

OWNERSHIP STRUCTURE AND CORPORATE GOVERNANCE CODE: THE CASE OF FAMILY BUSINESS ENTERPRISES IN GERMANY

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Abstract

Ownership of corporations in Germany is today highly concentrated in the hands of families and other companies. These ‘insider’ systems often result in core conflict tends to be between controlling shareholders and sometimes between strong stakeholders and weak minority shareholders. The aim of this paper is to research the characteristics of ownership and control in family business and point out the role of Family Business Governance in securing an appropriate control of the owning families. The authors give suggestions how to implement the German Governance Code recommendations in family businesses.

Keywords: Ownership Structure, German Corporate Governance Code, Family Business Enterprises

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1. Introduction

Ownership of corporations in Germany is today highly concentrated in the hands of families and other companies (Franks, Mayer and Wagner, 2005; Franks and Mayer, 2001). We define family business enterprises and followed Klein et al. (2003) through the following indicators: complete or significant participation of one or more family members in capital, managerial and control functions as well as the common intent to pass the business along to the next generation within the family.

These ‘insider’ systems often result in core conflict tends to be between controlling shareholders and sometimes between strong stakeholders and weak minority shareholders. A main benefit of concentrated ownership is that it permits a more effective monitoring of management. However, the costs associated with concentrated ownership involve low liquidity and reduced risk diversification, whereas dispersed ownership is associated with higher liquidity and more efficient resource allocation. A liquid market for equity allows the link between the preferences of successful capitalists for consumption and saving to be separated from the productive process. However, in the context of a liquid stock market, dispersed ownership may not encourage the long-term relationships required for long-term business investments that increase the productive capacity of the economy.

Assuring an appropriate ownership structure and control is a great issue in family business enterprises (Weissenberger-Eibl, 2004). Family Governance represents a first approach to handle potential disadvantages of family businesses. Due to the often

existing ownership concentration in German family business enterprises a particular set of problems arise. The Governance Code for family business is one of codes of conduct which is adjusted to family business needs and which gives the answer to this question. In the fourth paragraph “Ensuring an adequate control of the company management” the code includes recommendations about responsibility, structure of the controlling body, duties of the controlling body as well as rights and duties of the members of the controlling body.

Aronoff/Ward (1996) point out “a business that is well-governed is free to work toward the highest and best objectives of business” (Aronoff and Ward, 1996). It also applies to family businesses which play a very important role in the German economy (Walter, 1998). Good Governance supports a smooth leadership and control and hence the achievement of a company’s objectives. The corporate governance in family business differs considerably from those without family background (Winkeljohann and Kellersmann, 2006).

The assumption of this paper is as follows: Family Business Governance can be implemented in small and middle-sized companies as a tool of handling ownership structure and control. The aim of this paper is to research the characteristics of ownership and control in family business and point out the role of Family Business Governance in securing an appropriate control of the owning families.

This work is structured in six sections. The next section gives information on the dominance of business enterprises in German as the area of analysis. The third section presents a conceptual background of

ownership structure and corporate governance codes. In the following, we derive the need of an family business governance code in order to handle ownership structure and appropriate control mechanism in family run enterprises. The fifth section contains implications from the German Code of Good Governance for Family Business Enterprises with special focus on ensuring an adequate control of the company management. The last section presents concluding remarks.

2. Dominance of Family Business Enterprises in Germany

The research field of family business enterprises in Germany is characterized mainly by two issues: regulation of the business succession and a statistical and formal analysis of German middle-sized enterprises. According to Guldan (2004) there is no standardized definition of a family business enterprise. The notion “family business enterprise” derives from colloquial language and does not refer to any concrete legal form (Albach 2002, Eidemueller-Jucknat 1998). Discussing on family businesses there are significant differences between themselves which are very often inconsiderate called “family businesses” (James 2006). The notion of family business should be distinguished from the notion of parent company, which means nothing more than a company which has been set up by a single person (Fasselt 1992, Iliou 2004, von Moos 2003, Muehlebach 2004).

There are many diverse definitions of family businesses. But all the definitions possess usually core elements pertaining to the type of economic development which is considerably influenced both by financial and human resources of family members. Furthermore, apart from the formal and legal impact of family members on the managing behaviour, the financial impact should also be taken into account. It usually depends on the power position of the particular members of a family. Moreover, this type of influence is determined by company-specific circumstances and can deviate significantly from the formally defined legal rights (Weissenberger-Eibl, 2003).

