of the first large sample studies with a *separate* variable for the existence of a family constitution represent a significant advancement compared to previous large sample studies with a 0/1 *composite* family governance indicator variable. But the interpretation of studies like the one provided by Graves et al. depends very much on homogeneity. Generally speaking, a 0/1 indicator variable requires the assumption that the state which is coded "1" is homogeneous. However, if the variable "1" represents significantly heterogeneous development processes, document content, and constitution practices, the variable would only be statistically significant in a regression analysis if the family constitution (in the broadest meaning) exerts, despite all heterogeneity, a unified force on dependent variables like family or business performance. Insignificant results of a 0/1 family constitution variable need not necessarily indicate the absence of a link to the dependent variable, they could also be a consequence of the diverse settings represented by "1." Besides analyzing whether the assumed heterogeneity exists at all, small sample studies (single or multiple case studies) could try to develop more finely granulated variables to measure family constitutions, i.e., variables that go beyond 0/1 and reflect features like quality or issues dealt with in family constitutions (in the broadest meaning).

The few large sample studies provided so far ignore the time dimension. The 0/1 family constitution variable does not reflect how many years ago the development process was concluded. This lack of consideration of the time dimension is particularly relevant if the development process is assumed to be so eminently important. From a technical perspective, the integration of this variable in the analysis of the large sample studies should be possible without problems. But most probably, that information was not collected. The results for such a time variable could contribute to estimate the relative importance of development stage compared to application stage.

Analyzing family governance and, in this case, family constitutions require a theoretical foundation. So far, research of family firm management has been a net importer of theories and concepts from other economic fields that were then adapted for application in family firm management. An innovative idea was developed in the discussions. It bases on the observation that intra-family conflicts often root in conflicts between the interests of the individual family member and the interest of the family (and the family firm) at large. This structure resembles the basic problem occurring with club/public goods. For these goods, it might be that individual and collective rationality conflict with each other, leading to suboptimal outcomes for everybody. This field of research has been developed over decades, yielding a rich set of analytical approaches and mechanisms to mitigate such negative effects. It might be worthwhile to study whether this similarity could be exploited to transfer some of the concepts developed for these goods to the family firm context.

Another aspect from the discussion that points at a worthwhile research field is linked to the international dimension. Part of the conference discussions focused on the reasoning that different cultures have different ideas of the family and family cohesion which in turn could be expected to have an effect on the family constitution. This cultural component of the international dimension might not be new to the literature, so it does not need further consideration here, but a second nuance of the international dimension was also developed in the discussion. Its interdisciplinary character fits very nicely to the very basic idea of this conference series. It was debated that the respective national legal framework might have an effect on how the family constitution document might be set up. What is already regulated in national laws or typically settled in other legal documents? What is the probability that some kind of legally binding power is or will be attached to the family constitution? If such effects of the legal framework on the family constitution exist, it would not be a surprise if this in turn then affects the development process and the family constitution practice.

From a legal point of view, participants conjectured that the legal effects of family constitutions might become stronger in the future – a prediction that deserves further attention. In addition to that, it will also be interesting to observe whether certain types of family constitutions will travel around the world as private legal transplants, comparable to certain types of M&A contracts. Furthermore, one could explore more closely how different legal systems integrate the various legal sources of family governance into a coherent framework. As far as the emerging corporate governance industry for family businesses is concerned, it may be promising to examine the influence and market share of competing actors such as lawyers, accountants, and management consultants in shaping family constitutions, both nationally and internationally.

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