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Corporate Governance Development in Privately Held Family Businesses: A Multiple Case Analysis

PHILIPP HANNEMANN

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Thesis presented to Escola de Administração de Empresas de São Paulo of Fundação Getulio Vargas, as a requirement to obtain the title of Master in International Management (MPGI).

Knowledge Field: Gestão e Competitividade em Empresas Globais

Supervisor: Prof. Dr. Sérvio Túlio Prado Júnior

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Approval Date:
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Committee members:

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Prof. Dr. Sérvio Túlio Prado Júnior (EAESP-FGV)

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Prof. Dr. Antonio Gelis Filho (EAESP-FGV)

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Prof. Dr. Ricardo Rochman (EESP-FGV)

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Abstract

The objective of this study is to better understand and illustrate the process and the motivations for corporate governance implementation in Brazilian privately held family businesses. Three case companies were analyzed through an adapted developmental framework to illustrate the progression in corporate governance in response to changes in the ownership, investment and management dimensions over time. In this development, causal relationships between corporate governance and the three other framework dimensions were identified. It was found that the analyzed companies´ corporate governance implementation was motivated by the need to curb agency costs, whereas a cornerstone in this development was the first generational change. Only after the family businesses have reached the necessary maturity on all three dimensions, corporate governance practices were implemented. Put simply, the analyzed case companies developed formal systems as they grew more complex. This study complements the academic discussions on corporate governance in family businesses by offering Brazilian evidence on its underlying motivations and sequential implementation over time.

Keywords: Family Business. Corporate Governance. Developmental Framework.

Resumo

O objetivo deste estudo é entender melhor e ilustrar o processo e as motivações para a implementação de governança corporativa em empresas familiares brasileiras de capital fechado. Três empresas de caso foram analisadas através de um framework de desenvolvimento adaptado para ilustrar a evolução da governança corporativa em resposta a alterações nas dimensões de propriedade, investimento e gestão ao longo do tempo. Neste desenvolvimento foram identificadas relações causais entre a governança e as outras três dimensões do framework. Verificou-se que a implementação de governança corporativa nas empresas analisadas foi motivada pela necessidade de reduzir os custos de agência, e uma pedra angular neste desenvolvimento foi a primeira sucessão geracional. Simplificando, as empresas estudadas adotaram sistemas formais mais complexos assim que cresceram. Somente após as empresas terem atingido a maturidade necessária em todas as três dimensões foram implementadas práticas de governança. Este estudo complementa a discussão acadêmica sobre governança corporativa em empresas familiares, oferecendo evidência brasileira sobre suas motivações subjacentes e a execução sequencial ao longo do tempo.

Palavras-chave: Empresa Familiar. Governança Corporativa. Quadro de Desenvolvimento.

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CEO	-	Chief Executive Officer
CFO	-	Chief Financial Officer
HR	-	Human Resources
IBGC	-	Instituto Brasileiro de Governança Corporativa
PAT	-	Principal Agent Theory
SME	-	Small and Medium Enterprise

1 Introduction

In recent years, increasing academic effort has been directed towards the field of family business research. Prior to the 1980s very few academics paid attention to the particularities of family businesses (Heck, Hoy, Poutziouris, & Steier, 2008). This is surprising given the fact that numerous studies pointed to the dominant role this organizational form plays in many economies around the globe (Claessens, Djankov, Fan, & Lang, 2002). As stressed by Bertin (2007) family firms constitute approximately 70% of all registered companies globally. Usually, this percentage is even higher in emerging economies like Brazil (Araújo, Cabral, Santos, Pessoa, & Roldan, 2013). Several studies indicate that approximately 75% of the registered companies in Brazil are under family control (Mussi, Teixeira, & Massukado, 2008), representing a major source of income and employment for the country (Oliveira, 2006).

In line with intensifying academic research, the benefits of sound corporate governance in family businesses are becoming widely accepted. Many privately held family businesses voluntarily opt for the implementation of corporate governance in order to secure the firm´s and family´s long-term prosperity. Nevertheless, there are many variations in governance configurations among different family businesses. In fact, depending on the maturity of the family business governance needs differ. Logically, a company where ownership and management are bundled within one person, i.e. the entrepreneur, has different governance needs than a company with shared command and ownership. As family firms grow and develop over time ensuing generations cause numerous successions, which eventually leads to a more complex ownership structure. At the same time the business grows more complex as business lines and product portfolios are diversified. In addition the management structure may change, depending on the family´s involvement in the business. Somewhere in between the development of the ownership, business and management structure corporate governance practices are implemented. But when in this developmental process do family businesses actually decide to implement governance practices and what motivates them to do so? Are there specific events that lead to the adoption of corporate governance? Academics have not yet answered this question. Common sense indicates that in privately held family businesses corporate governance is implemented when it is needed, but no designated study addressing this topic could be identified in the literature review.

Therefore, the purpose of this study is to better understand and illustrate the evolutionary process of corporate governance implementation in family businesses by creating and making use of a developmental framework that is applied to the cases of three Brazilian privately held family businesses. At this stage research has produced an evolutionary model for family businesses based on three dimensions: ownership structure, investment structure and governance structure. However, the sequential development, i.e. which of the three dimensions evolves first and whether the development of one dimension induces the development of corporate governance has not yet been studied.

In more practical terms this study seeks to answer the following research questions: How does corporate governance evolve in the three case companies throughout their development? What are the motivators that induced the case companies to implement corporate governance practices? What is the causal relationship between the ownership structure, investment structure, management structure and corporate governance in the cases analyzed? In order to answer these questions three cases of privately held Brazilian family firms will be presented and analyzed with an amended developmental framework according to their developmental footprint from their inception until 2011, with a clear focus on when and why corporate governance practices were implemented.

This study is structured into six chapters. After a brief introduction to the research topic, an extensive literature review follows in chapter two. This review provides clarifications of the underlying terms *family business* and *corporate governance* including its basic concepts. This is followed by an economic justification why corporate governance, even though not legally required in privately held companies, is necessary. At the end of chapter two the basic developmental framework for family businesses is presented and extended for the purpose of this analysis. Subsequently, in chapter three the methodology of this study is outlined. Chapter four is dedicated to the presentation of the case studies and the application of the new developmental framework. Followed by this, chapter five presents the results of the analysis and chapter six concludes this study by stating its main findings, limitations and propositions for future research.

2 Literature Review

For many years publicly listed companies have dominated academic research on corporate governance. Only recently academics have begun to recognize that from an economic point of view it might be worthwhile to shed more light on corporate governance in privately held companies and especially family firms (Woywode, Keese, & Tänzler, 2012). Following this new course, academics found that governance issues that were thought to be particularities of public companies with granular shareholdings have gradually arisen in other business environments (Sicoli, 2013). A practical expression of this development is the *Code of Corporate Governance for Family Businesses* that is being established in many countries (Woywode, Keese, & Tänzler, 2012, p. 2). The code serves as a “lighthouse” for family businesses, maneuvering them through governance topics such as transparency, risk management, supervisory bodies and succession as well as personnel management. In the following the term *corporate governance* will be defined and its most important concepts presented.

2.1 Defining Corporate Governance

Even though thorough research on the topic has been performed, the term *corporate governance* remains an ambiguous one with no fixed meaning. Generally, the word *governance* describes the mechanisms through which relations between diverse constituents are regulated, whereas the word *corporate* specifies the locus of these mechanisms as being inside a business. Put simply, the ambitious goal of corporate governance is to limit opportunistic behavior of individuals affiliated with this business. Corporate governance is particularly important because the opportunistic behavior of those individuals is often not in the best interest of the firm and can create agency problems.

Today´s research on corporate governance is performed on five different layers. In its basic form corporate governance analyzes the supervisory board (layer 1). The second layer studies the relationship between shareholders, board members and management in what is called *corporate governance tripod*. The majority of research is performed in the first two layers of corporate governance; especially on the second layer academic attention primarily addresses principal agent problems. At a third layer corporate governance research focuses on the organization as a “corporate citizen” inside a socio-economic environment, taking direct stakeholders such as employees, suppliers and customers into account. Corporate social responsibility creates the fourth layer by including indirect stakeholders such as the government, the environment and society at large into the equation. Lastly, at its most holistic layer, corporate governance research involves the discussion of the entire governance environment which is embedded in the economic environment, the law, the culture, the values and the norms (Van-den-Berghe & Levrau, 2001).

The groundwork on corporate governance was made by Coase (1937) who referred to it in order to describe the internal coordinating mechanisms that curtail market related transaction costs (Coase, 1937). The term *corporate governance*, however, was first used in 1960 to indicate “the structure and the functioning of corporate policy” (Eells, 1960). It was only in 1979 when Williamson took up the subject in his theory of transaction costs to outline different types of organizational structure (Williamson, 1979). In his theory governance describes the coordinating mechanisms of organizational processes that are genuinely different from coordination induced by hierarchies and market forces.

This primary research has paved the way for many scholars to investigate the topic further. Unfortunately, common sense has taught us that too many cooks spoil the broth and thus many definitions for the same concept were developed over the years. For instance, Shleifer and Vishny (1997) refer to corporate governance as a complex system of rules created to ensure satisfactory returns on the capital invested in the venture, whereas other academics use the term *corporate governance* as an equivalent for the exercise of authority, direction and control (Zingales, 1998). Monks and Minow (2004) see corporate governance as the sum of affairs between owners, managers and the supervisory board. Daily et al. (2003) included a resource perspective in the definition and described corporate governance as the determination of the possible uses of different resources that are deployed within a firm including the mitigation of conflicts between the stakeholders (Daily, Dalton, & Cannella, 2003). More recently, Huse (2006) took a similar position as Monks and Minow by defining corporate governance as the interaction between groups of internal and external actors and the supervisory board, with the overall goal of economic value creation.

A key factor that most literature on this topic has in common though, is an apparent link of corporate governance to the concept of outsiders and insiders of the firm. Specifically, corporate governance is seen as a net of rules through which outsiders (i.e. investors) protect themselves against the risk of expropriation from insiders controlling the business (i.e. management). In addition, the supervisory board is considered in the majority of academic contributions as the main governing institution and academics have spent a lot of time analyzing board composition, size, degree of independence, and its ability to protect shareholders from opportunistic management actions (Sicoli, 2013).

In summary, it was found that definitions on corporate governance differ not only in the scope of parties involved, but also in the breadth of governing bodies and mechanisms in place. For the purpose of this study a broad definition of corporate governance is considered sufficient: corporate governance is a set of rules and mechanisms inside a company that regulates the owner-manager relationship with the goal of reducing conflicts of interests. This notion of corporate governance is used in the remainder of this study. In the following the Brazilian governance model will be briefly outlined.

2.1.1 Major Corporate Governance Models

In order to describe the Brazilian governance model, it is beneficial to briefly outline the two dominant governance models. In Anglo-Saxon countries the adoption of corporate governance is mostly motivated by agency concerns. Vast numbers of academic contributions link corporate governance to controlling opportunistic managers which underlines corporate governance´s importance to preserve investor´s capital, a concern inherent to the structure of the Anglo-Saxon Governance model. Many Anglo-Saxon countries such as Canada, the US and the UK have adopted a variation of the one-tier governance model. In this approach to corporate supervision executive directors and non-executive directors are elected to a board by the shareholders and operate together in one single governance body – the board of directors. As a result CEO-duality oftentimes occurs in one-tier boards, i.e. the position of the CEO and the chair of the board are held by one single person. In addition, one-tier boards often install specialized board committees such as audit, remuneration or nomination committees (Maassen, 2002). One-tier boards have been severely criticized by financial analysts, employees, investors and the like for the lack of formal independence. Independence in boards is evaluated by criteria such as the personal separation of the CEO and chairman position, the number of independent directors and the existence of independent oversight committees (Maassen, 2002).

As opposed to one-tier governance many continental European countries such as Germany, Finland and the Netherlands use a two-tier governance model. A two-tier system, also known as a dual board system, serves primarily as a shareholder protection against opportunistic managers and solves the CEO-duality problem. It is comprised of two boards with different functions and clear-cut decision-making power: the supervisory board and the executive board. In other words, the two-tier system separates management and supervision of the company from each other and places it in the hands of different organs (Grundei & Zaumseil, 2012). Consequently, a membership in both board types at the same time and in the same company is forbidden by operation of law (Jungmann, 2006). Hence, the main characteristic of the two-tier governance is not only the functional but also the personal separation of management and control.

2.1.2 The Brazilian Governance Model

The adoption of corporate governance in Brazil on the other hand is largely motivated by the inclusion of minority shareholders and their relation to the controlling voting block, which becomes obvious when studying the Brazilian governance code (IBGC, 2010). The abundance of family businesses compared to non-family businesses in Brazil and the fact that those businesses tend to have large numbers of minority shareholders underlines this phenomenon. The Brazilian governance system is a combination of the Anglo-Saxon one-tier system and the European dual board system, complemented by a number of specialized councils that are characteristic to Brazilian corporate governance, partially solving the agency concerns inherent to one-tier governance. Figure 1 illustrates the structure of the Brazilian governance model. Depending on the organizational form corporate governance requirements differ in Brazil. Limited liability companies (Portuguese: *Sociedade Empresária Limitada, Ltda.*), the organizational form of most family businesses, require little to no disclosures and are not legally bound to specific governance practices. However, some family businesses also have other organizational forms such as the corporation (Portuguese: *Sociedade Anônima, S.A.*). The Brazilian corporation can either be privately held, or publicly traded. Publically traded corporations are referred to as *Sociedades por Ações Abertas* and corporations with closed capital are called *Sociedades por Ações Fechadas*. Whereas the *Sociedades por Ações Fechadas*, the legal for of the three case companies analyzed in this study, are not required to implement corporate governance structures, the *Sociedades por Ações Abertas* are required by operation of law to establish corporate governance, including an executive board (Portuguese: *Diretoria*) and the supervisory board (Portuguese: *Conselho de Adminsitração*), jointly referred to as corporate administrators (Portuguese: *Administradores*,).[1]

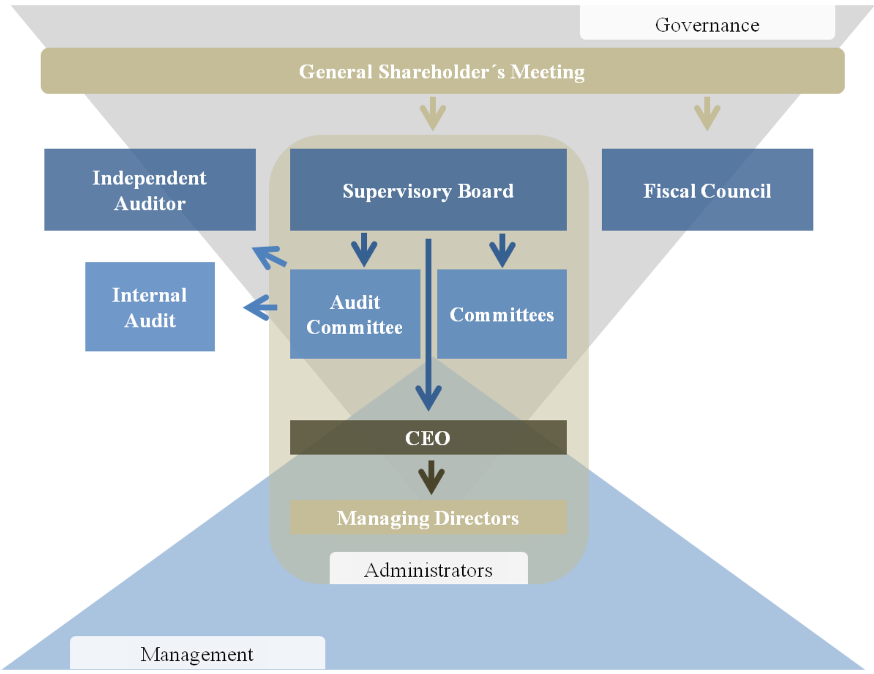
Analogously to the European governance model, the general shareholder´s meeting (Portuguese: *Assembleia Geral*) appoints the members of the supervisory board which in turn reports management activity to the shareholders and oversees the executive board. In addition, the supervisory board is in charge of nominating and, if necessary, dismissing the CEO (Portuguese: *Diretor-Presidente*) who has the responsibility to nominate the remainder of executives to the executive board (Portuguese: *Diretores*).