Freund (2000) proposed two basic poles to define a family business and has located the existing approaches within these dimensions. Thus, he defines a family business only by means of the ownership majority. On the other hand, a more detailed approach to the subject should include the following criteria: ownership up to 100% divided among fewer members of a family company, legal form of a private company, managing a company exclusive by the family and a clear objective of continuity of company management by a family member in the next generations.

A similar approach is suggested by Klein et al. (2003), whose way of defining a family business uses an ownership criterion as well. Nevertheless, by

precise examination, the legal form is not a determinative factor. On the other hand, other indicators like having an advisory board are emphasized. This article will define a family business according to the presented considerations and follows Klein et al. (2003) through the following indicators: complete or significant participation of one or more family members in capital, managerial and control functions as well as the common intent to pass the business along to the next generation within the family. Specific strategic peculiarities of successful family businesses have not been sufficiently identified so far.

Ownership of corporations in Germany is today highly concentrated in the hands of families and other companies. Franks, Mayer and Wagner (2005) provide the first longitudinal study of ownership and control of German corporations by assembling data on the ownership and financing of firms from samples spanning almost a century from 1860 to 1950. There were a large number of firms listed on German stock markets and firms raised large amounts of equity finance. This runs counter to the conventional view of Germany as a bank oriented financial system. Firms raised little finance from banks and surprisingly large amounts from stock markets.

Issuance of equity caused the ownership of founding families and insider directors to be rapidly diluted. Even by the start of the 20th century, founding family ownership was modest and ownership by members of firms’ supervisory boards, which was large at the beginning of the century, declined rapidly thereafter. New equity was frequently purchased by other companies in blocks rather than by dispersed shareholders. Furthermore, where equity was widely held by individual investors it was generally held on their behalf by custodian banks. Banks were able to cast a large number of votes at shareholder meetings, not only in respect of their own shareholdings which were in general modest, but as proxies for other shareholders. This is the case, even if one assumes that all bank proxies were voted on behalf of dispersed shareholders.

Franks, Mayer and Wagner (2005) document the creation of the ‘insider system’ of ownership that Franks and Mayer (1995) and (2001) describe in modern-day corporate Germany. This is characterised by inter-corporate holdings in the form of pyramids and complex webs of shareholdings, extensive bank proxy voting and family ownership.

3. Ownership Structure and Corporate Governance Codes

3.1 Ownership Structure

The majority of previous studies, such as Monsen et al. (1968) and Booudreaux (1973), differentiate between ownercontrolled (OC) firms and management-controlled (MC) firms in terms of different criteria of ownership percentage (Short, 1994). Owner-controlled firms are those where a

dominant shareholding interest exists, while management-controlled firms include those in which ownership is so widely distributed that no one individual or group has an interest that is large enough to allow them to exert a dominant influence. In the previous studies, varying cut-off points are used to distinguish between OC and MC firms.

Little consensus with regard to the ownership level at which there is effective control of the firm has been reached (Short, 1994). This arbitrary nature of measuring ownership structure impairs the reliability of their findings. Another concern associated with these studies is the failure to examine the identification of shareholders. Specifically, McEachern (1975) argues that OC firms should be further categorised into two groups in order to distinguish between outside owners who are not actively involved in management and owners who are also managers. He further argues that by treating no difference between these two groups, the previous studies assume that controlling shareholders who are also managers have similar incentives to those shareholders who are external to the firm. The problem associated with this view is that the owner managers may behave the same way as any other professional managers.

There are observed differences in the ownership and control of companies across countries (La Porta et al., 1999; Barca and Becht, 2001). The most striking of these relate to comparisons of concentration of ownership in different countries. Ownership concentration in the UK and USA is significantly less than in Continental Europe and the Far East. For example, in France and Germany, in more than 80% of the largest 170 listed companies, there is a single shareholder owning more than 25% of shares, and in more than 50% of these companies, there is a single majority shareholder. In the UK, by contrast, in only 16% of the largest 170 listed companies is there a single shareholder owning more than 25% of shares, and in only 6% is there a single majority shareholder.

