GOVERNANCE CODE FOR FAMILY BUSINESSES

Guidelines for the responsible management of family businesses and business-owner families

AN INITIATIVE OF INTES, FBN AND DIE FAMILIENUNTERNEHMER - ASU

Founded by Prof. Dr. Peter May

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FOUNDED BY PROF. DR. PETER MAY

PRELIMINARY REMARKS

The Governance Code for Family Businesses offers family-owned companies and their environment (stakeholders) a reliable framework for the assessment and optimization of their individual governance structures.

It was created in 2004 as the world's first initiative of its kind and was substantially revised in 2010. With the present 3rd Edition, the Commission meets its self-imposed mandate to review and update the Code at regular intervals.

The Governance Code for Family Businesses is a joint initiative of the INTES Academy for Family Businesses, the Family Business Network Germany (F.B.N.) and DIE FAMILIENUNTERNEHMER – ASU. It was founded by Prof. Dr. Peter May.

The Commission comprises well-known family businesspeople, researchers and consultants without the participation of which the Code, and its present revision, would not have been possible.

The new edition they have prepared goes into effect on May 29, 2015, and replaces the previous versions from the years 2004 and 2010.

The Code can be found online at: **www.kodex-fuer-familienunternehmen.de**

or obtained in written form from:
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GOVERNANCE CODE

FOR FAMILY BUSINESSES

PREAMBLE

Family businesses not only represent the majority of businesses and sources of employment in our country; they also have a special responsibility for society. Through the multi-generational orientation of their business model and the long-term approach that it involves, they have a commitment to to deal responsibly with their employees and all other stakeholders. Because of this, the property rights are also accompanied by a special responsibility on the part of the business-owning family to organize itself in a way that will ensure a modern, sustainable approach to business management.

Good governance is a component of modern, sustainable successful business management. The most important rules for listed public companies are laid down in the German Corporate Governance Code. It was not drawn up for family businesses without a capital-market orientation, because it requires a relatively high degree of homogeneity across the companies to which it applies. Family businesses, on the other hand, are characterized by a wide variety of legal forms, sizes and corporate, ownership and management structures. This variety gives rise to specific challenges that require special attention.

The Governance Code for Family Businesses presented here is addressed to all owners of family companies who want to rise to meet their special responsibility. It is intended to assist business-owning families who adopt a holistic approach to business management that strives to strike a balance between the interests of all stakeholders, and to preserve the business that has been entrusted to them for the generations to come - for the benefit of their family, their customers and their employees. The goal of the Governance Code for Family Businesses is to help business-owner families ask the relevant questions and to find answers that are individually tailored to the situation specific to the business and the family involved. The content of the Code serves as a touchstone for common decision-making by owners, as a guide for the development of individual rules, and as an important precondition for long-term, continued existence as a family business. This lends the Code its special legitimacy.

In its recommendations, the Governance Code for Family Businesses distinguishes between the wording "should" and "it is recommended." The Code uses the wording "should" in recommendations that are indispensable to good governance. The phrase"it is recommended" is used for recommendations from which deviations are permissible in justifiable, exceptional cases.

1. THE SELF-CONCEPTION OF THE OWNERS

Family businesses exist under the controlling ownership of one or more families whose intention it is to sustain this business for at least another generation. To assert itself successfully in the marketplace and strengthen social acceptance of the model of the family-owned company, the owners should make a clear commitment to a responsible approach to their role as owners. This includes establishing appropriate governance structures. In this connection, owners must make the following decisions and take the following actions, implementing these within both the company and the business-owner family.

1.1 Owners should determine the values and goals to which they feel committed in view of their family ownership and their family business.

1.2 In this connection, they should define the extent to which they want to take into account not only the interests of the owner family but also the interests of other stakeholders, in particular the employees and the customers, and to contribute to the development of society through sustainable management.

1.3 Owners should also define the importance they attach to maintaining the business as a family-owned business, and the extent to which the interests of the business take precedence over the interests of the ownership collective and the individual interests of the owners.

2. THE STRUCTURE OF OWNER RIGHTS AND OBLIGATIONS

Owners constitute the uppermost decision-making body. Within the legal framework they have chosen, they have the authority to set values and goals, and to make the final decisions. If they delegate this authority to an independent supervisory body, they are responsible for the proper functioning and quality of this body. In meeting this responsibility, the following must be particularly kept in mind.