1 The Brazilian Act 6404/1976 for Sociedades por Ações article 185 paragraph 2 requires this organizational type of firm to implement a supervisory board.

The members of the supervisory board are elected for a period of up to three years and can be re-elected subsequently, whereas the general shareholder´s meeting can dismiss the members at any time during this period. The minimum number of members of the board is three, who all have to be Brazilian residents. The majority shareholder is entitled by law to appoint fifty percent plus one of the seats of the supervisory board. It is important to note that contrary to the dual board system, Brazilian law does not prohibit executives to serve on their firm´s supervisory board, allowing for CEO duality. Nevertheless, executive representatives cannot occupy more than one third of the total seats in the supervisory board. It is common practice that the CEO completely decides on the appointment of officers on the executive board and directs their work (IBGC, 2010). Interestingly the Brazilian law gives minority shareholders the possibility to directly appoint a board member representative.

Next to the corporate administrators, the fiscal council (Portuguese: *Conselho Fiscal*) plays an integral role in Brazilian governance. This specialized council oversees the actions of managers and verifies their compliance with legal and statutory duties. Further, it reviews the annual report and all management proposals before these are presented in the general meeting, adding missing information for the shareholders, if necessary. The fiscal council reports errors, fraud or crimes to the supervisory board or in case the board does not act in the interest of the company to the general shareholder´s meeting. In addition, the quarterly balance sheets and earnings statements are analyzed by the fiscal council (IBGC, 2010).

Figure 1: Brazilian Corporate Governance



Source: Author´s own illustration based on (IBGC, 2010)

Consequently, taking all aspects of Brazilian Corporate governance into account it is not directly comparable to the one-tier or the dual board governance. It incorporates elements of both systems and adds distinctive Brazilian facets such as the fiscal council. As mentioned above, privately held family businesses are not legally required to implement corporate governance but often decide to do so. In order to analyze this phenomenon further the term family business needs to be clearly defined in the following.

2.2 Defining Family Business

Defining what a family business actually is seems to be an equally challenging endeavor. Again, academic literature provides an array of definitions circling around the same concept, without finding consensus (Miller, Le Breton-Miller, Lester, & Cannella, 2007). Nevertheless, two approaches to defining family businesses are predominant in the literature (Hack, 2009): first, the “Components of Involvement Approach” and second, the “Essence Approach” (Chua, Chrisman, & Sharma, 1999). The very simplistic components approach considers any kind of family involvement as sufficient (i.e. ownership, management, governance or succession) for a firm to qualify as a family business. The fundamental issue stemming from this approach is that there are no clear-cut thresholds regarding the intensity of involvement, leaving too much leeway for interpretation (Siebels & Knyphausen-Aufseß, 2012). In addressing this limitation the essence approach recognizes the involvement of the family only as a necessary condition. In addition to this, the essential family involvement must be aimed at behaviors that generate certain distinctiveness before it can be defined as a family firm. In other words, family involvement itself does not convey “the intention, vision, behavior or impact that constitutes the essence” required by this second approach (Chrisman, Chua, & Sharma, 2005). Hence, following either one approach two firms with the same degree of family involvement can be defined differently (Siebels & Knyphausen-Aufseß, 2012). Its theoretical feature, however, makes the essence approach more attractive to researchers as it invites them to develop models and frameworks to capture the essence of family involvement (Chrisman, Chua, & Sharma, 2005). However, an objective threshold of the determinants necessary to constituting a family business under the essence approach does not yet exist.

As none of the existing approaches did the trick so far, academics started to combine definitional approaches and created a multidimensional scale to measure family involvement. Under this paradigm Astrachan et al. (2002) developed the Family Power Experience Culture Scale (F-PEC), which measures the intensity of family involvement as a discrete variable (Siebels & Knyphausen-Aufseß, 2012). The F-PEC scale allows for a gradual classification of a business as to being more or less influenced by the family. In this context we speak of the "degree of familiness" of a business.

Apart from theoretical approaches to defining what a family business actually is, several other more tangible approaches exist that identify the characteristics of a family business. In common parlance the term *family business* is used synonymously for a small business. However, this usage of the term falls short by disregarding at least one important “species” of family business: the publicly listed family firm. A publicly listed family firm is partly owned by third parties (diffused shareholding) but one or more families still hold the majority of shares in the company. It is true that the latter condition is primarily met by small businesses, but it holds true in the same way for many blue chips listed on the Brazilian stock exchange such as Inpar, Marco Polo or Pão de Açúcar which are partly owned by families (Amaral, 2007). Thus, the classification of a company as a family business according to size or legal form defeats the purpose (Woywode, Keese, & Tänzler, 2012). For the purposes of this study, however, we will focus on privately held family firms, excluding those listed on stock exchanges, because it is those companies that voluntarily introduce corporate governance to their business.

Comparing the remainder of existing definition attempts in the literature, four criteria genuine to family businesses can be identified. First, one or more families hold the majority of voting rights or capital. Second, one or more families exert a significant influence on the company via family members either in managerial roles or via decision and control rights from a supervisory body. Third, the family induces a particular corporate culture or values onto the business. Fourth, the company is a going concern, i.e. it will be passed on to the next generation of the family (Churchill & Hatten, 1987). Hence, if all four criteria are met the company at hand can be defined as a family business.

Nevertheless, it is often difficult to empirically assess whether a specific company satisfies these four criteria. Even though it is relatively easy to determine the shareholdings of a family in a company's capital and their respective voting rights, the extent of influence a family exerts on the management of a company and its values and culture as well as the going concern of the business, are much harder to measure. Even if both ownership and management are in family hands some academics only consider a firm a family business if succession, i.e. proof for the going concern, has taken place at least once (Churchill & Hatten, 1987).

It is also important to note that in the past years academics have considered the corporate culture imprinted by the family as constitutive for a family business. This in turn is consistent with the public and political opinion that family businesses behave differently than other companies in economic life, pursuing decisive visions that are passed on to potential successors (Woywode, Keese, & Tänzler, 2012). After having defined corporate governance and family businesses an economic justification for the importance of corporate governance in family businesses will be provided.

2.3 The Importance of Corporate Governance in Family Businesses

The four characteristics inherent to family businesses and the fact that these business behave differently than other non-family firms raise the question whether family businesses also have different governance demands than non-family firms? The answer to this question can be found in the *Agency Theory* and its unfolding in family businesses.

2.3.1 Principal Agent Theory

Traditionally, the separation of ownership and management is the nexus of interest in corporate governance. As long as family businesses are led by the entrepreneur who holds the majority of the firm´s shares, the implementation of corporate governance is not a major concern. He will most probably monitor the company and its management very closely himself. However, when due to successions the entrepreneur no longer manages the company, he will have a vested interest that the firm is managed as well as possible. Generally, with ongoing successions ownership and management are gradually separated from each other. As the ownership structure grows more complex it becomes more difficult to monitor the management. In situations of distant supervision, managers are inclined to act according to their self-interest rather than according to the interest of the shareholders. This type of conflict of interest is researched in the Principal Agent Theory (PAT) (Van-den-Berghe & Carchon, 2001).

The cornerstones of the PAT go back as far as the 18th century. It was Adam Smith who found that individuals act out of self-interest rather than conviction (Smith, 1976): *"it is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest".* This finding gave birth to an entire stream of research that analyzes the contractual relationship in organizations where one or more individuals (the principals) nominate another individual (the agent) to operate on their behalf (Jensen & Meckling, 1976). Following from this, the shareholders (owners of the company) are considered principals and the managers are considered agents. Such relationships become problematic when information asymmetry and conflicting interests between the principal and the agent prevail. As a result, the principals can fall prey to agency problems, i.e. opportunistic behavior on behalf of the agent. In turn, detecting and mitigating these agency problems through control mechanisms (corporate governance) incurs costs, i.e. agency costs. In other words, under the assumption of information asymmetry, agency costs arise through the separation of ownership and control (Fama & Jensen, 1983).

Apart from the theoretical foundations of the PAT, academics and practitioners try to find disciplining mechanisms to force managers to align their goals with those of the owners. In this regard an independent supervisory board functions as one of the most fundamental institutions.

2.3.2 Agency Costs in Family Businesses

Logically, from the general outline of the PAT it could be inferred that through the alignment of ownership and control in family businesses agency costs and thus the need for corporate governance is low (Daily & Dollinger, 1992). Unfortunately, this logical inference is flawed to some extent. Chrisman and his colleagues (2005) even argue that family businesses benefit more from agency cost control than other non-family businesses. As a matter of fact, family businesses are exposed to different types of agency costs than non-family businesses. Agency costs in a family business typically stem from altruistic behavior, management entrenchment as well as shareholder expropriation; problems publicly listed companies rarely have (Schulze, Lubatkin, Dino, & Buchholz, 2001).

Parental altruism is a common cause for agency costs in family firms. When ownership and management are bundled in the person of the entrepreneur, for instance, the owner-manager tends to make decisions that favor her employed children but potentially harm the business. Ahrens et al. (2012) empirically prove this claim by showing that growth rates in sales and profits of companies led by family successors were significantly lower than those of their peers managed by recruited successors. As primary cause of this the authors identify the lower average human capital of family successors in comparison to external successors.

But not only low human capital incurs agency costs. Personal ties to the family agent may compromise the principal´s ability to objectively evaluate and monitor the agent´s performance. Even if misconduct by family agents is detected, it is unlikely that sanctions follow out of the fear of social repercussions inside the family (Klein, 2004). This lack of control over family agents, in turn, creates sufficient leeway for family agents to engage in opportunistic behavior such as shirking or free-riding (Chua, Chrisman, & Bergiel, 2009). In general it can be assumed that the more altruistic the principal, the likelier opportunistic behavior of family agents and the incurrence of agency costs to curb unproductiveness (Ling, Lubatkin, & Schulze, 2002).

Next to altruism researchers find management entrenchment to be a common source of agency costs in family businesses. Agency problems can occur on different levels, vertically between owners and managers and horizontally among the owners of the family business (Villalonga & Amit, 2006). Management entrenchment describes situations in which managers attempt to outplay governance mechanisms. For example, vertical management entrenchment occurs when managers hide negative results from the owners, whereas horizontal management entrenchment occurs when owner-managers extract private benefits from other owners or use their ownership stake to impose their interest upon the remainder of the shareholders (Chrisman, Chua, & Sharma, 2005). A common occurrence, when for instance ownership rights exceed cash flow rights, is so-called tunneling (Villalonga & Amit, 2009). Tunneling involves the reshuffling of cost or revenues through transfer prices below or above fair market value in order to manipulate the earnings of those entities where the family has favorable cash flow rights. Withal, if not brought under control, entrenchment can have negative effects on the performance of the family business (Eddleston & Kellermanns, 2007) and decrease firm value (Morck, Shleifer, & Vishny, 1988), making sophisticated corporate governance mechanisms necessary.[2]

Another central problem in many family businesses, especially if the company has a heterogeneous ownership structure, is the determination of a dividend policy that is adequate for the economic conditions of the firm. In other words, what threshold should a dividend not exceed in order to not jeopardize the long-term competitiveness of the company? In fact, this question is not easily answered. However, there are indications that mid-sized companies, including the spectrum of different family businesses, are still far from economically optimal dividend policies. One indicator for this are the often alarmingly low capital ratios of small businesses, in particular those of small family businesses (Woywode, Keese, & Tänzler, 2012). This phenomenon can be either traced back to the fact that SMEs rather deposit low amounts of equity and that the profits generated are low so that the capital base of family businesses is generally weak, or it could be the case that SMEs tend not to reinvest the profits generated to maintain the competitiveness of their company, but rather withdraw the profits completely and distribute it to the owners. In consequence, family businesses, especially the smaller ones, are prone to crises and fall frequently in the vicinity of insolvency or over-indebtedness.

2 Discussions on the effect of corporate governance on firm value are not within the scope of this thesis. However, the interested reader can find two different approaches on how pin down the effect of corporate governance in (Kaplan, 1994) and (Morck, Shleifer, & Vishny, 1988).

Next to the dividend policy, the treatment of family shareholders requires appropriate governance as often not all family shareholders participate equally in the management of the company. On the one hand, those family members that hold a considerable percentage in the company´s capital tend to have lively business interests in addition to the power to implement their personal convictions in business decisions. On the other hand, there are family members who have less interest for the company. Oftentimes these are shareholders that live either far away from the business and thus do not have a close relationship with the company, or merely hold a marginal share in the capital of the firm (Shleifer & Vishny, 1997). The challenge for the family business is to ensure that those shareholders who do not participate actively in the business are involved early on in corporate policy decisions (inclusion of minority shareholders) in order to maintain consensus within the family.

Several scholars active in the area of family businesses research believe that harmony within the family is one of the main prerequisites for commercial success of a family business (Miller & Breton-Miller, 2006). Conversely, the failure of family businesses often has its origin in conflicts within the family. Another problem that should be addressed in the corporate governance of family businesses concerns the rules of entry and exit of shareholders. As opposed to public companies shareholdings in a family business may not be valued easily and are not freely tradable. Even though free trade of shares is not wanted in the first place, as family businesses seek to retain decision-making power for themselves, the entry and exit of members must be possible and should be regulated through appropriate governance.

Family complexity is another issue that can be solved through corporate governance. Put simply, family complexity depends on the number of family members, the type of relationships among them and the number of generations alive. Hence, as the number of family members involved in the family firm increases, its complexity inevitably rises. Logically, extended family ownership leads to increasing ownership complexity (Lambrecht & Lievens, 2008) and thus agency costs. In the following the most common governance modules to curb agency costs in family businesses will be presented.

2.4 Corporate Governance in Family Businesses

The preamble of the German code of corporate governance for family businesses starts with the following statement: "family businesses require corporate governance […] tailored to their needs, comprising the company and the family. It is primarily about ensuring a responsible influence of the owner on the company and to integrate the family as a supporting pillar into the company´s governance in a professional manner" (Kommission Governance Kodex für Familienunternehmen, 2004). The governance code indicates that the governance of family businesses is directly coupled to the owner family and resembles a synthesis, or at times a compromise, between family values and corporate functions. It follows, that these two institutions can only coexist fruitfully if the governance addresses the family and the firm at the same time.

Family firms set themselves apart through the existence of the family; an element which can be seen as a source of friction or a success factor at the same time. The family is mostly concerned with the sustenance of its members and is determined by logic of "sentiments, unity, tradition and harmony" (Sicoli, 2013). The firm, however, has the goal of generating economic value and is driven by values such as rationality and the ability to react to market changes. Hence, the interaction of family and firm and the mutual influence both exert on each other directly impact the governance models in family businesses.

Basically, the governance structure of a family business has to consider two interacting but distinct subsystems: the firm governance and the family governance (Aronoff & Ward, 1996). The firm governance can be defined as the locus of control and administration of the business and comprises the executive management, the supervisory board and the general shareholder´s meeting (Neubauer, Lank, & Ward, 1998). The central role of the executives is the strategic management of the firm, whereas the supervisory board controls the executives. The family governance regulates and maintains coherence within the family (Mustakallio, Autio, & Zahra, 2002) and usually consists of a family council and the general shareholder´s meeting (Neubauer, Lank, & Ward, 1998). As opposed to publicly traded companies where both subsystems are decoupled (Simon, 2005), their overlap in family-owned businesses points to the inevitable interaction and the mutual influence they impose on each other (McCollom, 1988).

Contrary to what the reader might expect, it is this dichotomy that makes governance structures in family businesses often more complex than in publicly listed firms. Therefore, a commonly accepted model of corporate governance for family firms, valid in every context and constant over time, does not exist (Zocchi, 2008). As a matter of fact, even the identification of common ground between the governance structures of different family firms turns out to be a complicated endeavor for at least two reasons: first, the difficulty of identifying a family firm as such and second the multiplicity of typologies that require different forms of governance as will be presented in the course of this study.