Concentration of ownership is appreciably higher on the Continent of Europe than in the UK. High levels of ownership concentration have also been reported for the Far East and South America, and ownership is as dispersed in the USA as in the UK. Not only does the level of ownership differ appreciably between the UK and USA and most of the rest of the world, but so too does the nature of that ownership. In the UK and USA, institutions, such as pension funds, life insurance firms and mutual funds, and individual investors are the main holders of corporate equity. Ownership is dispersed in the sense that no one institution or individual holds a large stake in a single company. This is described as an 'outsider system' (see Franks and Mayer, 1995).

On the Continent and in the Far East, families (or family holding companies) and other firms are the main holders of share blocks. Inter-corporate holdings of large blocks of shares are commonplace, frequently in the form of pyramids of shareholdings, cross-

shareholdings, or complex webs. As noted above, in most countries, bank holdings of shares are modest and holdings by the government vary appreciably across countries. This is described as an 'insider system' (Mayer, 2008). In the insider systems where ownership is concentrated, owners have incentives to be actively involved in the management of firms. In Albert Hirschman's terms, they are more likely to exercise 'voice' rather than 'exit' which characterizes outsider systems where ownership is dispersed. There is little or no separation between ownership and control, and agency problems should be largely absent (Mayer, 2008).

3.2 Corporate Governance Codes

By the beginning of the twentieth century Germany had enacted a corporate code that provided more extensive corporate governance than existed in virtually any other country at the time. This may have been critical to the rapid development of the German stock market at the end of the 19th and the beginning of the 20th century. Furthermore, the Exchange Act of 1896 reinforced the control of the banks over German securities markets.

Codes of good governance can be considered a set of best practices regarding the board of directors and other governance mechanisms. Such codes have been designed to address deficiencies in the corporate governance system, by recommending a set of norms aimed at improving transparency and accountability among top managers and directors (Fernandez-Rodriguez, Gomez-Anson and Cuervo-Garcia, 2004).

Aguilera and Cuervo-Cazurra (2004) found that codes of good governance were issued mainly by the stock market or by managers' associations. Directors' associations, investors' associations, and the government did not play a large role in developing national governance practices. This evidence runs against the popular claim that institutional investors are the primary triggers of good governance, although these investors may have pressured stock-exchange commissions and private associations to improve governance practices at country level.

In most legal systems, codes of good governance have no specific legal basis, and are not legally binding (Wymeersch, 2006). Enforcement is generally left to the effectiveness of internal corporate bodies (i.e., the board of directors) and of external market forces. Only in a few countries (e.g., Germany and the Netherlands in Europe), the law attaches explicit legal consequences to the code or even to its provisions (Wymeersch, 2005).

Even if compliance with code recommendations is traditionally voluntary and based on the "comply or explain" rule, empirical evidence shows that publicly traded companies tend to respond to the main code recommendations (Canyon and Mallin, 1997; Gregory and Simmelkjaer, 2002). Furthermore, a previous study (Fernandez-Rodriguez et al., 2004) suggests that the market reacts positively to

announcements of compliance with the code. In brief, codes of best practices exert major influence on the corporate governance of listed companies, or at least formally (v. Werder, Talaulicar and Kolat, 2005).

The content of codes has been strongly influenced by corporate governance studies and practices. Codes touch fundamental governance issues such as fairness to all shareholders, clear accountability by directors and managers, transparency in financial and non-financial reporting, the composition and structure of boards, the responsibility for stakeholders' interests, and for complying with the law (Gregory and Simmelkjaer, 2002; Coombes and Chiu-Yin Wong, 2004).

The core of codes of good governance lies in the recommendations on the board of directors. Following the dominant agency theory (Alchian and Demsetz, 1972; Jensen and Meckling, 1976; Fama and Jensen, 1983), governance codes encourage the board of directors to play an active and independent role in controlling the behavior of top management. In particular, scholars and practitioners (Lorsch and MacIver, 1989; Demb and Neubauer, 1992; Charan, 1998; Conger, Lawler III and Finegold, 2001) recommend: the quest for an increasing number of non-executive and independent directors; the splitting of Chairman and CEO roles; the creation of board committees (nomination, remuneration and the audit committee), made up of non-executive independent directors; and the development of an evaluation procedure for the board.

