THE FAMILY CONSTITUTION AS A NEW INSTRUMENT OF CORPORATE GOVERNANCE IN GERMAN FAMILY BUSINESSES

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Abstract

The governance of family businesses is a new and exciting field of research. Germany has a particularly large number of successful family businesses. The article discusses the basic idea of the family constitution, a mechanism of corporate governance in family businesses.

1. INTRODUCTION

In recent years, research and practice in business administration have been increasingly devoted to family businesses, as they have been neglected by business administration in the past decades (Priem & Alfano, 2016). In addition to the economic and business management specifics, business management in general, financing, business succession, external management and other business management functions, papers on the specifics of corporate governance in family businesses are increasingly being published. This is of increasing interest not only in Germany but also internationally (Daspit et al., 2017).

For the German situation of family businesses, an interesting area of tension arises: on the one hand, family businesses are regarded by the public as particularly successful, good employers that operate successfully on a sustainable basis. On the other hand, cases such as

Aldi, Oetker and Tönnies have also recently become known in which disputes within the family have had a negative impact on the respective companies.

Here, both classic corporate governance instruments and special family governance instruments can help to reduce information asymmetries. One of these mechanisms is the family constitution (Ulrich & Speidel, 2017). This term is used in this paper as a collective term for documents that are referred to in practice, for example, as a family code or family mission statement and can be used as a basis for discussing structures and strategies in the family context. Several studies on family businesses have already been conducted in this regard (Fleischer, 2016; Mengers & Prigge, 2017).

In this study, the previous theoretical and empirical findings of the family variant are examined.

2. CORPORATE GOVERNANCE MECHANISMS IN FAMILY BUSINESSES

Basically, corporate governance in family businesses works differently than in non-family businesses because the additional system "family: is added to the established systems "business" and "management". 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. Basically, three sets of interests can be distinguished (Becker & Ulrich, 2008):

- In the owner company, which is managed by one person who holds all shares in the company, there are no principal-agent conflicts.
- In the family business, where $n > 1$ person from the family/multiple family trunks are involved in ownership and management, there are multiple conflicts of interest between people inside and outside the family.
- In an externally managed company, where the family has withdrawn from operational management, there are not only the "typical" principal-agent conflicts, such as the supervision 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, the three situation constellations mentioned above give rise to asymmetries that have a negative impact on the company's value creation and, therefore, need to be "managed". This can be done through a catalog of governance instruments which, although themselves costly, can reduce agency costs.

In general, corporate governance is less formalized in family firms than in non-family firms (Klein, 2008). Written or formal mechanisms are partially or fully replaced by corporate culture and the cohesion of actors in the business, so the lower level of formalization of corporate governance is not a major problem for fairly simply structured family businesses. However, with increasing complexity caused by the size of the company, the product portfolio, internationalization processes or, above all, the increasing number of 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) may be added. These instruments include the family constitution, which is briefly explained below.

3. EFFECTS OF THE FAMILY CONSTITUTION ON BUSINESS PRACTICE

The family constitution is a written document that contains the fundamental beliefs and principles of the business 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 the family and the company. This instrument has its origins in the Anglo-American legal system, where the term "family business protocol" has become established (Brenes et al., 2011). In German, the family constitution is often referred to as "family charter", "family protocol", or "ownership or family strategy" (Kirchdörfer & Lorz, 2011).

The family constitution is informal. It is not legally binding or enforceable in the first step and is not formulated with legal precision. It is formulated in general terms and can rather be declared as a declaration of intent with at most a moral binding effect. In its nature and function, it is to be distinguished from the social contract. It precedes other contracts. Thus, many of its rules lead to partnership, inheritance or marriage contracts and make them legally binding and enforceable. In order to avoid problems with the legal interaction of rules with different legal statuses, the content of the family constitution should be clearly formulated and, if possible, appear in identical form in contractual agreements. In the event of deviations, the family constitution naturally has no legal binding force. However, it often has an indirect influence on the interpretation of other contracts and can thus possibly influence their provisions.

The family constitution is a way for the entrepreneurial family to reach a consensus (Zellweger & Kammerlander, 2015). Raising awareness of agreed-upon goals strengthens the family. But understanding conflicting goals can also be used to clarify conflicts and prevent disputes. All family members are involved. Decision-making autonomies are reduced, arbitrariness and abuse of power are reduced (Baus, 2013).

The path to a family constitution involves further risks. There is a risk that the family constitution will be filled with complex issues that should be reserved for the bylaws and that it will be seen as a substitute for them. The provisions of the family constitution then run into the void due to their legal non-binding nature and are not necessarily effective. Moreover, differences between the family constitution and the articles of association can also lead to legal problems. Another danger is that goals are set without reference to entrepreneurial reality or that regulations overshoot the mark. As positive as breaking down the metrics of the information system is, individuals can lose in the process. They may have less power, a different position, or less financial support as a result of the new regulations.

According to the results of an empirical study by the INTES Institute, older and larger family businesses with a diversified shareholder structure and external management and supervisory boards have a family constitution (Schween et al., 2011).

4. RECOMMENDATIONS FOR ACTION AND CONCLUSION

This research provides an overview of existing theoretical and empirical evidence on family governance and family constitutions.

From a theoretical point of view, the study shows that the situation often assumed in the literature that stewardship theory prevails over principal-agent theory in family firms is not necessarily correct, as the family constitution can also be interpreted as a reaction to an increase in principal-agent conflicts within the family (Siebels & Knyphausen-Aufseß, 2012).

For practice, several conclusions can be drawn from the remarks in this investigation. The family constitution has arrived in the practice of larger family businesses. Whether this is always the case in smaller family businesses as well was questioned by the study participants, who cited a high degree of complexity and the presence of multiple generations as basic requirements for it to make sense.

Nevertheless, the question arises whether and to what extent the informal mechanisms of trust in family firms are influenced by the family constitution. In addition to the new theoretical approach to socioemotional wealth, this problem area should be a focus for further research on family governance and family registration.

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