2.1 General structural parameters

2.1.1 When defining values and goals, owners should articulate their expectations with regard to entrepreneurial orientation, particularly where this concerns the relationship of stability, profitability and long-term growth. It is recommended that these expectations be coordinated with the owners' long-term strategy for asset management.

2.1.2 In addition, owners should also make statements concerning the owners' role in the management and control of the business.

2.1.3 In cases in which a supervisory body is not required by law, the owners should decide whether and to what extent they wish to delegate the authorities to which they are entitled, particularly as these concern the advice and control of business management, to a voluntary body.

2.1.4 Owners should organize themselves in such a way as to ensure that their decision-making powers are secured at all times. It is recommended that majority and minority rights be clearly stated and appropriately balanced.

2.1.5 At all times, business and information structures should be designed in such a way as to afford the owners, any supervisory bodies and the managers of the business an accurate assessment of the economic and financial situation of the company, and of compliance with the agreed values and goals.

Owners should also specify whether and to what extent this internal transparency should apply for external stakeholders as well.

2.2 Individual structural parameters

2.2.1 Owners' main rights of participation include

- the right to participate in the owners' meeting,
- the right to vote,
- the right to access and information.

In the exercise of these participatory rights, it is recommended that all owners be treated equally, and that they be given the opportunity to exercise these participatory rights personally. It is recommended that any departures from this be subject to clear rules, separate justification and reticence of application.

2.2.2 A determination should be made as to the individuals by whom an owner may elect to be represented in the owners' meeting and/or in the exercise of his or her right to vote. In the case of minors or owners who, over the long term, are prevented from personal participation (e.g. due to execution of a will), it is recommended that steps be taken to provide for a reasonable opportunity to participate on the part of the individuals who have been authorized to do so in a representative capacity.

2.2.3 Voting rights should be linked to the magnitude of the party's proprietary interest. Special rights that represent a departure from this and benefit individual owners or groups of owners should be subject to clear arrangements and special justification; reticence in the exercise of such rights is recommended.

2.2.4 It is recommended that the access and information policy of the business be structured in such a way as to permit owners

- to gain an accurate picture of the economic and financial situation of the business and of compliance with the values and goals of its owners,

- to familiarize him- or herself with the most important aspects of the business and to come to an understanding of its strategy,
- to strengthen ties to the business.

But it is also recommended that rules be established for the exercise of the right to information on the part of the owners, and that precautions be taken to prevent possible abuse of the right to information.

2.2.5 Owners should determine whether, in what numbers and under what circumstances members of the owner family may work in or for the company and/or derive benefits from the company.

For the case in which members of the owner family are employed in the business, it is recommended that rules be established governing the selection process and specifying who may exercise hiring authority.

2.2.6 Owners should clearly specify the rights and responsibilities attendant upon the individual owner by virtue of his or her role as owner. This is particularly true for

- participation in the owners' meeting,
- the exercise of voting rights,
- the confidentiality of matters internal to the business and/or family,
- forbearance of competition,
- ensuring that the family-owned business will face as little detriment as possible as a result of the consequences of divorce, claims of legal shares of inheritance and/or inheritance tax.

It is recommended that steps be taken to see to it that owners enter into nuptial agreements with contracts with gain-restrictive effect and make testamentary dispositions consistent with the provisions of the articles of association.

3. SUPERVISORY BODY

As companies grow in size and the complexities confronting owners increase, even family businesses that are not obliged to do so by law are advised to establish and independent, voluntary supervisory body. Such an entity can help ensure the quality and objectivity in the advice and control of business management. If the owners decide to establish such a voluntary body, they should focus on the following principles.

3.1 Responsibilities and internal regulations of the supervisory body

3.1.1 The owners should clearly specify the responsibilities of the supervisory body. In particular, they should determine whether and to what extent the supervisory body is responsible for

- appointments and dismissals as well as other personnel decisions relative to management of the business,
- decision-making with regard to a possible chairperson or spokesman for company management, rules of procedure and other decisions concerning the internal organization of the company management,
- consent to the business strategy, to business planning, to extraordinary measures by the management or to other avenues of participation in managing the business,
- adopting the annual financial statements and the use of profits,
- agreements with owners, members of the owner family and members of the supervisory body,

and, beyond this, for the extent to which it is to be involved in decisions originally reserved to the owners.