4. Need for Family Business Governance Codes

There are numerous attempts of defining corporate governance in literature (Carney 2005, Iliou 2004, Kirchdörfer and Kögel 2000). For example, Carney (2005) defines corporate governance as a collectivity that embodies incentives, authority patterns, and norms of accountability that generate specific organizational propensities to strive for transparency and a well-balanced relation between managing and control. The corporate governance should regulate the co-operation of the top committees and set rules for a good governance in a company. The standard definition of corporate governance among economists and legal scholars refers to problems arising from the separation of ownership and control, namely the agency relationship between a principal (investors in publicly traded firms, voters for utilities) and an agent (managers for corporations, politicians for state-controlled firms). A divergence of interest between managers and shareholders (or between politicians and voters) may cause managers (politicians) to take actions that are costly to shareholders (voters). One of the most striking differences between countries' corporate governance systems relates to the cross-country difference between firm ownership and control. This difference is not simply an accident of

history, but the result of major differences among the legal and regulatory environments of countries.

Ownership of corporations in Germany is today highly concentrated in the hands of families and other companies. These 'insider' systems often result in core conflict tends to be between controlling shareholders and sometimes between strong stakeholders and weak minority shareholders. A main benefit of concentrated ownership is that it permits a more effective monitoring of management. However, the costs associated with concentrated ownership involve low liquidity and reduced risk diversification, whereas dispersed ownership is associated with higher liquidity and more efficient resource allocation. A liquid market for equity allows the link between the preferences of successful capitalists for consumption and saving to be separated from the productive process. However, in the context of a liquid stock market, dispersed ownership may not encourage the long-term relationships required for long-term business investments that increase the productive capacity of the economy.

Kirchdoerfer and Koegel (2000) argue that family members participating in a business regard the family connections and its principles as a primary element of their engagement. Consequently, family businesses are, in the sense of communities of values, much more affected by tradition and significantly more constant in pursuing the proposed philosophies than other organizations. Muehlebach (2004) identified potential advantages and disadvantages of a family business. Potential advantages are long term perspective, strong corporate culture, product quality, market knowledge as well as flexibility and fast decisions. The potential benefits are confronted with the potential disadvantages of a family business, like, such as nepotism (favouritism), transfer of family conflicts into the business' deals and strategic rigor. In order to avoid the disadvantages of a family business, an outside view is strongly needed. For most of us, the tendency toward optimism is unavoidable. It is unlikely that companies can remove the organizational pressures that promote optimism (Lavallo and Kahneman 2003). Simply understanding the sources of overoptimism can help managers challenge assumptions, bring in alternative perspectives and take a balanced view for ensuring an appropriate control.

Due to the often existing ownership concentration in German family business enterprises a particular set of problems arise. As a consequence of this structure and the problem of the free-rider, shareholders have few incentives to monitor managerial actions and delegate in the market for corporate control (Franks and Mayer, 1997). In fact, high ownership concentration has been proved to encourage manager monitoring and to improve firm performance (Demsetz and Lehn, 1985; Bergström and Rydqvist, 1990). Where investors are best protected against managerial discretionary decisions, ownership concentration may not have any significant influence

on the firm's value because shareholders do not need concentrated ownership structures in order to have their rights protected.

The German Corporate Governance Code was introduced to the public in February 2002 for the first time. It has promoted the discussion about approved standards of responsible executive and managerial structures in a company. Family businesses can not take over the recommendations of the German Corporate Governance offhand, because they evidently differ from stock companies referring to the tight connection between management and ownership. This implies beneficial effects, but also risk. Most of the German companies are not in possession of a changing public. It regards first of all middle-class companies which are permanent under control of one entrepreneur or a family business.

The absence of a significant relation could even arise as the result of two countervailing effects: a disciplinary role of ownership concentration (in a similar vein as leverage works) which increases firms' performance, and a negative impact due to the problems between large and small shareholders (although less important than in civil law countries). On the contrary, when the conflict between large and small shareholders is more outstanding, ownership concentration favours a potential risk of expropriation.