In small-sized family firms governance is not a major concern because, albeit not formalized, it mostly represents a combination between family values and those of the business. Nevertheless, with continuous business growth a delegation of decision authority from the founding family towards other stakeholders will possibly take place, gradually eroding the centrality of the entrepreneur along with his ability to resolve internal conflicts. In other words the absence of an "absolute leader" in combination with the tense relationship between corporate and family governance can trail down to familial clashes with negative consequences (possibly financially negative) for the firm. In such situations family councils have the power to mediate and, if successful, reunite the interests of the stakeholders who can be owners, supervisors and managers at the same time (Sicoli, 2013). As pointed out, the supervisory board and the family council are the most essential governance elements in a family business and will therefore be introduced in more detail in the following.

2.4.1 The Supervisory Board in Family-Businesses

An alternative to direct monitoring by the entrepreneur is governance through a supervisory board elected by the shareholders. Even though not legally required, the supervisory board is considered the most important governance body in privately held family businesses, next to the family council. The imperative of the supervisory board is the alignment of interests between the managers of the company and its owners (Voordeckers, Gils, & Heuvel, 2007). From this stems the main task of the supervisory board which is the provision of control and advice to the management (Heuvel, Gils, & Voordeckers, 2006). To date, most research on supervisory boards has been performed on publicly listed firms and was mainly focused on the American one-tier governance system.

As opposed to public firms, family firms often deal with non-economic family objectives. In this regard, outside director representation is often used as a proxy for the independence of the board (Johnson, Daily, & Ellstrand, 1996). The fact that outsiders are not restrained by social imperatives of the family allows them to remain autonomous, which is a necessary condition to fulfill the board´s control function (Klein, 2005). Nevertheless, empirical findings show that supervisory boards in family businesses are rarely independent.

Families have a valid motivation to control the management of the company because usually they have large parts of their private wealth invested in the business. Driven by the fear of losing decision making power over their investments, family owners tend to occupy the majority of board seats. This tendency increase as the socio-familial goals present inside the firm get stronger (Voordeckers, Gils, & Heuvel, 2007). For this reason family businesses tend to appoint affiliated board members such as bankers, consultants or lawyers, whose lack of independence protects their decision making power to some extent (Anderson & Reeb, 2004). For the same reason CEO-duality is often found in family businesses´ supervisory boards. Other academic studies suggest that external directors are often only appointed to the board as a reaction to pressure from outside shareholders who wish to protect their own investment in the business from entrenchment (Fiegener, Brown, Dreux, & Dennis, 2000).

Next to the control function, the advisory function is another task the supervisory board performs (Heuvel, Gils, & Voordeckers, 2006). For instance, Corbetta and Salvato (2004) argue that control may lower the management´s motivation to act in the organization's best interest. However, they point out the board's opportunity to foster pro-organizational behavior of managers by replacing control with the provision of advice. In fact, this view is supported by researchers who argue that the level of goal alignment between owners and managers influences the size and the composition of the supervisory board. It can be inferred that a high degree of goal alignment between owners and managers corresponds to a high percentage of affiliate members and a smaller board (Jaskiewicz & Klein, 2007). Affiliate board members can be considered advantageous in providing advice due to the close relation they maintain with the firm and the family and the complementary business know-how from their personal and professional qualifications (Huse, 2005). Next to their expertise, affiliate board members provide access to external resources obtained from personal networks which enables them to offer more distinguished advice and positively affect firm performance (Arosa, Itturralde, & Maseda, 2010).

The third task of the supervisory board, unique to the family business, is the maintenance of family relationships, or, in other words, the mitigation and resolution of conflicts (Voordeckers, Gils, & Heuvel, 2007). Again, scholars find a positive effect of external board members in keeping board discussions focused on objective facts, helping to achieve internal consensus (Johannisson & Huse, 2000). More often though family relationships are governed through dedicated family councils, especially when the family shareholder base is diverse.

2.4.2 The Family Council

The acknowledgement of the family dimension through family governance is a fundamental part of the governance structure in family businesses (Klein, 2009). Family governance is typically achieved through the implementation of a family council, next to the supervisory board (see Figure 2). A family council is a governance module that is exclusively found in family businesses and its manifestation can have diverse forms. Regardless of its manifestation, however, the family council´s objectives are manifold and crucial to the well-being of the family business. Also, the family council differs from a family assembly in terms of its limited size and its positioning as a constitutional body of corporate governance (Gallo & Kenyon-Rouvinez, 2005). Depending on the size of the firm and the family the optimal council size is suggested to be around 30-40 members (Neubauer, Lank, & Ward, 1998).

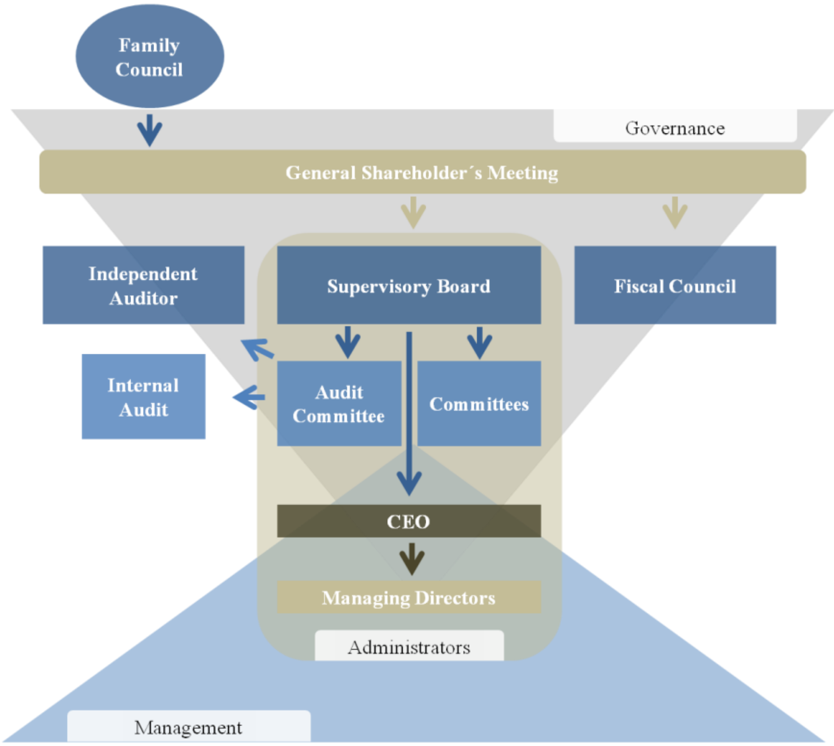
The family council offers a forum for family discussions about attitudes, opinions and values towards the company, which are then subsumed and presented to the management and the supervisory board (Koeberle-Schmid, 2008). It offers a podium where family conflicts can be debated and mitigated before they have adverse effects on the business (Stöhlker & Müller Tiberini, 2005). Hence, the family council has the function of a structured nexus between the family and the business sphere, aligning opposing interests or counteracting emotional detachment of shareholders. Academics summarize the core tasks of the family council as a) influencing the business in the direction of family interests, b) guaranteeing unity inside the family, and c) protecting the family ownership over generations (Koeberle-Schmid, 2008).

In addition, literature suggests three different ways on how a family council can assert influence (Koeberle-Schmid, 2008a). First, the family council may develop the strategy and vision and establish objectives for the firm, which are subsequently presented to the management and the supervisory board. Second, the council may participate in board member selection. Third, the council could steer the decision making process concerning management succession (Gallo & Kenyon-Rouvinez, 2005). In addition, the family council can support the involvement of inactive family members and diminish information asymmetry for the sake of cohesion among shareholders (Mustakallio, Autio, & Zahra, 2002).

According to the Brazilian corporate governance institute it is not only the task of the family council to define the boundaries between family interests and company objectives, i.e. the management of the relationship between the family and the business (Witt, 2008), but also the preservation and alignment of family values with the firm (IBGC, 2010). Next to this, the family council may engage in asset protection and the administration of real estate and other goods (family office). In many cases it is the task of the family council to create mechanisms (e.g. holding fund) for the acquisition of the shareholdings of other owners in case of an exit (IBGC, 2010). Importantly, the family council has to ensure a structured succession planning, including the transfer of property and inheritance as well as the preparation of family members to succeed in the organization. Further, it is the task of the family council to define criteria for the election of suitable independent board members joining the board of the firm.

It often proves helpful to make decisions made in the family council explicit by creating a family constitution. Therefore, in the following the family constitution will be introduced.

Figure 2: The Family Council in Brazilian Corporate Governance



Source: Author´s own illustration based on (IBGC, 2010, p. 16)

2.4.3 The Family Constitution

For a family council to decisively exert influence on the business a family constitution should be agreed upon (Angus, 2005). The family constitution defines the rules of the game, i.e. the interaction amidst family members as well as the interaction between the family and the business (Witt, 2008). The most important difference between a family constitution and a shareholder´s agreement is their signatories. Whereas a shareholders' agreement addresses only the shareholders of a company, a family constitution addresses the entire family. In a family business not every member is always a shareholder but may still have a valid interest in the firm. Hence, it is important that all family members sign an agreement that ensures the sustainability of the family business.

As a matter of fact, this set of rules is one of the most important precautions that ensure the long-term survival of a family business. A reservoir of rules, timely formulated, documented and accepted by all family members ensures that stability is maintained, communication secured and that conflicting interests are expressed and addressed when they are still small (Schween, Koeberle-Schmid, Bartels, & Hack, 2011).

Unfortunately, researchers find that only one quarter of family businesses have a family constitution in place. Those that in fact have a family constitution are often larger, older and have more diffused ownership than their peers. A family constitution brings two types of value to the business: cohesion, identification, management control and stability (emotional value added) as well as economic success (economic value added) (Schween, Koeberle-Schmid, Bartels, & Hack, 2011).

The constitution defines important subjects such as the handling of spouses, ownership transfer rules, terms for shareholder exit, rights and duties of shareholders, who should be accepted as shareholder, methodologies for the valuation of shares, qualifications of family members allowed to work in the family business or how dividends are determined (Baus, 2010).

All in all, limited research has been performed on family councils and only very few empirical studies were made (Koeberle-Schmid, 2008a). Therefore, characteristics such as types of members, voting modes, frequency of meetings or the positioning of the family council in relation to the shareholders' meeting have not yet been addressed in academic literature (Witt, 2008). Although family councils bring about many advantages for the family business, they are not yet wide-spread. After a period of five years the family constitution should be revised to reflect any changes in the family business. In the following the other councils, as well as the advisory board as a common alternative to a statutory supervisory board will be introduced.

2.4.4 Councils and the Advisory Board in Family Businesses

Next to the family council a variety of other councils prevail within modern family businesses. As a matter of fact, councils are an integral part of many midsized companies today. Although in principle even very small companies can put councils in place they will usually only be constituted when a certain size or age of the firm is reached (May & Sieger, 2000). In contrast to listed companies in which a mandatory supervisory board must be installed, privately held companies use the lack of legal regulation that allows for considerable leeway in the governance design for an increased use of councils.

The task spectrum of councils is diverse and ranges from advising the management over mediating between management and shareholders to management control. Among the motives for its establishment is the desire for professionalization, qualified decision making taking external opinions into consideration, or representational tasks. In the latter case, the council contributes to the good image and network of the company. For instance, in negotiations with banks it can be advantageous to have a dedicated council of experts handling bank relations. In addition, councils are often implemented for the selection and recruitment of senior management and their compensation.

On the optimal composition of councils science and practice reached no consensus. Generally, business owners want next to themselves honorable and prominent representatives in their councils. But May and Winner (2000) argue that a council should not consist of affiliated individuals such as representatives of banks because in these cases the council loses its independence and a danger of linking the council's activities with its members own economic interests persists. Hence, in family businesses an adequate mix of shareholders and independent members is advisable.

Another important motive for the establishment of a council is its advisory role. Councils are traditionally put in place as permanent organs in addition to the management, the supervisory board and the shareholders' meeting. In other cases, however, councils are the first evolutionary step towards a more sophisticated corporate governance structure. The type of council that is often used in those transitory periods is the advisory board. According to the IBGC “the existence of an advisory board, preferably made up of independent members, is good practice, particularly for organizations taking the first steps in the adoption of corporate governance” (IBGC, 2010). The advisory board is a simplified governance body in comparison to the statutory supervisory board. Its implementation costs and formal requirements are more in line with the needs of family businesses in pre-mature stages. These characteristics make the advisory board a plausible alternative in the process of implementing corporate governance practices, offering the opportunity to include external advisors and to deliberately qualify decision making without the required formality of a statutory supervisory board. As opposed to the supervisory board, the advisory board members often do not have voting rights and do not act on behalf of the law, but offer professional advice that can be either accepted or rejected by the shareholders of the business. Put more bluntly, advisory boards allow independent members to contribute to the organization and gradually improve its corporate governance. On the one hand, advisory boards help the firm to adequately model decision requirements in the face of meetings with external professionals, often through quantitative and qualitative analyses, and on the other hand it provides the owners with the opportunity to share decision alternatives with external professionals whose competencies and experiences complement those of the firm.

However, family businesses should be mindful in creating councils. An undifferentiated council appointment can lead to permanent damage of the corporate culture and thus to loss of competitive advantage (Klein, 2005). After reviewing the most important aspects of corporate governance in family businesses, the following section will introduce the developmental framework for family businesses that lies at the core of this study.

2.5 The Family Business Development Framework

Family businesses develop differently from non-family businesses, especially those held privately. Several researchers have attempted to identify the most relevant dimensions in which family firms develop over time. For instance, Ward (2011) was the first to draw the attention to different ownership categories in family firms and suggested a typical evolution from founder ownership, towards a sibling partnership and lastly to a family dynasty. The logic behind his reasoning was that often ownership becomes more diluted over time, i.e. with ensuing generations, from a single controlling shareholder to a few owners and then to a broad ownership distribution.

Of course, there are exceptions. Firms can be founded as a sibling partnership as opposed to a single founder, or move back and forth over generations as a result of consolidation, expansion and ownership transfer. Hence, an accurate as opposed to a schematic portrayal of family ownership would reveal a much greater variety of ownership structures through different classes of shares, a large variety of trusts and multigenerational combinations of large and small shareholdings. However, for academic purposes a schematic classification is more useful.

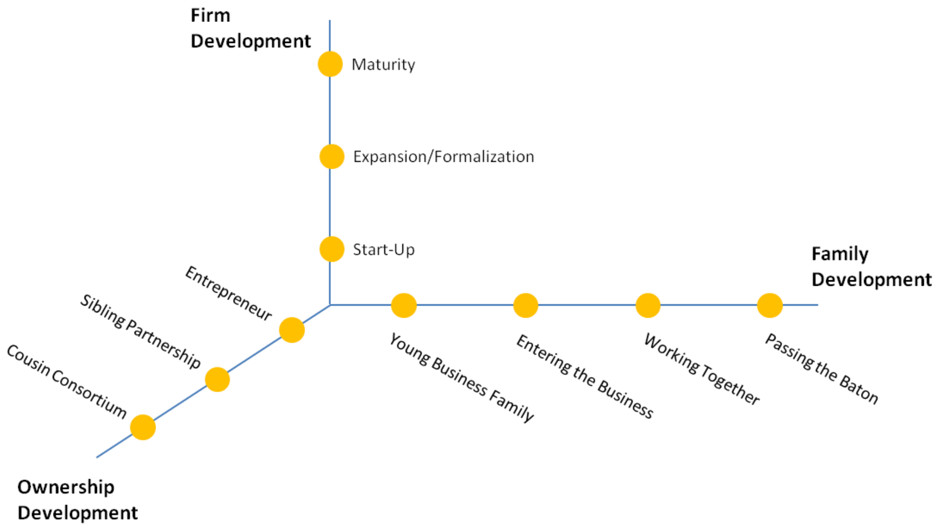
The cornerstones of Ward´s theory were further developed by Gersick et al. (1997) who refer to the evolution of family businesses as developmental. The authors have added two additional dimensions to Ward´s theory and built a three-dimensional model of family firm evolution in order to classify family businesses (see Figure 3). Each family business thus has a developmental character according to where it is placed on each dimension.