3.1.2 The content, scope, means and rhythm of management reporting should be clearly defined. The same applies to further access and information rights on the part of the supervisory body and the questions of the extent and, in the event, the nature of the owners' access rights that should be transferred over to this body.

Reporting as well as access and information rights should be designed such that the supervisory body and its members are unrestricted in the exercise of their responsibilities at all times.

3.1.3 Internal organization and decision-making processes should be set up in such a way as to permit the supervisory board to exercise the responsibilities delegated to it. In particular, it should be ensured that

- the supervisory board convenes with appropriate frequency,
- the effectiveness of its activities is subject to review on a regular basis (evaluation)
- and that the members of the supervisory entity can obtain training and further qualifications in keeping with their responsibilities.

3.2 Composition of the supervisory body

3.2.1 The size, structure and composition of the supervisory body, as well as the suitability of its members, should be commensurate to the size of the company, the complexity of the ownership structure and the responsibilities taken on.

Owners are recommended to consider that family-independent expertise on the part of the supervisory body can improve the quality and objectivity of its work.

3.2.2 With this in mind, the owners should particularly determine

- the extent to which the owner family can or should be represented in the supervisory body,
- how the chairperson and the other members of the supervisory body are appointed to and removed from office,
- the majorities required for a vote,
- the professional and personal requirements that membership will require,
- the duration of the term in office to which members of the supervisory body will be appointed, and whether any age or term limits will be specified.

3.2.3 Care should be taken to ensure that, at all times, the supervisory body has members in possession of the skills required to properly fulfill their responsibilities, that the requisite qualifications are covered, and that the members of the supervisory body act in the overall interest of the family business and its owners.

When selecting members for the supervisory body, care should also be taken to ensure that the members identify with the values and goals of the owners.

Because the chairperson constitutes the interface between family and business interests, he or she should enjoy the particular trust of the owners.

3.2.4 The owners should determine whether and under what circumstances a member of company management may, following his or her resignation, be appointed to the supervisory body, particularly for service as chairperson of that body.

3.2.5 When selecting the membership of the supervisory body, care should be taken to ensure that conflicts of interest are avoided.

3.3 Remuneration, liability

3.3.1 The members of the supervisory body should be adequately remunerated for their efforts. The mechanisms applicable in this regard should be clearly defined.

3.3.2 The principles and scope of possible liability on the part of supervisory body members should be clearly laid out.

4. MANAGEMENT

The management runs the family business within the framework of their statutory responsibility, the values and goals laid down as guard rails by the owners, and the authorities specified by the owners (articles of association, rules of procedure, etc.). The following should be specifically noted in this regard.

4.1 Responsibilities of company management

4.1.1 Company management should develop the strategic orientation of the company, taking the owners' values and goals into account, regularly coordinating implementation with the owners and/or the supervisory body they have created.

4.1.2 Company management should see to it that relevant provisions of law are observed along with the company's internal policies (compliance) while looking after appropriate opportunity and risk management within the company, in accordance with the values and goals of the owners.

4.1.3 Company management should report to the owners, and/or the supervisory entity they have put in place, with regard to the results of their efforts. Further particulars in this regard will be arranged directly or in accordance with 3.1.2.

4.2 Composition of company management

4.2.1 The size, structure and composition of company management should be aligned with the size of the company, the respective market requirements and the responsibilities assumed.

4.2.2 If company management consists of several members, a decision should be made as to whether there should be a chairperson or spokesperson. In addition, rules of procedure and a business-division plan should be set up and a determination made as to who is to decide these matters.

4.2.3 Specifically, the owners should make a clear determination as to whether and under what circumstances members of the owner family may be appointed to and dismissed from company management, and as to who is to decide these matters. These rules should be clear, transparent and objectively verifiable.

The same applies to their exoneration, the particulars of their employment contracts (including their remuneration) as well as all other agreements concluded with them.