Among the 50 biggest non-public organizations, there are 26 in German possession. Companies such as Aldi, Otto, Haniel and Bertelsmann are managed by entrepreneur families. Behind the brands like BMW, SAP, Metro, Altana and Henkel are hidden founders and families who form management concepts and values in these companies. Whereas in public organizations good governance is about to protect an anonymous investing public against incompetence and arbitrariness of their trustees in executive and supervisory board, Good Governance in family business is interpreted differently. More important is the question, how to assure a responsible and long term performance of the company owners (Carney 2005). The German Governance Code for family business is one possible answer to this question (Banze 2006). Moss (2003) gives five cornerstones of German Corporate Governance in family business: cohesion among family partners, transparency and equal treatment of family partners, separation of family and company, business before family and clear assignment of responsibilities.

The wider the decision-making ability of majority shareholders is, the higher the risk of expropriation becomes (Johnson et al., 2000; Gutiérrez and Tribó, 2004). Nonetheless, the possibility of expropriation may present a non-linear effect, since beyond a certain level of ownership, large shareholders bear the costs of their actions to a greater degree and thus the private benefits they may hope to extract will be smaller (Bennedsen and Wolfenzon, 2000; Thomsen and Pedersen, 2001; Claessens et al., 2000). Thus the risk of expropriation is the result of a dual relation

between the firm's value and the level of ownership of the controlling shareholders: a decreasing relationship at lower levels of ownership and a positive one for higher levels of the largest shareholder's ownership.

The academic debate about the Family Business Governance started quite recently. There is very little research that examines challenges and mechanism of a Family Business Governance based on theoretical models and empirical studies (Iliou 2004, Kirchdoerfer and Koegel 2000). Particularly, there are no clear recommendations how to perform under the Family Business Governance in small and middle-sized companies – especially in family business enterprises. A thorough concretization of a "Good Governance" in a family business is definitely necessary, as according to James family businesses dispose of various tools and possibilities to exert influence (James 2006).

5. Implications from the German Code of Good Governance for Family Business Enterprises

5.1 Roll-Out of New Corporate Governance Practices

The decision to issue a code of good governance can be assimilated to the adoption of new practices in an existing corporate governance system (Aguilera and Cuervo-Cazurra, 2004). Codes of good governance are, in fact, best practice recommendations regarding the characteristics of the board of directors and other governance mechanisms. They provide a voluntary means for innovation and improvement of governance practices. A diffused practice can be defined as an innovation within a social system, although the innovation does not necessarily entail an "improvement," but rather a change in the current state (Strang and Macy, 2001). Many scholars explain the adoption of new practices and their homogeneity within a social system by referring to two main theoretical approaches: efficiency theory, and institutional theory (DiMaggio and Powell, 1983; Tolbert and Zucker, 1983; Westphal, Gulati and Shortell, 1997; Strang and Soule, 1998; Strang and Macy, 2001). Reasons of efficiency and legitimation both compete with and complement each other (Scott, 2001). The two approaches are not necessarily incompatible because organizations may adopt practices for different reasons (Tolbert and Zucker, 1983). There is evidence suggesting that both efficiency and legitimation reasons may lead to the adoption of new practices (Tolbert and Zucker, 1983; Aguilera and Cuervo-Cazurra, 2004).

The first theoretical approach views organizations as rational actors, albeit in a complex environment, and points to the gains in efficiency or effectiveness that may follow innovation or the adoption of a practice (Thompson, 1967; Blau and Schoenherr, 1971). Some examples of adoption motivated by technical or rational needs are the adoption of the

multidivisional form (Chandler, 1962), the creation of professional programs by failing liberal arts schools (Kraatz and Zajac, 1996), or the introduction of conventions into the broadcasting field (Leblebici, Salancik, Copay and King, 1991).

Conversely, the second theoretical approach views organizations as captives of the institutional environment in which they exist, and suggests that practices are adopted because of their growing taken-for-grantedness improving qualities, which make adoption socially expected (Meyer and Rowan, 1977; Tolbert and Zucker, 1983). Tolbert and Zucker (1983), in their study on civil service reform in US municipalities, illustrated that early adopters were driven to change by technical-competitive reasons, and late adopters were driven to conform to what had become best practice. They argued that the early adopters of civil service reforms provided the legitimacy for innovation, and other organizations were then under pressure to adopt the reforms for fear of losing legitimacy. Tolbert and Zucker (1983) defined institutionalization as “the process through which components of formal structure become widely accepted, as both appropriate and necessary, and serve to legitimate organizations.” If practices become institutionalized, their adoption brings legitimation to the adopting organizations or social systems, even if sometimes these practices fulfill symbolic rather than task-related requirements.