The first dimension is concerned with the ownership development of the family business over time. Even though the ownership structure in each family business reflects its history and membership most cases fall into one ownership type. It follows that the progression from one ownership type to another can be thought of as a predictable sequence that is partially driven by the aging and generational expansion of the family. Hybrids, for instance, controlled by a group of siblings with several cousin shareholders and perhaps a management team of minority shareholders are considered transitional from one stage to another.

The second dimension measures the family development over time. Considering how families change, the necessity for a developmental approach becomes obvious. The entry of new generations, the passing on of control from parents to children, the relations between siblings and cousins as well as marriage and retirement are all factors that have a strong influence on the family business and can all only be described over time. Unlike the other two axes a business cannot move forwards and backwards so easily on the family axis.

The third dimension concerns the firm development over time. This dimension builds on the idea of business life-cycles. Along these dimensions variations in growth, internationalization, indebtedness and capitalization as well as product and process maturity occur. The authors already indicate that the firm development may have an effect on the governance of the company (Gersick K. , Davis, Hampton, & Lansberg, 1997). They argue that a proportional development along all three axes is necessary for a healthy development of the family business. If this is not the case, conflicts of interest between the family members and the business can arise.

Figure 3: The First Developmental Framework for Family Businesses



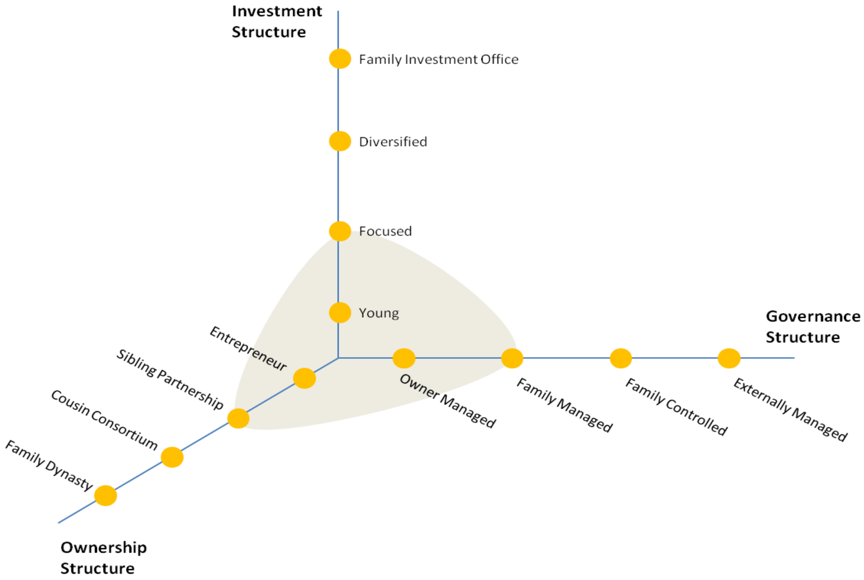
Source: Author´s own illustration based on (Gersick K. A., Davis, Hampton, & Lansberg, 1997)

However, the initial three-dimensional framework from Gersick et al. (1997) does not address the governance of the firm and the implications increasing business and family complexity have on it. In a study on family constitutions Schween et al. (2011) revised the three-dimensional framework of family businesses and replaced the family development axis with an axis for governance (see Figure 4). The new model allows for the categorization of family firm´s corporate governance in relation to its business complexity (investment structure) and family complexity (ownership structure) (Schween, Koeberle-Schmid, Bartels, & Hack, 2011).

Through this categorization, it becomes evident that family businesses can have a high degree of heterogeneity when compared to each other, similar to what was concluded by the

F-PEC scale previously mentioned.[3] Logically, configurations of corporate governance differ as progressing along the axes of ownership structure and investment structure leads to different necessities for governance, depending on the ownership configuration (Chen, 2010), the generational cycle (Bettermann, 2009), the complexity of the business (Klein, 2009) and the desired governance outcomes (Jaskiewicz & Klein, 2007).

Figure 4: The Second Developmental Framework for Family Businesses



Source: Author´s own illustration based on (Schween, Koeberle-Schmid, Bartels, & Hack, 2011)

However, no study that analyzed according to which chronological order family businesses move along the axes was identified in the literature review that supported this study. Therefore, it remains unclear whether the progression on one axis induces the progress on another, or not. This study argues that corporate governance structures in family businesses evolve naturally, i.e. increasing business complexity and/or family complexity create the necessity for more sophisticated control mechanisms which subsequently lead to the development of governance practices.

In order to demonstrate the development of family businesses over time and to single out the sequential establishment of governance institutions the framework developed by Schween et al. (2011) was again revised by the author in the believe that a more suitable framework to assess corporate governance development can be created. In fact, in the literature review no analysis comparable to the study at hand was identified.

First, the third axis originally labeled governance structure was relabeled into management structure because this terminology better resembles the different types of family

[3] The majority of family businesses are in the grey area shown in Figure 4.

involvement shown on this axis. Second, a fourth axis was added, labeled governance structure that aims to categorize a company´s adoption of corporate governance practices in four stages. The remainder of the new framework is identical to the previous one by Schween et al. (2011). Figure 5 illustrates the newly created framework.

Figure 5: The New Developmental Framework for Family Businesses

Source: Author´s own illustration

The classifications of the newly added axis as well as the other three axes can be found in Table 1. The development of the three Brazilian privately held family businesses along these four axes over time will be analyzed in the remainder of this study. In the following chapter the methodology applied will be briefly discussed.

Table 1: The Four Developmental Dimensions in Detail

Ownership Structure	
Type	*Characteristics*
Entrepreneur	1 owner or married couple, other owners do not posess decision authority
Sibling Partnership	2-4 family owners, effective control in the hands of one sibling generation
Cousin Consortium	5-29 family owners, usually spanning over three generations; mixture of employed and non-employed owners
Family Dynasty	30 or more family owners, including heirs from all living generations
Investment Structure	
Type	*Characteristics*
Start-Up	Nascent family business with few established processes
Focused	Focused on one line of business
Diversified	Diversified business lines with varying risk profiles and products
Family Investment Office	Family holds minority interest in the firm without leadership claims, concentrates on private wealth management
Management Structure	
Type	*Characteristics*
Owner Managed	Ownership and management are identical
Family Managed	Active and inactive family owners
Family Controlled	Family controls external management through supervisory board or council
Externally Managed	Family neither involved in management nor in its control but is a shareholder
Governance Structure	
Type	*Characteristics*
None	No corporate governance practices in place
Basic	First adoption of corporate governance practices directed towards facilitating decision making and increasing transparency. Advisory boards are usually introduced at this stage
Advanced	Increased adherence to corporate governance practices, usually supevisory boards with independent board members as well as shareholders´ agreements are introduced at this stage
Sophisticated	Strong adherence to corporate governance practices, usually family councils are introduced at this stage

Source: Author´s own illustration

3 Methodology

This section briefly outlines the methodological choices as well as the case selection in order to achieve the goal of this study.

3.1 Type of Study

Given the subject of this study a qualitative research approach was adopted. A qualitative research approach encourages the approximation of the researcher to the researched object, allows for the analysis of a phenomenon in its entirety and facilitates the exploration of contradictions and paradoxes (Vieira, 2004). As a matter of fact, studying the developmental process of family businesses in its chronological sequence can hardly be accomplished by using a quantitative approach. Due to the fact that privately held family firms are not required to publish their results, data accessibility and the formation of a representative sample is only possible to a limited extent.

There are several taxonomies of qualitative research that have two basic criteria classifying them according to the purpose and the means of the study (Vergara, 2007). The purpose of this research is explanatory, aiming to explain the factors that motivate family businesses to adopt corporate governance mechanisms even though they are not legally required to do so, as well as the sequential movement on the axes of the family business development framework. The means in order to achieve this goal were bibliographic research of academic journal publications by subject matter experts and the subsequent identification and amendment of a suitable framework that was applied in a multiple case study analysis with subsequent cross case comparison.

It is important to note, that the financial situations of the companies that constitute the case studies were not investigated. The analysis at hand is merely limited to the adoption of corporate governance practices by those companies. It is not among the objectives of this study to relate governance practices and performance, but rather the lived experience of corporate governance implementation in family businesses.

3.2 Research Methods

The analysis of the academic literature on corporate governance and family businesses was based on primary and secondary sources, spanning over academic journals and selected books on the topics and then condensed into a categorical literature review that supports the understanding of the reader and puts the analysis at hand into its academic context. Subsequently, a developmental framework for family firms was presented and amended for the purpose of the analysis. It was then sought to detect developmental steps according to the four-dimensional model in the cases of three Brazilian privately held family firms.

According to Yin (Yin, 2005, p. 32), the research strategy of a case study "is an empirical inquiry that investigates a contemporary phenomenon within its real life context", which aims to gather detailed and systematic information about a phenomenon (Patton, 2002) and involves a thorough and exhaustive study of one or a few objects in order to allow its broad and detailed understanding (Gil, 2007). The cases at hand are bound by time (from inception to the year 2011) and activity (corporate governance development) and allow collecting detailed information by mapping their activities over time according to the developmental framework (Stake, 1995). Hence, this study analyzes the target organizations´ sequential implementation process of corporate governance mechanisms by probing into a deeper understanding of the motivating factors that led to its adoption. This research in form of a multiple case study is performed under the premise that there are no existing studies that analyze the evolutionary process of corporate governance implementation in family firms, leading to the belief that more than one company surveyed could provide additional information on a subject that is still unexplored.

With regard to construct validity Yin (2005) explains that it is associated to the determination of correct measurements for the concepts studied. Thus, the author has to assure analytical categories were defined outlining exactly what is analyzed. Therefore, the dimensions of the developmental framework studied are explained in detail in Table 1. The external validity seeks to establish the domain in which the findings of a study can be generalized. However, in case studies the generalizations that can be made are purely analytical and not statistical. In analytical generalizations the investigator aims to generalize a particular set of results to some broader theory without using the sampling logic. Accordingly, the external validity of this study will be determined by comparing the results with existing theory as well as through the logic of replication which is obtained through multiple case study analysis.

The case studies used are secondary material provided by the IBGC and were rearranged and amended by the author to better suit the analysis at hand. In addition to the material provided by the IBGC, archival references from the companies in question were studied in order to draw a more complete picture of the companies´ governance implementation. Questions that were still unanswered after the material was studied were addressed in short, unstructured telephone interviews with company representatives. Concerning the analysis the empirical evidence obtained was systemized according to developmental steps within the theoretical framework previously presented. Then, patterns of behavior following the variables of the framework were observed and documented.

The design, data collection as well as the analysis of the primary data and the presentation of results of the cases were performed by the IBGC. However, on the basis of the material provided by the IBGC the output was reorganized and analyzed according to the developmental framework by the author. The data collection phase of research included the completion of questionnaires by managers of the respective family businesses in order to create a snapshot of their governance structure. In line with Yin (2005) who claims that interviews constitute the main source of evidence for a case study, the IBGC conducted semi-structured interviews with company representatives in order to better understand the processes that led to the adoption of the governance practices indicated in the survey. During the process families, managers and supervisory board members were interviewed.

In a second step the information gathered was analyzed and categorized by the IBGC in order to present the cases in a more comparative way, facilitating the analysis at hand. Specifically, the IBGC divided the original cases into the following sections: company history, family history, corporate governance, evolution of corporate governance, motivations, next steps and lessons learned. Hence, the cases start with a brief description of the company's operations to situate the reader and then describe how the business has evolved since its founding as well as the family involvement in the business over time. Although the separation of the family history from the company history is a complex task in a family business, it was chosen to highlight the development of the family separately to make the evolution between generations visible. This separation of family, company and governance evolution allows for a detailed analysis of the evolutionary process by outlining which evolutionary step may have led to the adoption of specific corporate governance practices. The corporate governance section includes a description of current practices and a report on its progress. This is especially important because it describes the order of adoption of practices, taking into account that not all organs and structures are created in the same evolutionary order. The corporate governance evolution section includes an analysis of the most relevant steps in the adoption process that led to the current model of governance of the companies. Both, practices that are currently implemented, as well as processes that have failed are outlined to further the understanding of what may have contributed to or hindered the full implementation of governance practices. In the motivations section the factors that motivated the companies to implement governance practices are of interest. The next steps section indicates some procedures that the companies were planning to adopt in the near future. It is worth noting that the next steps of the companies were not limited to those described in the cases but new practices according to the need of the companies caused by events not captured in this study may have arisen. Finally the cases conclude with a section on the lessons learned.

3.3 Case Selection

After the publication of a book on corporate governance in publicly listed family businesses in 2006, the IBGC sought to advance the study of unlisted family businesses through cases of medium-sized family businesses. The choice of this segment stems from the perception of the family businesses´ significance in the Brazilian economy. Initially, it was intended to give an overview of corporate governance practices as was provided in the book of 2006. However, a limiting factor led to a change in the project: the difficulty of obtaining comparable data from unlisted family businesses in Brazil. Therefore, the IBGC decided to analyze a small group of unlisted family businesses in depths in the form of case studies.

Yin (2005, p. 69) notes that in multiple case studies each case must be selected individually so that it allows “predicting similar results as well as literal and theoretical replication". The individual selection process of the case companies through the IBGC was non-probabilistic and rather driven by the availability of information and the companies´ willingness to provide the information via surveys and interviews, as well as typical family business characteristics that allowed a certain degree of comparability to other family businesses. Consequently, it was important that the case companies had substantial governance practices in place in order to be able to analyze their evolution accordingly. In this first edition of case studies, the IBGC has tried to select medium sized family businesses from the state of São Paulo with domestic business activities, a time to market of over 40 years and annual revenues over R$ 100 million. It was important that succession has taken place at least once and that at least the second generation was in command, while the third was being prepared. Hence, the three companies analyzed are Brazilian family businesses from the industrial sector. It was the intention of the IBGC to create exemplary case studies of corporate governance implementation for all states of the country. Thus, in this first edition all three case companies are headquartered in the state of São Paulo. In a forthcoming edition (2015) the IBGC will present three additional case companies from three other states of Brazil, excluding São Paulo.

In general, the results from the application of a multiple case study have greater credibility and are considered more convincing than single case studies because they better address the replication features outlined by Yin (2005). Any application of a sampling logic to the case studies would be misplaced in qualitative research because it does not allow individual case selection and the prior prediction of similar results.

4 Multiple Case Study Analysis

In the following the cases of three Brazilian privately held family firms from the state of São Paulo will be presented and analyzed regarding their developmental footprint according to the four-dimensional framework. The focus of this analysis lies on the corporate governance evolution over time and the motivating factors that led to its adoption.

4.1 Sasazaki

Founded in 1943, Sasazaki specializes in the manufacturing of doors, windows and frames. With revenues of R$ 200 million in 2010 and 1,250 employees Sasazaki holds a 20% market share in Brazil. Sales are concentrated in the domestic market of which 90% are sold to the retail sector and the remainder to the construction sector. Sasazaki markets its products in approximately 5000 points of sale throughout the country including leading retailers of building materials. Even though the company does not export its products, they can be found in many countries where the construction companies are active. Since 2000 Sasazaki supplies construction companies directly. The family business operates an industrial plant in Marilia (SP) with a production capacity of 1.2 million pieces per year. The production is divided into two product lines: steel items which account for 60% of sales and aluminum items corresponding to the remaining 40%. Raw materials including chemicals to treat the products are supplied by major domestic and international manufacturers.

4.1.1 Company History

In 1943, after ten years of working in agriculture, the brothers Kosaku Sasazaki and Yusaburo Sasazaki moved to the city Marilia to start the family business. Along with their common friend Kyomassa Shibuya they began to manufacture small objects such as lamps, turnbuckles and clothespins from recycled tinplate.