As a matter of principle, the members of the owner family and family-independent members of company management should be treated on an equal footing. This also applies to decisions made pursuant to 4.2.2. (rules of procedure and business division).

Particularly where there are multiple owners, in the interest of objectivity it is recommended that family-independent persons be involved in decision-making concerning family members.

4.2.4 Family businesses should have a long-term succession plan in place. At a minimum, it is recommended that this succession plan include a binding age limit for members of company management, along with considerations for the preparation of potential successors, for the selection decision and for the structure of the transfer process.

There should also be a contingency plan in place that specifies what must happen in the event of an unplanned, premature succession.

4.3 Remuneration, liability

4.3.1 The members of company management should be adequately remunerated for their efforts. In this regard, there should be a clear determination as to

- who is in charge of remuneration decisions,
- the principles on the basis of which remuneration is paid,
- who is to be informed, and to what extent, of the amount of remuneration.

4.3.2 The principles and scope of possible liability on the part of company managers should be clearly laid out.

5. MEASUREMENT AND DISPOSITION OF EARNINGS

Because they must rely on the financing provided by members of the owner family, and because of their multi-generational orientation, family businesses must devote special attention to safeguarding their capital and liquidity base. Specifically, the measurement and disposition of earnings must take the following into account.

5.1 Measurement of earnings

5.1.1 The owners should lay down clear accounting and valuation principles for use in preparation of the annual financial statements. Specifically, they should make a basic determination as to how any accounting and valuation options are to be exercised. It is recommended that these considerations be guided by the precautionary principle.

5.1.2 It is recommended that a family-run business have its annual financial statements audited by an external auditor, even in the absence of a legal obligation to this effect.

5.1.3 The selection and commissioning of the external auditor should be performed by the owners and/or the supervisory body established by them.

5.1.4 Approval of the annual financial statements should be performed by the owners and/or the supervisory body established by them.

5.1.5 Prior to the decision to approval of the financial statements, the owners and/or the supervisory body established by them should have ample opportunity to take appropriate notice of the financial statements and the audit report of the external auditor, and to ask the auditor any questions they may have.

5.2 Disposition of earnings

5.2.1 The rules on the disposition of earnings should be designed such that they not only promote achievement of the stability, profitability and growth targets established by the owners but also help prevent disputes among the group of owners.

5.2.2 The owners should ensure that a large enough portion of after-tax profit remains within the company to strengthen the company's equity position. This determination should take due account of the legitimate interests of all owners in a distribution of earnings.

5.2.3 To objectify a reasonable balancing between the financial interests of the company and the owners' interest in a distribution of business proceeds, it is recommended that the amount distributed or reinvested be made contingent upon achievement of certain key financial figures.

5.2.4 To create a reliable framework for all stakeholders, it is also recommended that basic principles governing the allocation of earnings be incorporated within the articles of association.

5.2.5 The mechanism by which earnings are distributed or reinvested should also be made transparent to all owners.

6. TRANSFERS OF OWNERSHIP, WITHDRAWAL FROM THE GROUP OF OWNERS

To secure controlling ownership on the part of the business-owner family over the long term, the owners should take steps to ensure that shares of the company remain in family hands. This leads to systemic limitations on the free transferability of shares, limitations that must strike a reasonable balance between group and individual interests. With this in mind, and in the interest of sound governance, the following principles must be observed.

6.1 The owners should establish unequivocally the persons to whom ownership of the company may be transferred without any further restrictions.

They should also lay down clear conditions under which transfers to other persons are permitted, together with the legal consequences that such a transfer to other persons, contrary to agreements, would entail.

Correspondingly clear rules should be in place, applicable not only to transfers inter vivos but under testamentary arrangements as well.

6.2 To offset the the limitation on free transferability under 6.1., owners should be granted a reasonable right of termination.

Specifically, the owners should clearly define

- under which conditions,
- at which times,
- subject to which valuation rules and
- with which modalities of payout

an owner can withdraw from the shared family business. It is recommended that the owners also specify how the financing of any severance payments can be ensured.