The process of homogenization is called isomorphism, and defined as a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions (Hawley, 1968). There are two types of isomorphism: competitive and institutional (DiMaggio and Powell, 1983). Competitive isomorphism assumes a system rationality that emphasizes market competition, niche change, and fitness measures. A common view is that this type of isomorphism is relevant for fields in which free and open competition exists, and may apply to early adoption of innovation. However, this does not present an entirely adequate picture of the modern world of organizations. To do so, it must be supplemented by an institutional view of isomorphism, according to which organizations compete not just for resources and customers, but for political power and institutional legitimacy, and for social as well as economic fitness (DiMaggio and Powell, 1983).

The large majority of contributions on the diffusion of new practices focused on the mechanisms facilitating or inhibiting the transmission process. These studies imply a binary approach of adoption/non-adoption for the most part, and treat the practices themselves as relatively unchanging and uniform. However, innovation diffusion is a dynamic process, and diffusing practices may be modified or “reinvented” by adopters (Tornatzky, Eveland, Boylan, Hetzner, Johnson, Roitman and Schneider, 1983; Rogers, 1995). Reinvention is likely to be the

rule, not the exception, and researchers call for further study on the factors explaining changes in practice content (Cool, Dierickx and Szulanski, 1997; Campbell, 2005).

Finally, institutional theorists highlight organizations that may resist conforming to external pressures because of inertial effects and firm history (Tolbert and Zucker, 1983). North (1990) affirms that institutions are shaped by historical factors limiting the range of options available to decision-makers. Matthews (1986) argues that inertia plays an important role in institutional persistence. Old institutionalists (Selznick, 1949) highlight the role of politics in shaping formal structures, and focus their analysis on group conflict because of diverging interests. New institutionalists devote less attention on “how incumbents maintain their dominant positions” (DiMaggio and Powell, 1991: 30). However, DiMaggio and Powell acknowledge that “actors in key institutions realize considerable gains from the maintenance of those institutions,” and that “the acquisition and maintenance of power within organizational fields requires that dominant organizations continually enact strategies of control” (DiMaggio and Powell, 1991).

5.2 German Governance Code for Family Business Enterprises

Landau and Chisholm (1995) state that the most pernicious constraint ever laid on organizations is the doctrine of efficiency. They describe it as a precept that appears so self-evident and so much a matter of common-sense as to be beyond doubt. While efficiency has achieved the status of an axiom of right, as a praexiological rule, it might be dangerous for family businesses. It may even guarantee errors that are clearly avoidable.

Whereas in public organizations a Good Governance is about to protect an anonymous investing public against incompetence and arbitrariness of their trustees in executive and supervisory board, is Good Governance in a family business interpreted differently. More important arising from the ownership concentration in family business enterprises is the question, how to assure a responsible and long term performance of the company owners.

The Governance Code for family business is one of codes of conduct which is adjusted to family business needs and which gives the answer to this question. The appointment of the Governance Code for Family Business Commission by “Intes” and “Welt am Sonntag” aims at providing family businesses and their co-partners with a reliable framework for evaluation and improvement of their company constitution: “The objective of the Governance Code for Family Business is to set up a code of conduct focused predominantly on the particular needs of a family business” (German Governance Code for Family Businesses,

commencement clause). The Governance Code for Family Businesses from September 2004 suggests ideas and recommendations in eight areas. These are commitment to a responsible entrepreneurship, transparency of company structures, ensuring a qualified management and its succession, ensuring an adequate control of the company management, involvement of other company members, financial statement, profit distribution, steps to preserve the family possession and family governance as an essential supplement to the corporate governance in family businesses.

In the fourth paragraph “Ensuring an adequate control of the company management” the code includes recommendations about responsibility, structure of the controlling body, duties of the controlling body as well as rights and duties of the members of the controlling body. The owners are responsible for making use of control mechanisms. If the family business has several partners, then it should set up a volunteer controlling body (a so-called advisory board, governing board, supervisory board, management committee, etc.). This even applies to those companies which are not required to do so by law (German Governance Code for Family Business Enterprises, paragraph 4.1).