In 1944 the company manufactured its first agricultural machine, a cotton planter. From then on the production of agricultural equipment continued to be the main business until the 1970s. At that time the leaders of Sasazaki visited the Expo70 in Japan and came into contact with frames, the products the company currently produces. However, the production of frames in Brazil seemed difficult due to the absence of steel suppliers who could deliver on a sufficient scale. In 1975 severe frosts slowed down the agricultural business in the region which had negative effects on Sasazaki´s production of agricultural machines. Consequently, the company decided to change the industry and started to produce window frames. The first product developed was a steel-made Venetian window. In 1976 Sasazaki expanded its product line producing door frames. Despite the new product diversification the production of agricultural machinery was only completely discontinued in 1992.

In 1999 when Sasazaki was already an established player in the doors, windows and frames market the company created a new business line of aluminum products. Aluminum products are not only lighter than steel products, but also more weather resistant. Following the initiative of a new CEO the company expanded regionally into the Northeast of Brazil and opened a representative office and a distribution center in Recife (PE) in 2011.

4.1.2 Family History

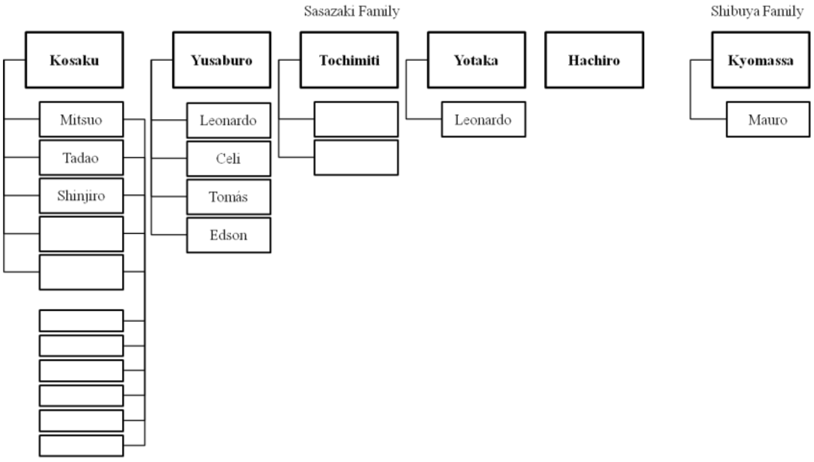
The family history began in Brazil in 1933 when the Sasazaki family arrived in Santos (SP). Coming from Japan – along with hundreds of other immigrants – the family settled on a farm in Guaimbê, a small town in Western São Paulo. In 1943 the brothers Yusaburo and Kosaku moved to Marilia to found the family business Sasazaki. From the beginning their mutual friend Kyomassa Shibuya worked with them but held no ownership in the company. The brothers had distributed the ownership equally among themselves and made decisions jointly. Fifteen years later in 1958 the first change in the ownership structure took place: the younger siblings Yotaka, Hachiro and Tochimiti Sasazaki as well as Kyomassa Shibuya became shareholders in the business.

Sasazaki was formally managed by the two founders until 1981, when Kosaku retired. From that year on Yusaburo became CEO of Sasazaki. Kyomassa Shibuya remained in the firm as a managing director and was responsible for the production and management of the factory. In the same year the second generation of the family began working in the family business. In 1987 the first transition in the management of Sasazaki took place. Yusaburo Sasazaki died and the role of the CEO was assumed by his brother Hachiro Sasazaki, former CFO of the company. In 1987 Kyomassa Shibuya also retired and the management started planning the succession process of the second generation.

Seven years later Tomas Sasazaki, son of Yusaburo who served as CFO, died in an accident ruling out one possibility of succession. In 2002 Hachiro Sasazaki stepped down from the CEO position and served as chairman of the supervisory board. The youngest brother Tochimiti Sasazaki assumed the role of CEO and when his brother Hachiro Sasazaki died he took over the chairman position as well. In 2004 Tochimiti, the last member of the first generation, announced with six months prior notice that he would leave the CEO position and chose to contribute only as chairman of the board. This led to the first management succession of the family business. Tadao Sasazaki, who was the son of the founder Kosaku and served previously as a managing director within the company, took over as CEO.

In 2011 the company counted 13 active family owners, including four supervisory board members, the managing director of institutional relations Leonardo Sasazaki as well as eight heirs who became involved in the company in 2004. Figure 6 illustrates the family tree of the Sasazaki family and only considers family members who work or have worked in the family business.

Figure 6: Family Tree of the Sasazaki Family

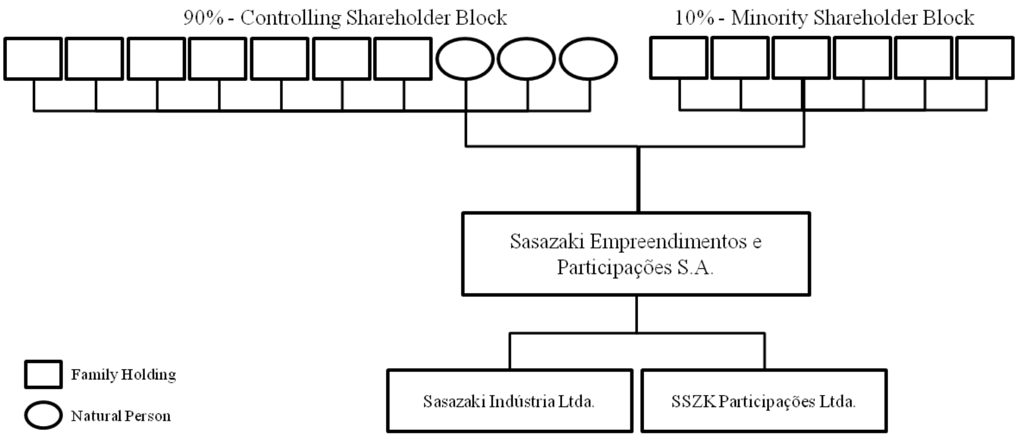


Source: Author´s own illustration based on (IBGC, 2011, p. 17)

4.1.3 Corporate Governance

Currently, Sasazaki has 24 shareholders of the second and 36 shareholders of the third generation that are distributed in family holdings as shown in Figure 7.

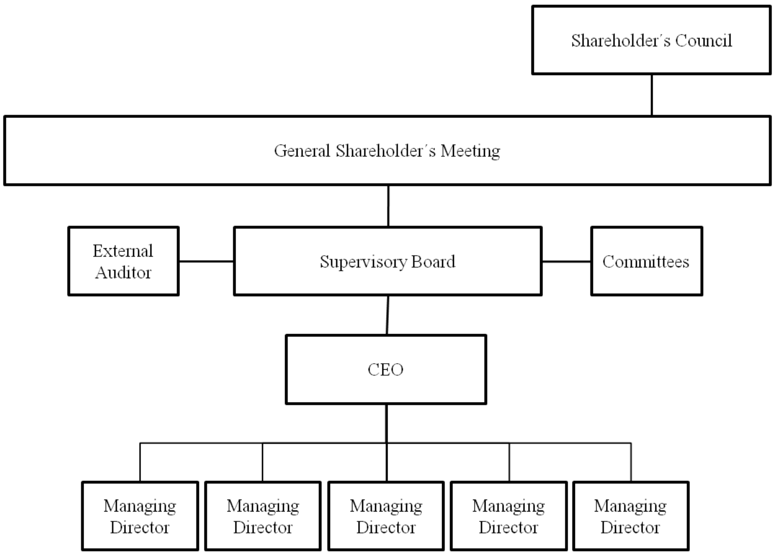
Figure 7: Sasazaki´s Ownership Structure



Source: Author´s own illustration based on (IBGC, 2011, p. 18)

Sasazaki is currently controlled by a block that holds 90% of the company´s share capital. The controlling block is divided into seven family holding companies and three individuals. The remaining 10% belong to six holdings of former employees who were offered a participation in the company as a means of retention. The latter minority shareholders have no effective control over the company because each holding votes according to the respective percentage held in the general shareholder´s meeting. The company´s (Sasazaki Empreendimentos e Participações S.A.) corporate governance model is illustrated in Figure 8.

Figure 8: Sasazaki´s Corporate Governance



Source: Author´s own illustration based on (IBGC, 2011, p. 19)

The shareholders' council embodies 100% of the share capital and is represented by ten delegates. It operates similar to a family council in discussing issues related to the admission of family members to the management and supervisory board, as well as matters relating to the company's philanthropic work and the preparation of heirs to act as shareholders. The general shareholder´s meeting consists of 16 members (one representative from each family holding and three individuals who chose not to participate in holdings). It deliberates on matters customarily pertaining to an assembly such as the approval of the company´s accounts, the election of supervisory board members, amendments to the bylaws, mergers and acquisitions etc. The supervisory board is responsible for defining the company's strategy as well as electing the CEO and nominating the external auditor. The board is also responsible for management control as well as goal setting and monitoring its compliance. In order to elect a board member an 18% stake in the firm´s capital is required. Thus, although the minority shareholders do not have the required percentage they can vote together with one of the family holdings in order to appoint a representative of the minority shareholders to the board. Table 2 depicts the supervisory board composition as of 2011.

Table 2: Composition of Sasazaki´s Supervisory Board

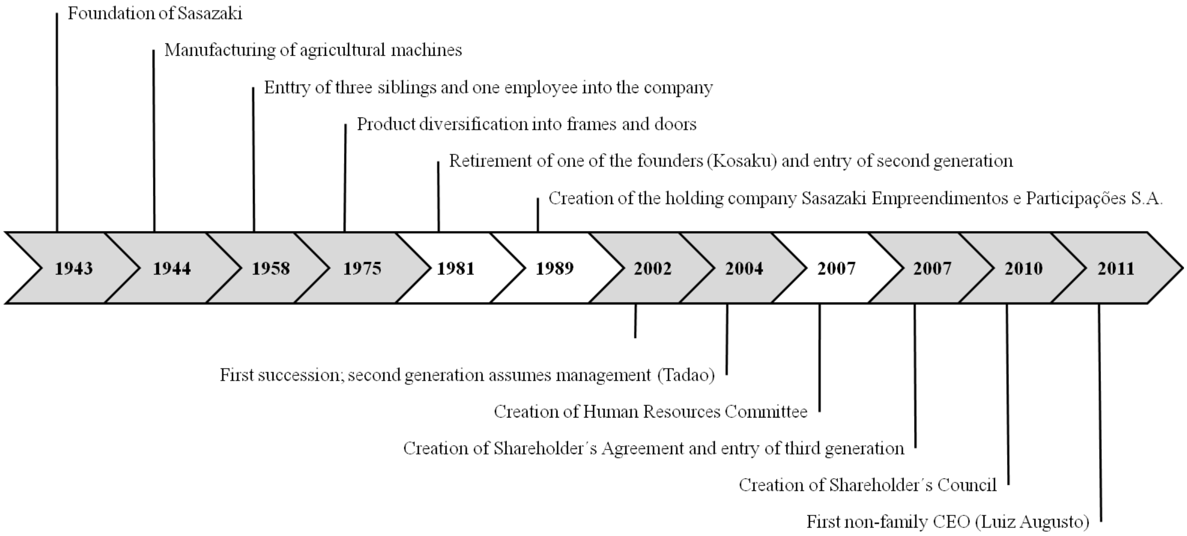
Supervisory Board Member	Type
Tochimiti Sasazaki	Family member and Chairman
Shinjiro Sasazaki	Family member
Celi Sasazaki	Family member
Mauro Sasazaki	Family member
Choite Teramoto	Minority Representative
Carlos Libretti	Independent
Marcos Sardas	Independent

Source: Author´s own illustration based on (IBGC, 2011, p. 20)

4.1.4 Evolution of Corporate Governance

The following timeline illustrates the most important milestones in the historical development of Sasazaki, whereas the years marked in are critical to the analysis conducted in this study.

Figure 9: Sasazaki´s Development Timeline



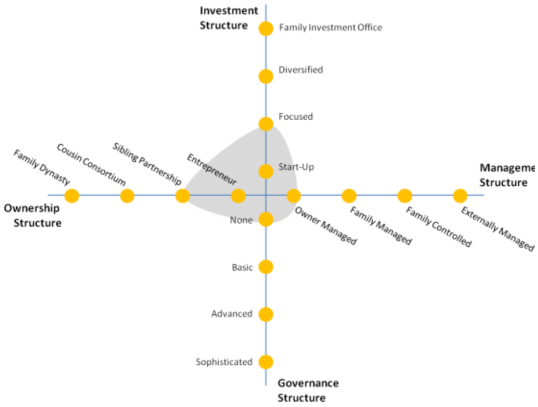
Source: Author´s own illustration

During the year of its foundation Sasazaki showed a usual developmental footprint (see Figure 10). Founded and managed by two brothers the owner managed sibling partnership was still in the start-up phase with few defined processes and no requirement for corporate governance. The two brothers were the only two shareholders in the business and monitored it directly. During the founding year the company emancipated from creating simple objects out of recycled tinplate towards the production of agricultural machines. In 1944 the first agricultural machine was produced which subsequently leads to a movement on the investment structure axis from start-up to focused (see Figure 11).

Figure 10: Sasazaki in 1943

Source: Author´s own illustration

Figure 11: Sasazaki in 1944



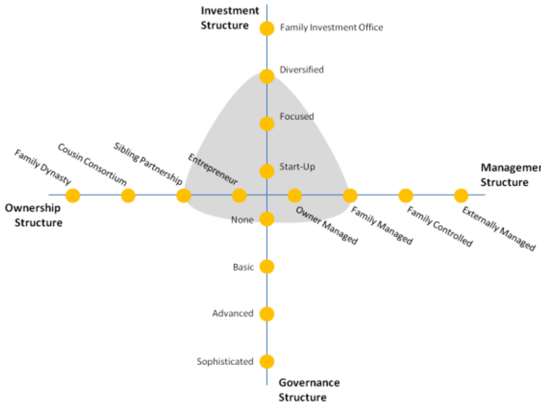
Source: Author´s own illustration

The need for corporate governance practices became first evident in 1958, when the three younger brothers and the friend who worked in the company since its foundation became shareholders. The younger brothers assumed management positions within the company and thus Sasazaki moved along the management structure axis towards family managed. However, as the new shareholders were from the same generation as the founders no movement on the ownership axis occurred (see Figure 12). During the 1970s Sasazaki expanded its production into doors, windows and frames. From then on the family had to manage an increasingly complex diversified business (see Figure 13).

Figure 12: Sasazaki in 1958

Source: Author´s own illustration

Figure 13: Sasazaki in 1975



Source: Author´s own illustration

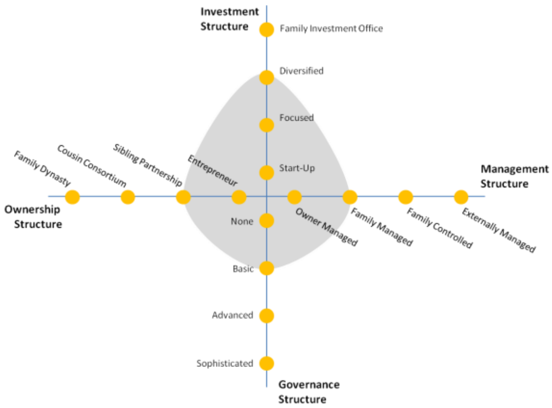
In 1981 one of the founders retired and Yusaburo continued as sole CEO of the company. Anticipating the retirement of Hachiro who assumed the role of CEO in 1987 after Yusaburo´s death, the succession planning started. Over the years, management transition had occurred by virtue of retirements or deaths. In 1989 Sasazaki created the holding company Sasazaki Empreendimentos e Participações S.A. which until today controls the operations of the company. The shareholders of Sasazaki received their shares in the firm´s capital from this holding company, contributing to increased transparency and a personal separation of the owners from the business. The creation of this holding company can be considered the foundation for Sasazaki´s corporate governance. With the death of Tomás in 1994 the sons of Yusaburo decided to constitute a family holding company in order to facilitate the equity succession which further contributed to increasing transparency in the ownership structure. During this period the remaining shareholders were also instructed to create their family holdings. In 1999 a reshuffling of the shareholder base took place where seven former non-family shareholders sold their participations. Still in anticipation of the first succession to come, a consulting firm was hired to help set rules to ensure the company´s going concern in a shareholder´s agreement and a code of ethics which was effectively signed in 2001 and was supposed to mark the cornerstone of the company´s governance. The first shareholder´s agreement was motivated by the need to curb family members´ use of company assets for personal purposes. Among other topics, the agreement regulated the entry and exit of family members into the company´s management as well as the use of its assets. Unfortunately, the shareholder´s agreement became more of a letter of intent that was not followed by all parties since it had no enforcement mechanism. Hence, even though the foundations for corporate governance were created through the holding structure and the well intended shareholder´s agreement, no movement on the company´s axes took place.