7. FAMILY GOVERNANCE

Whoever seeks to keep a business in family ownership over the long term must not only focus on the interests of the business but must also take a professional and responsible approach to the way in which the owner family is organized. Good family governance aims to strengthen and foster long-term consolidation of the feeling of cohesion on the part of the owner family and their identification with the company – in the sense of a common project. Another concern of good family governance is to avoid potential conflicts or help resolve them.

Family-owned businesses and their owner families are so varied that there can be no schematic recommendations for good family governance. The right solution must be worked out individually, based on the company and family size, the existing diversity and the history specific to the owner family. The following should be specifically noted in this regard.

7.1 Basic principles

7.1.1 Businesses can remain family businesses only as long as they succeed in preserving the greatest possible consensus within the owner family and their agreement to maintaining the undertaking as a family business. The owners are recommended to pay particular attention to these aspects, and to look after the concerns of the family with the same level of care devoted to the management of the family business.

7.1.2 The owner family should draw up values and goals for the family and link these them with the values and goals for the company to create a coherent mission statement. In addition to material concerns, emotional aspects should also be taken into account.

7.1.3 An approach to family governance should also specify

- who is a member of the owner family,
- the circumstances under which new family members can be included in the owner family,
- the circumstances under which membership in the owner family can be lost,
- who has voting rights in family-governance matters.

Specifically, solid family governance should also address the question of how the next generation is introduced to its entrepreneurial responsibility and how those family members will be dealt with who, while not owners themselves, nonetheless bear responsibility for the continued existence of the family and the family business.

7.2 Approach

7.2.1 It is recommended that rules of conduct be established to govern dealings within the owner family, particularly

- regarding communication and dealings within the owner family, between the business and the family, and with the general public,
- regarding conduct in cases of conflict
- regarding conduct in case of emergency.

7.2.2 In the event of violations of existing rules of conduct, the conflict process (e.g. escalation levels) and the measures and consequences should be known to all members of the owner family. These also include means of redress and reconciliation.

7.2.3 It is recommended that conflict management be structured in such a way that conflicts within the owner family will not impinge upon the concerns of the business.

7.3 Activities

7.3.1 The larger the owner family becomes, the more it is recommended that activities be carried out jointly, with responsibilities for their implementation defined accordingly.

7.3.2 In any case, the business-owner family should take steps early on to ensure skills development among (future) owners, to ensure "committee skills." It is also recommended that members of the broader business-owner family be involved in skills development, to provide them with a grasp of the specificities of their family.

7.4 Organization

7.4.1 For purposes of specification, implementation and evolution of family governance, the owner family should identify the individual(s) to whom responsibility for this should be transferred.

7.4.2 The requirements profile, term of office, mode of selection and skills that this requires should be set by the owner family.

8. CREATION AND VALIDITY OF AN OWN GOVERNANCE CODE

8.1 It is recommended that the elements of this Governance Code be incorporated into individual rules.

8.2 These rules should be jointly drawn up and approved by the owner family. The process of joint elaboration and opinion-forming is at least as important as the outcome.

8.3 The individual rules should be reviewed by the owner family from time to time and amended if necessary. With this in mind, early on the family should determine the decision-making authorities and majorities required for subsequent amendment of their Code.

8.4 The family should also determine the legal quality attaching to the Code and its content, particularly as this relates to articles of association and other legal documents.

GLOSSARY

Supervisory body	The body (e.g. supervisory board, advisory board) within a company that advises and/or controls company management.
Corporate governance	Management and control of a company with the aim of ensure the long-term success of the company. In family businesses, this also includes the goal of ensuring that the company remains in family ownership over the long term.
Family owners	The owners of a business who stem from the owner family.
Family business	These are subject to controlling ownership by a family with a multi-generational orientation.
Family governance	Organization of the owner family with the goal of strengthening the feeling of cohesion among members of the owner family and their identification with the company, and strengthening this over the long term.
Owners	The proprietors, partners, shareholders, general partners, et al., of a company.
Owner family	The group of persons specified by the owners pursuant to 7.3.

Owners' meeting
The shareholders' and general meeting of a company, with the attendant rights and obligations of participation and property ownership.

Stakeholders
Individuals, groups and institutions, that have an interest in the company, or that place claims upon the company (such as e.g. customers, suppliers, employees, or the state).

Management
Managers and executives, the board of directors, the personally liable shareholders of a company who manage that company.

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