In order to improve objectivity and quality, the codes recommends that expertise from outside the family could be included in the controlling body. As the will or capability of the family decreases with regard to qualified perception of the controlling function, it becomes increasingly important to implement external members in the controlling committee. Furthermore, the code recommends that members of the controlling body should not acquire their positions due to delegation rights held by a single owner or group of owners. At least a majority of the members should be selected unanimously by all owners (German Governance Code for Family Business Enterprises, paragraph 4.2.6).

Rights and duties of the controlling body are regulated in detail. Paragraph 4.3 shows the most important duties of the controlling body:

- Appointing managing directors and relieving them of office,
- Entering, ending and creating the contents of the company’s employment contracts including all compensation issues,
- Making decisions pertaining to the rules of procedure, allocation of duties and appointing a chairperson or a management spokesperson,
- Preparation of or passing a resolution pertaining to dismissal.

According to the code, the committee, as a body representative of the owner, can be involved in significant management decisions. Passing the strategy and all planning derived from this strategy, as well as management measures of essential significance should require previous approval by the controlling body. For this purpose, the controlling body should specify a list of those management measures requiring approval without removing the

basic preparation between management and the controlling body.

“The members of the controlling body should be obliged to further the prosperity of the company as a whole, or that of all owners as the case may be. They should not represent particular interests and they should not be bound by instructions from individual owners or owner groups.” (German Governance Code for Family Business Enterprises, paragraph 4.4.3).

Companies with a great number of individual and scattered shareholders require Family Governance concepts in order to keep the shareholders together and to make them stick to the company’s values, strategy and objectives. However, in comparison to the Commission of the German Corporate Governance Code, the Governance Code for Family Businesses does not set any obligatory regulations. Its framework and content stays vague. Even if this could be interpreted as a weakness of the present code though unavoidable due to the complexity and variety of issues in the context of ownership structure.

This is obvious when looking at paragraph 4.4.4 in particular. “The members of the controlling body should be held responsible for errors in carrying out their duties at least in cases of criminal intent and gross negligence. Limitation of liability according to amount or using insurance to cover the risk of liability should be allowed as long as an appropriate deductible is agreed upon.” (German Governance Code for Family Business Enterprises, paragraph 4.4.4). A more concretised approach is desirable in order fulfil the control function of the committee and dealing with the special extent of ownership structure in German family business enterprises.

Family Governance represents a first approach to handle potential disadvantages of family businesses. Besides the recommendations how to prove the strategic orientation of family businesses on the regular basis, a Family Governance can provide a set of principles how to avoid interactions between family conflicts and family business. What is more, a Family Business Governance can help to promote the establishment of a controlling body which, in consequence, can lead to a long term and sustainable existence of a family business.

6. Concluding Remarks

Ownership of corporations in Germany is today highly concentrated in the hands of families and other companies. We defined family business enterprises and followed Klein et al. (2003) through the following indicators: complete or significant participation of one or more family members in capital, managerial and control functions as well as the common intent to pass the business along to the next generation within the family. These ‘insider’ systems often result in core conflict tends to be between controlling shareholders and sometimes between strong stakeholders and weak minority shareholders. A main benefit of concentrated ownership is that it permits a more effective

monitoring of management. However, the costs associated with concentrated ownership involve low liquidity and reduced risk diversification, whereas dispersed ownership is associated with higher liquidity and more efficient resource allocation. A liquid market for equity allows the link between the preferences of successful capitalists for consumption and saving to be separated from the productive process. However, in the context of a liquid stock market, dispersed ownership may not encourage the long-term relationships required for long-term business investments that increase the productive capacity of the economy.

Family Governance represents a first approach to handle potential disadvantages of family businesses. Due to the often existing ownership concentration in German family business enterprises a particular set of problems arise. The Governance Code for family business is one of codes of conduct which is adjusted to family business needs and which gives the answer to this question. In the fourth paragraph “Ensuring an adequate control of the company management” the code includes recommendations about responsibility, structure of the controlling body, duties of the controlling body as well as rights and duties of the members of the controlling body.

It is strongly recommended that family businesses, due to the growing importance of ownership structure and control, apply the concept of a Family Business Governance as a tool of an advantageous implementation of good practices. In this way, a company can ensure its continuity and survival.

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