It was only in 2002 when Hachiro reached the age limit and the first planned transition in Sasazaki´s management took place. Tochimiti Sasazaki who was the company's commercial director took over as CEO. In the same year the supervisory board was formally constituted as a way to accommodate ex-managers, inducing Sasazaki to move on the governance axis from none towards basic (see Figure 14). Shortly after, two directories for members of the second generation were created: Tadao the son of Kosaku became industrial director and Leonardo the son of Yusaburo became administrative director. Also in 2002 the chairman of the board Hachiro Sasazaki died. His brother Tochimiti who held the position of CEO took over the chairman position as well and the company started into a period of CEO duality. In the same year a consultant was hired to structure the supervisory board of Sasazaki and to assist in the training of board members as well as to act as an independent board member himself, giving more focus and order to the board meetings.

As a result of the age limit the CEO Tochimiti only had a transitory management position. In 2004 as envisaged and planned six months ahead, Tochimiti Sasazaki walked away from the CEO position continuing as chairman of the supervisory board. Therewith the first planned succession of Sasazaki to the second generation of the family was completed and

Tadao Sasazaki took over as CEO of the family business and Sasazaki moved towards a cousin consortium (see Figure 15).

Figure 14: Sasazaki in 2002



Source: Author´s own illustration

Figure 15: Sasazaki in 2004

Source: Author´s own illustration

In 2007 the supervisory board created an HR committee to handle matters relating to succession management and the board itself. In the same year the second attempt to implement a shareholder´s agreement was successful. With the shareholder´s agreement the organization regulates the entry of family members into management positions prioritizing merit and qualifications. Furthermore, the agreement imposes rules on the appointment of members to the board, the participation in assemblies as well as the preparation of heirs since there were eight heirs from the second and third generation to be integrated into management and supervisory positions. These measures led Sasazaki to move towards the advanced stage on the governance axes (see Figure 16). At the end of the year the board formally adopted the independent board member without voting rights as provided for in the shareholders' agreement.

Figure 16: Sasazaki in 2007

Source: Author´s own illustration

Figure 17: Sasazaki in 2010

Source: Author´s own illustration

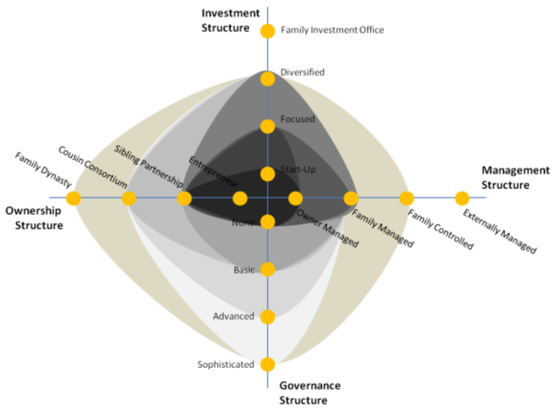
In 2010 a review of the shareholder´s agreement took place and the shareholder´s council was created. The new role of the heirs to act as shareholders instead of managers required appropriate training which will be held in the shareholder´s council through a specialized individual development program. With the establishment of the council as a distinct institution to train heirs and preserve family values Sasazaki moved on the governance axis from advanced towards sophisticated (see Figure 17).

After two and a half years of working together with the consultancy that defined not only the new shareholder´s agreement but also the new management structure, the family began to leave the company's management contributing only through supervisory organs such as the supervisory board the and shareholder´s council. Only the director of institutional relations stayed within the company´s management so that the family name of Sasazaki remained in the company. The first non-family CEO was selected in 2011 completing the professionalization of the company and pushing Sasazaki on the management structure axis from family managed to family controlled (see Figure 18). The non-family CEO Luiz Augusto Barcelos Barbosa took over after a short period of co-management with Tadao Sasazaki and the independent board members were granted the right to vote at board meetings. At the same time all heirs from the second and third generation became partners in the business through the respective family holdings. By the end of 2011 Sasazaki counted 60 family shareholders (including the Shibuya family) pushing it towards family dynasty on the ownership axis.

Figure 18: Sasazaki in 2011

Source: Author´s own illustration

Figure 19: Sasazaki´s Development over Time



Source: Author´s own illustration

4.1.5 Motivations

The case of Sasazaki exemplifies the separation between ownership, family and management in a systematic manner, supported by the shareholder´s agreement with legal power to organize the shareholder base around the goal of preserving the organization. The main motivator for its establishment was the increasing shareholder base due to the growing families of each brother and the shareholders who entered in 1958. The agreement was necessary due to both, the growth of the business and the growth of the shareholder base.

Regulating the relationship of each family nucleus that owns shares in the company was instrumental to preserving value for Sasazaki. The creation of family holdings to accommodate each family nucleus aimed at protecting the assets of the company and at isolating potential conflicts that each nucleus could cause. The need to change the way the company remunerates its shareholders from salaries to dividends was another reason that led to the adoption of the shareholder´s agreement. The idea was that shareholders should be treated as such, reaping the dividends of the company. In addition, with the shareholder´s agreement the succession planning process was formalized. This included the imposing of rules on heirs who desired to work in the management of the family business as well as the hiring of a non-family CEO.

Throughout its history Sasazaki faced several unplanned transitions in the management where no prior preparation for the new CEO was possible. Rigorous planning, however, now allows the company to consider more than one alternative candidate for the succession. Initially, Sasazaki had a consultant who assisted in structuring the supervisory board. Subsequently, the supervisory board was composed of family members as well as independent members who had no voting right but contributed external visions to the discussions. Ultimately, the independent board members gained the status of statutory board members and obtained the right to vote.

The separation of family and management also contributed to the strength of the supervisory board. Previously, the board was responsible for monitoring the family management which created some discomfort in goal setting and monitoring (family entrenchment) as the dismissal of family managers or the enforcement of goals, audits and budgets could lead to repercussions inside the family. As a matter of fact, a board consisting only of family members that has to supervise a management composed only of family members is not more than figurative. Hence, the contracting of a non-family CEO emphasized the supervisory board´s role as it allows for a process of internal audit, budgeting and monitoring of the management through the supervisory board.

All in all, the adoption of governance practices played a significant role when the company and the family gained greater complexity with many shareholders at the age to work in the company.

4.2 Mazzaferro

Mazzaferro is incorporated as a *Sociedade Anônima de Capital Fechado* and operates in the chemical and petrochemical industry. The company was established in 1953 by Nello

Mazzaferro, an Italian immigrant who arrived 1949 in Brazil. Mazzaferro was initially founded to market products related to fishing. However, today the company operates three business lines and generates R$ 200 million revenue with 820 employees. The production of polymers accounts for 50% of the company´s revenues, whereas the fabrication of monofilaments and household materials as well as fishing materials generates the remainder of the revenues. Mazzaferro owns three industrial plants in São Paulo, São Bernardo do Campo and Diadema. The company is vertically integrated and does not only produce the raw material (polymers) but also the yarn itself. Its products are exported to over 30 countries.

4.2.1 Company History

When the company was founded in 1953 Mazzaferro imported nylon yarn from Italy to resell it in Brazil. The brothers Mario and Nello started wrapping the imported yarn on spools in the garage of their house in Vila Mariana. In 1957 they purchased their first extruder machine and began to produce the nylon yarn themselves in order to offer a more regular supply of fishing-related nylon products in the domestic market. With ongoing expansion of the business the first industrial plant was opened in São Bernardo do Campo in 1963.

During the 1970s and 80s the company invested in new facilities in Diadema, São Paulo and São Leopoldo, allowing for the diversification of the business model. During the course of this expansion Mazzaferro started the production of mono- and multifilament, as well as house wares and cleaning products. In 1971 Mazzaferro invested in the production of raw material and purchased a large plant for the production of polymers.

The early 1990s were difficult for the company. National economic policy had changed and with the opening of the market for imported products the chemical industry became subject to strong foreign competition. Thus, Mazzaferro was forced to reorganize its product portfolio and business processes to remain competitive. The reorganization process lasted from 1992 to 1996. In 2002 the São Leopoldo unit was closed and the production of house wares was relocated to São Paulo. The agricultural business that was part of the company since 1984 was sold.

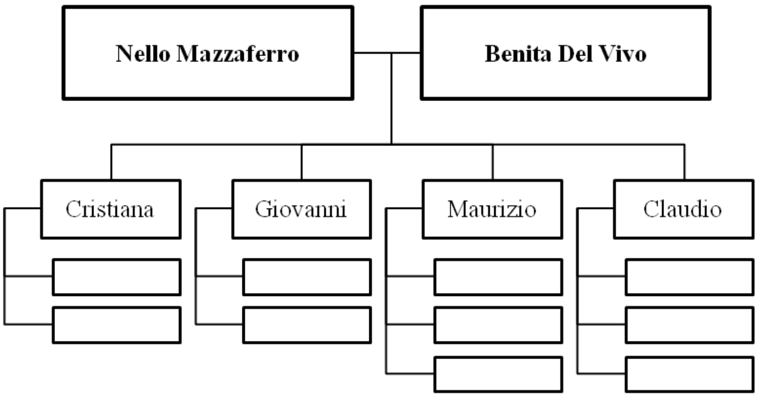
Currently, Mazzaferro has three business units. The polymers unit manufactures polymers in São Paulo which serve as raw material for various applications including nylon and yarn. The monofilament and cleaning products unit uses the nylon and yarn to produce cleaning products such as brooms and toothbrushes in São Bernardo do Campo and the fishing products unit manufactures fishing lines in the city of Diadema.

4.2.2 Family History

During the course of the Second World War Nello Mazzaferro migrated from Italy to Brazil in 1949. In the beginning he worked together with his brother Mario Mazzaferro in a factory for electric motors in São Caetano do Sul. A friend who owned a fishing shop advised the brothers to import nylon fishing lines from Italy, claiming that the product would sell well in Brazil with good profit margins. In 1953 Nello started to bring nylon lines from his travels to Europe and after some time he convinced his brother to become a partner in the nascent business. Later the brothers invited Pier Luigi Como, a radio technician they met in one of their trips, to become a partner. Their former neighbor Massimo Ballardini from Italy also came to Brazil to take care of tax and accounting matters in the company. Both eventually became minority shareholders and worked with the firm for many years.

Nello had four children who were born in São Paulo but brought up in Italy. Whereas the three sons Giovanni, Claudio and Maurizio returned to Brazil after they had finished university, the eldest daughter Cristiana remained in Italy (see Figure 20).

Figure 20: Family Tree of the Mazzaferro Family



Source: Author´s own illustration based on (IBGC, 2011, p. 40)

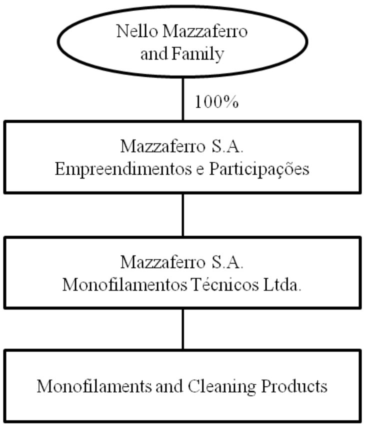
Nello and Mario Mazzaferro were the two main executives in the company until the early 1990s. Pier Luigi Como and Massimo Ballardini worked for Mazzaferro until 2007. The second generation of the family also held executive positions in the company. Mario´s son Piero was a managing director in charge of one of the branches until 2008. Pier Luigi Como´s sons Luiz Paulo and Giancarlo held a managing director position in logistics fishing area and as CFO, respectively. The children of Massimo Ballardini Carlo and Marcos worked in the area of quality management and administration, respectively. The heirs of the minority shareholders left the company during a restructuring that sought to professionalize the management.

Today the second generation of Nello Mazzaferro´s family manages the company. Claudio and Maurizio are the two CEO´s and Giovanni is chairman of the board. The third generation is composed of ten members with ages ranging from 12 to 20 years and is still too young to work in the family business.

4.2.3 Corporate Governance

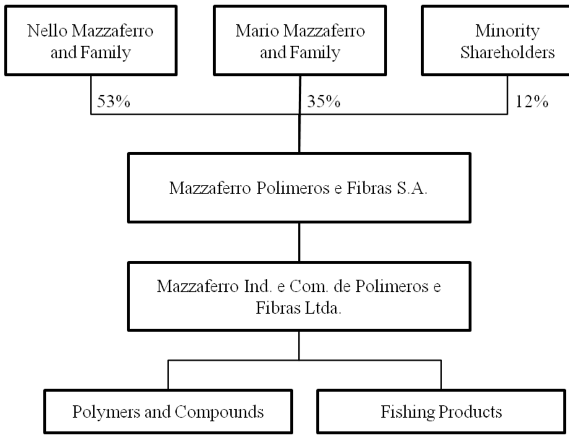
The family of Nello Mazzaferro controls the majority of shares with voting rights. There are minority shareholders that belong to the families of Mario Mazzaferro, Pier Luigi Como and Massimo Ballardini. The company's operations are divided into two units: Mazzaferro Monofilamentos Técnicos Ltda. and Mazzaferro Polímeros e Fibras S.A., representing 20% and 80% of revenues, respectively. Nello Mazzaferro´s family controls Mazzaferro Monofilamentos Técnicos Ltda. owning 100% of the common shares (see Figure 21).

Figure 21: Control Structure Monofilamentos



Source: Author´s own illustration based on (IBGC, 2011, p. 41)

Figure 22: Control Structure Polimeros

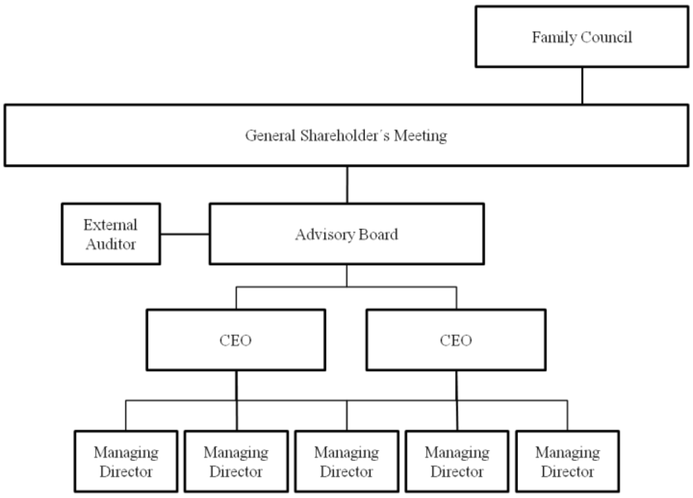


Source: Author´s own illustration based on (IBGC, 2011, p. 41)

Mazzaferro Polímeros e Fibras S.A. has next to Nello Mazzaferro´s family also other shareholders as Figure 22 shows. Nello Mazzaferro´s family holds its share in Mazzaferro Polímeros e Fibras S.A through Mazzaferro S.A. Empreendimentos e Participações. The heirs of Mario Mazzaferro hold their participation through a holding company called OIRAMS.

The corporate governance model of Mazzaferro is illustrated in Figure 23. The advisory board functions similar to a non-statutory supervisory board and seeks to act in accordance with corporate governance best practices. It is important to note, however, that the presence of two CEOs is not a practice recommended by the IBGC. Nevertheless, in view of the ongoing restructuring it can be considered a temporary situation that will be resolved through the hiring of an external manager.

Figure 23: Mazzaferro´s Corporate Governance Model



Source: Author´s own illustration based on (IBGC, 2011, p. 43)

Decisions about the family´s relationship with the company are taken inside the family council. This includes decisions on topics such as incoming and outgoing shareholders as well as partnerships that are proposed to the advisory board as recommendations to aid the final decision making process. The composition of the advisory board can be seen in Table 3.

Table 3: Composition of Mazzaferro´s Advisory Board

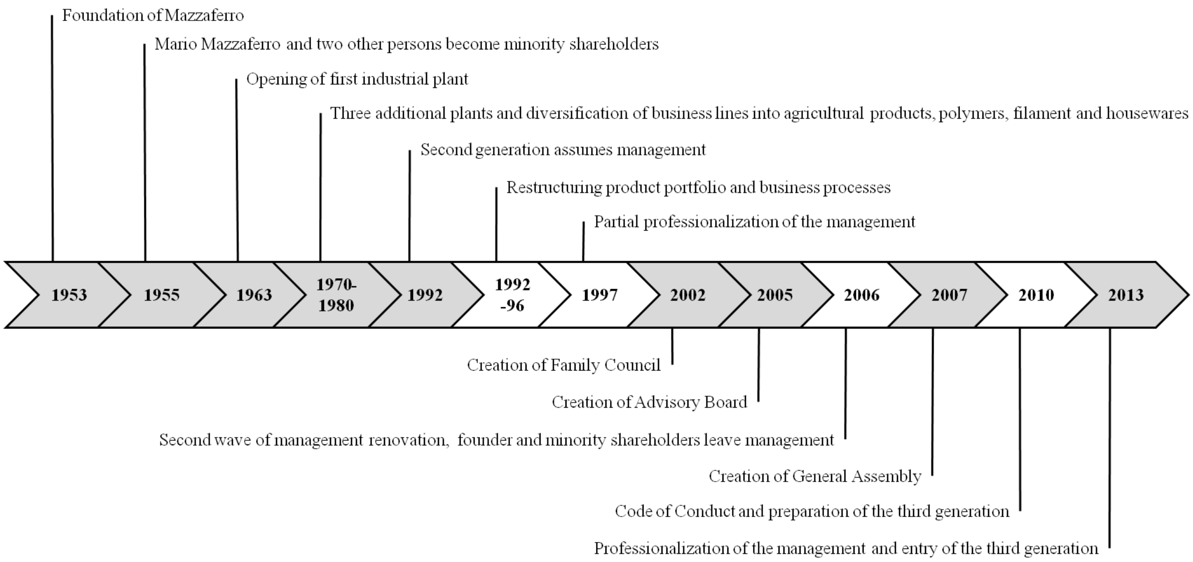
Advisory Board Member	Type
Giovanni Mazzaferro	Family member and Chairman
Maurizio Mazzaferro	Family member
Claudio Mazzaferro	Family member
Clóvis Correa	Independent
Thomas Brull	Independent
Herbert Steinberg	Honorary

Source: Author´s own illustration based on (IBGC, 2011, p. 43)

4.2.4 Evolution of Corporate Governance

The following timeline depicts the most important milestones in the historical development of Mazzaferro, whereas the years marked in grey are critical to the analysis conducted in this study (see Figure 24).

Figure 24: Mazzaferro´s Development Timeline



Source: Author´s own illustration

During the year of its foundation Mazzaferro showed a usual developmental footprint (see Figure 25). Founded and managed by Nello Mazzaferro the company was still in the start-up phase with few defined processes and no requirement for corporate governance. In 1955 Nello Mazzaferro invited his brother Mario as well as Massimo Ballardini and Pier Luigi Como to become minority shareholders in the business. Subsequently, the company evolved to a sibling partnership as it was now managed jointly by the two brothers (see Figure 26).In 1963

Figure 25: Mazzaferro in 1953

Source: Author´s own illustration

Figure 26: Mazzaferro in 1955

Source: Author´s own illustration

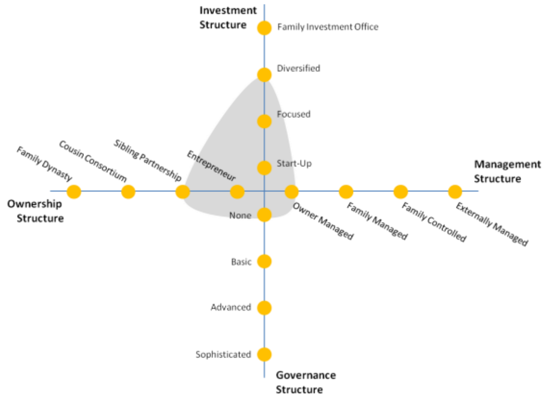
Mazzaferro opened its first industrial plant and focused the business on the production of nylon yarn. Hence, Mazzaferro moved from start-up towards focused on the investment structure axis (see Figure 27).

During the 1970s and 80s Mazzaferro added three additional plants to its portfolio and diversified its product offering. The company now produced not only polymers but also filaments, house wares and agricultural products. This product diversification led Mazzaferro to move from focused towards diversified on the investment structure axis (see Figure 28).

Figure 27: Mazzaferro in 1963

Source: Author´s own illustration

Figure 28: Mazzaferro in 1970-80



Source: Author´s own illustration

Mazzaferro was led by its founder Nello Mazzaferro until the early 1990s. His brother Mario remained with the company until his death in 1994. In 1992 Nello´s children Giovanni, Claudio and Maurizio were already working in the family business and assumed leadership positions after a few months of rotation inside the company. The entry of Nello´s heirs induced the company to evolve from owner managed towards family managed on the management structure axis (see Figure 29).

Figure 29: Mazzaferro in 1992

Source: Author´s own illustration

Figure 30: Mazzaferro in 2002

Source: Author´s own illustration

At that time the company was in financial distress and the opening of the markets by the government of Fernando Collor de Mello had exposed inefficiencies in Mazzaferro´s management model. Hence, Mazzaferro went into a period of internal business processes and product portfolio restructuring that was completed in 1996. The young executives understood that in addition to good controls it was important to adopt a system of meritocracy. Therefore, in 1997 the company's management had to be renovated, including the dismissal of managers linked to the founder that did not fit into the new meritocratic management model. During the course of this renovation parts of the management were professionalized and leaner corporate structures were created. Since 1998 the company is formalized and the family owners received dividends as opposed to salaries and direct withdrawals. Family holdings were put in place for both, the controlling family as well as for minority shareholders, protecting the company against familial problems between its owners. This personal separation from the business increased ownership transparency and served as the basis for further corporate governance practices.

In anticipation of the founder´s retirement in 2002 a family council was created. The council was designed to improve the governance practices of the company as well as regulate the entry and exit of family shareholders into the company. One of its decisions was that the third generation will be a shareholder but not necessarily participate directly in management of the family business. It is among the family council´s responsibilities to prepare the third generation to take over shareholder responsibilities. The early creation of the family council marked the first governance institution for Mazzaferro and pushed the company on the governance axis from none towards basic (see Figure 30).

From this moment Mazzaferro started into a period of governance improvement. In 2004 the succession was formalized through a cross testament of Nello Mazzaferro and his wife in which both agreed to transfer their shares after their death equally to the four brothers, except for Maurizio who holds the swing vote through a minimum equity advantage. In 2005 the advisory board was created in order to accommodate family shareholders after they left the company´s management. The advisory board meets six times a year and deals with strategic issues and monitors the company. Its creation marked the second formal governance institution for Mazzaferro and led to another movement on the governance axis towards advanced (see Figure 31).

Figure 31: Mazzaferro in 2005

Source: Author´s own illustration

Figure 32: Mazzaferro in 2007

Source: Author´s own illustration

In 2006 the second management renovation took place under which the patriarch Nello Mazzaferro as well as other minority shareholders who still held executive roles in the company retired from their functions. The succession to the second generation was thus completed. In the end, only Claudio and Maurizio remained in the family business, both as CEOs. This functional overlap of positions resulted from a decentralized management structure in which each business unit was considered independent. Furthermore, the role of the chairman of the advisory board was to moderate and mediate between executives in case of diverging opinions on the business.

Mainly because of the existence of minority shareholders a general shareholder´s meeting was considered an important governance instrument for Mazzaferro. Since 2007 all shareholders meet regularly in the general shareholder´s meeting. Although this process still required improvements it was an important step towards the participation of minority shareholders, especially after they had left the management of the company. Among the tasks of the general shareholder´s meeting are discussing the financial results of the company as well as company related affairs such as sales or purchases of assets and decisions to enter or exit business lines. An online system supports the minority shareholders´ involvement and enables them to review reports on operational and financial performance in advance.

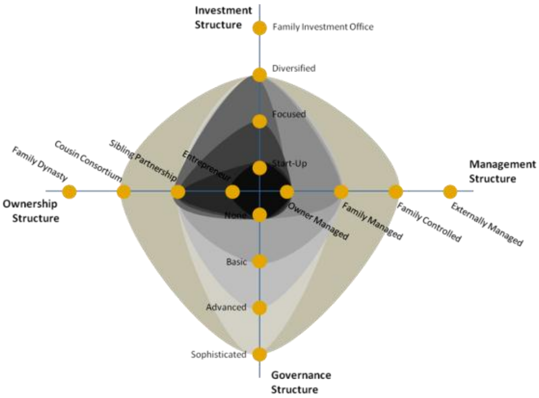
The creation of the general shareholder´s meeting induced Mazzaferro to progress on the governance axis towards sophisticated (see Figure 32). In 2008 the problem of CEO duality was resolved through a personal separation of the CEO and the chairman positions. Giovanni Mazzaferro took over the chair of the advisory board. In the process of formalization of the business the company mandated one of the big four firms in 2009 to audit the company´s accounts.

The succession process to the third generation was planned relatively early. The first step was the creation of the code of conduct for the third generation in 2010. Among other things the code of conduct coordinates the entry of family members in the company and sets rules governing relations between the parties in order to avoid possible disputes between the cousins. In 2013 the first members of the third generation became shareholders in the company which induced Mazzaferro to evolve to a cousin consortium on the ownership scale (see Figure 33). A complete professionalization of the management was also scheduled. Family members were already facing restrictions regarding their entry into executive positions and in 2013 a professional with the appropriate skills to replace the two family CEOs was chosen. Claudio and Maurizio remained active members of the supervisory board monitoring the management. As a result of the professionalization Mazzaferro moved on the management axis from family managed towards family controlled. The formalization of the advisory board as a statutory supervisory board is planned in the future. Currently, the advisory board works very well in the same way as a formal supervisory board but without the inflexibility this structure requires.

Figure 33: Mazzaferro in 2013

Source: Author´s own illustration

Figure 34: Mazzaferro´s Development over Time



Source: Author´s own illustration

4.2.5 Motivations

The main motivation that led to the adoption of corporate governance practices was the perception that the company could not move forward in the long term if it did not solve the problem of family succession. It was necessary to align all shareholders, including the minority shareholders, with respect to the needs of the company. Thus, the search for information transparency which is an important part of good corporate governance became of fundamental importance. In addition, the idea that the third generation should be aligned to the same goals was a motivating factor which culminated in a code of conduct for the members of this generation. Finally, the family intended to professionalize the company, i.e. no family members will hold management positions, with selected members as board representatives. Although the entry of family members in the management of the company was not prohibited, appropriate rules were developed that required an endorsement from a professional standpoint ensuring adequate qualifications.

The succession of the first generation was a major challenge that shaped Mazzaferro´s family governance. Nello Mazzaferro was the CEO from the foundation until the early 1990s. Thus, the replacement of the entrepreneur and patriarch of the family had to be very well organized to avoid unnecessary conflicts in the family and the management. From an operational standpoint Nello has put together a well structured company. However, because ownership and management were bundled in his person the need to implement corporate governance was secondary as policies for a company with a shared command were not yet necessary. Due to differences in information and education the children had to convince the patriarch that the going concern of the company would depend upon the definition of terms within the organization while there were still no disputes among the family members. The process was to ensure that the family kept the business under its control. The main results of the adoption of corporate governance practices were reducing familial conflicts and addressing the transfer of administrative control from the first to the second generation (IBGC, 2011, pp. 35-56).

4.3 Cerradinho

The Cerradinho Group is headquartered in Catanduva and has the legal form of a *Sociedade Anônima de Capital Fechado*. Cerradinho operates in the production of ethanol and energy as well as in the exploration and distribution of gasoline. In 2010 the group reported combined revenues of R$ 1 billion, however, with the disposal of the production in São Paulo in 2011 sales dropped by 30%. Cerradinho consists of four independent businesses among which Cerradinho Bioenergia generates 90% of sales. The other businesses that are part of the group are *Cerradinho Floresta* which administers rural lands used for the production of sugar cane by the Noble Group; the gas station network *4 Centão* in the interior of São Paulo as well as the *Geracão Futura Empreendimento Imobiliários* that is active in the allotment of land for real estate purposes. Cerradinho´s industrial plant is located in Chapadão do Céu, extending over 400 thousand square meters with an annual milling capacity of 3.3 million tons of sugar cane. With a production capacity of 1.5 million liters of ethanol Cerradinho produces around 70 megawatts of energy, large parts of which are commercialized in Brazil. In 2011 the group had a total of 1,800 employees.

4.3.1 Company History

Cerradinho was formed after José Fernandes acquired the sugar producing company Usina Romão in 1973 and renamed it to Usina Cerradinho Açúcar e Álcool. Supported by subsidies of Proálcool – a large-scale governmental program that incentivized the substitution of combustibles derived from petroleum with alcohol in the 1970 – Cerradinho was able to install its first distillery in 1975.

After many years in the initial organizational setup the growing demand and the possibility to reach new markets motivated Cerradinho to diversify its product line. Thus, in 2002 a plant for the production of yeast and a unit for energy cogeneration from sugar cane bagasse were installed. Continuing market growth allowed Cerradinho to further expand its production and the second cogeneration unit was completed in 2005 in Catanduva.

In 2006 Cerradinho opened its second industrial plant Usina Cerradinho in Potirendaba which increased the production capacity to 3.5 million tons. The following year began the construction of the third plant in Chapadão do Céu which came into operation in 2009 and added another 3.3 million tons of production capacity.

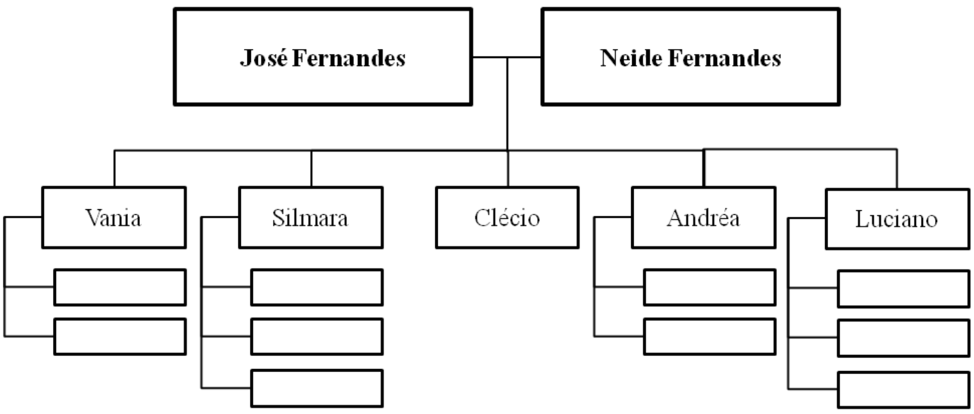
In September 2010, after having signed a long-term partnership with ALL – America Latina Logistica, Cerradinho installed a railway terminal for the reception, storage and transfer of ethanol, connecting the Midwest region of Brazil to the municipality Paulínia. The new terminal not only replaced road transport but reduced the emission of greenhouse gas and added economic value by reducing costs. The terminal has a capacity to handle two million liters of ethanol per day.

In the final phase of the construction of the Chapadão do Céu unit in 2008 the financial crisis impacted Cerradinho through a shortage of liquidity in the domestic and international credit market. The situation worsened through financial losses resulting from currency devaluation on dollar derivatives linked to the borrowings of the company. In order to adjust its capital structure Cerradinho sought to establish a partnership and initiated negotiations with a multinational company to form a joint venture. However, after several months of analyses the deal did not materialize. In 2011 as a result of the continuing tense financial situation the group decided to sell the Catanduva and Potirendaba plants to the Noble Group, a large commodity trader headquartered in Hong Kong that invests in fuel and logistics in Brazil. Cerradinho managed to keep the plant in Goiás but the sale severely downsized its productive capacity and its revenues.

4.3.2 Family History

Following the acquisition of the Usina Romão in 1973 José Fernandes remained the CEO of the company until 1983, the year of his death. José Fernandes had five children: Vania, Silmara, Clécio, Andrea and Luciano (see Figure 35)

Figure 35: Family Tree of the Fernandes Family



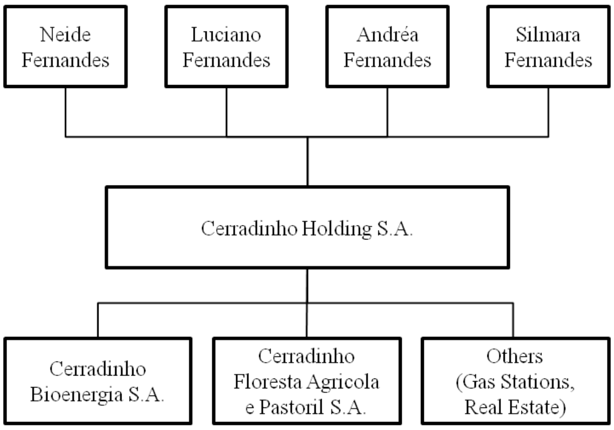
Source: Author´s own illustration based on (IBGC, 2011)

The firstborn son of the founder Clécio took over the management of Cerradinho after his father's death, but died three years later in a car accident, leaving no heirs. Following these events the younger son Luciano who was barely 18 became the new CEO of the company. Luciano previously worked in the agricultural area of the business and had the support of his brother in law who worked in the financial department of the company. The older sister Vania worked as a director in the family business between 1975 and 1995. Silmara was deputy director between 1977 and became managing director when she took over the human resources and social responsibility departments in 2008. Currently, Silmara is a member of the supervisory board. Andréa was industrial director since 1989 and became managing director for the business areas sugar, ethanol and energy in 2008. Andréa also holds a seat in the supervisory board. The third generation of the family consists of ten members between ten and thirty years old of which only one is an employee of the company.

4.3.3 Corporate Governance

Cerradinho Holding S.A. is a family holding company that is 100% owned by the Fernandes family (see Figure 36). The shares of the holding company are divided among the members of the Fernandes family with the family matriarch being the majority shareholder. The Cerradinho Holding, in turn, owns the entire share capital of Cerradinho Bioenergia S.A.; the largest company of the group and parent company of Usina Chapadão do Céu.

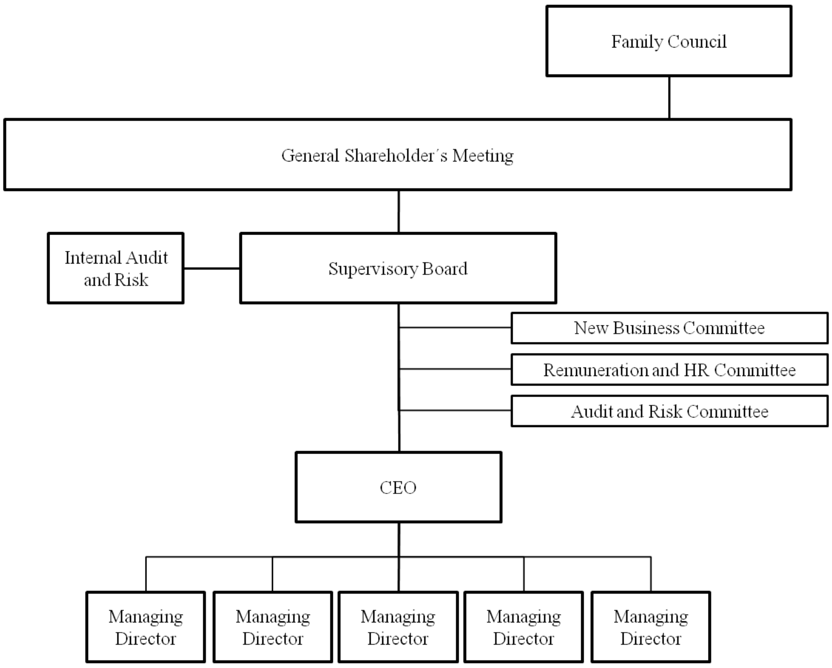
Figure 36: Ownership Structure of Cerradinho



Source: Author´s own illustration based on (IBGC, 2011, p. 63)

Figure 37 shows the corporate governance architecture of the Cerradinho Group. The general shareholder´s meeting is made up of four people who meet annually within the first four months following the end of the fiscal year and extraordinarily whenever required. The general shareholder´s meeting deliberates on matters such as amendments to bylaws, the accounts of the firm as well as on the appointment and dismissal of supervisory board members.

Figure 37: Cerradinho´s Corporate Governance



Source: Author´s own illustration based on (IBGC, 2011, p. 65)

Both companies, Cerradinho Holding and Cerradinho Bioenergia are governed by the same supervisory board, but meetings are held separately and specific to each company. According to the bylaws the supervisory board holds monthly meetings and must be composed of at least three and at most seven members of which at least 20% have to be independent board members who are elected by the general shareholder´s meeting for a term of two years with the possibility of re-election. The supervisory board is currently composed of three family members and one independent board member (see Table 4).

Table 4: Composition of Cerradinho´s Supervisory Board

Supervisory Board Member	Type
Luciano Fernandes	Family member and Chairman
Andréa Fernandes	Family member
Silmara Fernandes	Family member
João Pinheiro Nogueira Batista	Independent

Source: Author´s own illustration based on (IBGC, 2011, p. 65)

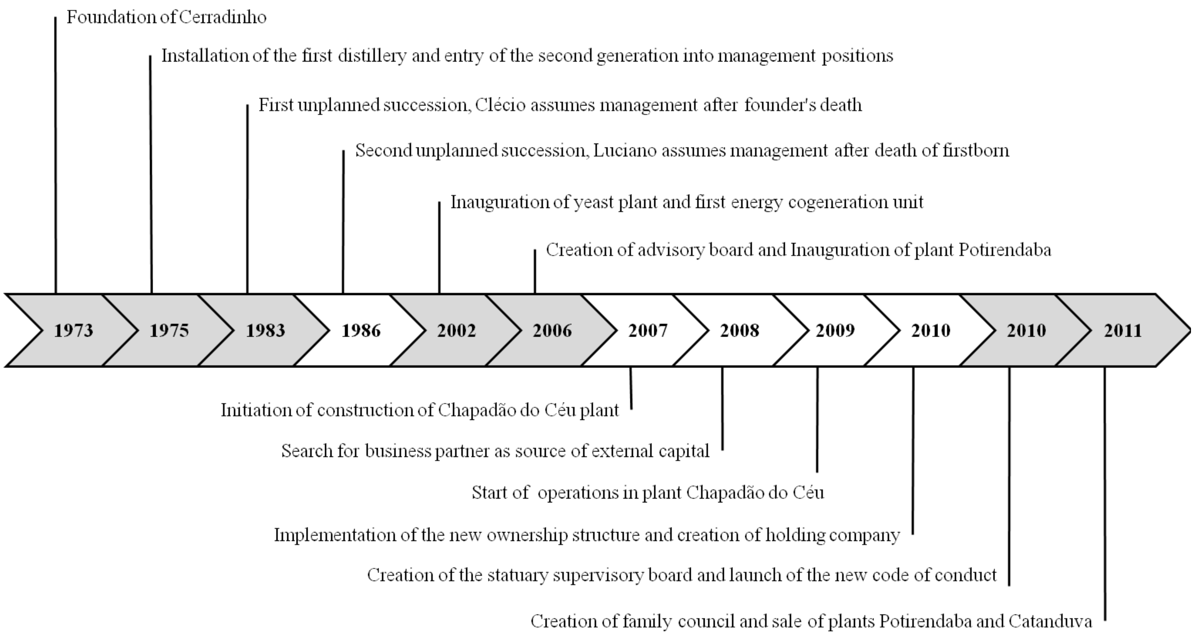
The Cerradinho holding is a unifying and coordinating instrument regarding the strategic interests of the controlling shareholders defining corporate policies on human resources, communication and environmental responsibility. In the case of Cerradinho Bioenergia the holding company is represented on its supervisory board and committees (investment and business, HR and remuneration as well as audit and risk). The committees are formalized through bylaws and have specific duties. They are composed exclusively of board members with occasional participation of managing directors as advisors.

In the management of Cerradinho Bioenergia some family members hold managing positions. Luciano, for instance, serves as CEO and Andréa as managing director for the industrial area. A member of the third generation, Caio Fernandes, serves as CFO of the company.

4.3.4 Evolution of Corporate Governance

Until 2005 corporate governance practices were not a major concern for Cerradinho. Its technical excellence in production was the bright spot of the company. However, increasing expansion of the operations as well as the entry of additional family members reminded the firm that the company governance was not on the same level as its operations. The following figure illustrates Cerradinho´s development over time (see Figure 38). The years marked grey in the timeline constitute developments that led to a movement in the four-dimensional development framework which will be portrayed in the following.

Figure 38: Cerradinho´s Development Timeline



Source: Author´s own illustration

In 1973, at the time of the founding of the company Cerradinho had the usual characteristics of a start-up (see Figure 39). It was owned and managed by the entrepreneur José Fernandes and still in the process of establishing its operations. In 1975 Cerradinho installed its first distillery which focused the business on the production of ethanol and led the company to progress on the investment structure axis towards focused (see Figure 40).

Figure 39: Cerradinho in 1973

Source: Author´s own illustration

Figure 40: Cerradinho in 1975

Source: Author´s own illustration

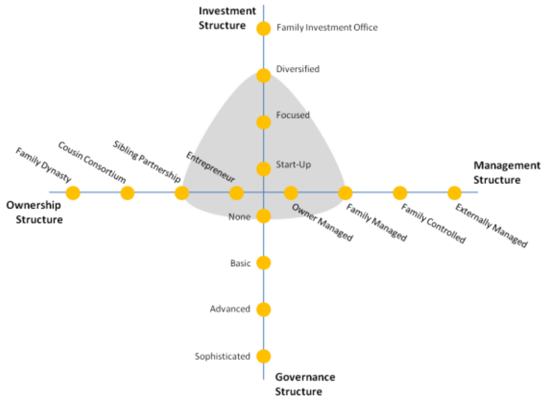
In the same year the second generation started working in the family business and obtained ownership rights. As a result Cerradinho moved from owner managed towards family managed on the management axis. However, as the founder still acted as CEO and had effective control over the company Cerradinho could not yet be considered a sibling partnership. Gersick et al. (1997) refer to this transitory state as the "working together" period where two generations work together but the succession has not yet taken place.

In 1983, as a result of the sudden death of the founder, the first unplanned succession took place. Clécio the first born son became CEO of the company and Cerradinho developed to a family managed sibling partnership that was still focused on one line of business (see Figure 41). In 1986 the second unplanned succession occurred and Luciano assumed the CEO position after the death of the firstborn. This transition, however, had no effect on the developmental characteristics of the company.

Figure 41: Cerradinho in 1983

Source: Author´s own illustration

Figure 42: Cerradinho in 2002



Source: Author´s own illustration

Until 2002 the developmental footprint of the company did not change. In that year the company´s business was diversified through the inauguration of a yeast plant and an energy cogeneration unit. This development led Cerradinho to progress on the investment structure axis towards diversified (see Figure 42). In 2006 Cerradinho hired a consulting firm to restructure the company´s management which broadened its view on corporate governance. The first action in this regard was a partial professionalization of the management and the creation of a code of ethics. The next step was the implementation of a non-statutory advisory board. The board was composed of three family members and one independent board member. With the creation of the advisory board Cerradinho implemented the first formal governance institution in its history which induced the company to progress on the governance axis from none to basic (see Figure 43). In the same year the business expanded further with the inauguration of the Potirendaba plant and the construction of the Chapadão do Céu plant in 2007.

Figure 43: Cerradinho in 2006

Source: Author´s own illustration

Figure 44: Cerradinho in 2010

Source: Author´s own illustration

However, as result of the financial crisis Cerradinho was in need of external capital. In search of a strategic partner to the business, corporate restructuring was necessary to separate and define the shareholdings of the family members. This process was completed in 2010 and involved the creation of family holdings and led to the creation of the Cerradinho Holding S.A. in order to separate family assets from the business. The separation took place in a comparatively late phase in the company´s development but increased the ownership transparency and depersonalized the business structure of the company. In the course of its implementation some members that held managing positions inside the firm moved to the holding structure in order to take on supervisory positions. The open positions were filled with external professionals supporting the professionalization of the business. The remaining managing shareholders were paid market rates and receive dividends in the same way as the remainder of the shareholders according to their share in the firm´s capital.

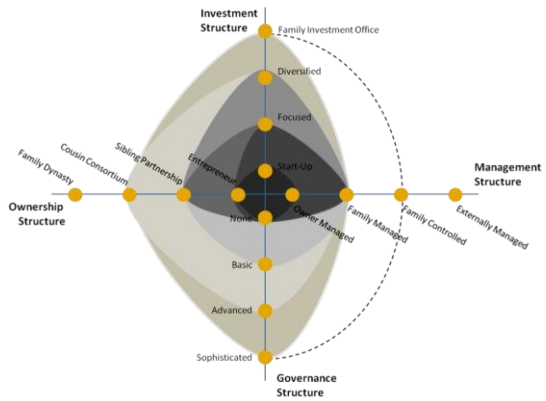
Various audits from external auditors between 2009 and 2011 helped Cerradinho organize adequate control processes. Nevertheless, it took the firm until 2010 to build the statutory supervisory board with defined internal bylaws. The bylaws of Cerradinho now accounted for corporate governance practices such as a participation of 20% independent board members in the supervisory board and 100% tag along right for all shareholders. Still in 2010 three committees of the supervisory board were statutorily constituted, each of which was formed by a family member and the independent board member. In combination these two developments led to the progression on the governance axis from basic towards advanced (see Figure 44). The role of the board secretary and meeting support was played by a member of the third generation.

The establishment of a supervisory board and relevant committees allowed for the installation of a family council in 2011 that operated within the holding structure. This development resulted in the progression from advanced towards sophisticated on the governance axis (see Figure 45). The first activities of the family council were related to the structuring of the succession process and the establishment of family protocols in order to organize the entry of family members from the third generation. At the same time a member of the third generation started to engage in the management of the family´s wealth via a family office. This induced Cerradinho to move on the investment axis towards family investment office. In addition, as a member of the third generation served as CFO of the company and other members of this generation were moving into the company, Cerradinho evolved to a cousin consortium on the ownership axis. The continuous professionalization of the company indicates that Cerradinho will develop towards a family controlled company in the near future in which family members only hold supervisory positions (see dotted line in Figure 45). It is envisaged that after completing the assignment of an additional independent

Figure 45: Cerradinho in 2011

Source: Author´s own illustration

Figure 46: Cerradinho´s Development over Time



Source: Author´s own illustration

board member, Luciano and Andréa will leave the management and continue to contribute through the supervisory board. This finding is in line with the increasing focus on corporate governance in previous years.

After the attempt to sign a partnership agreement with another company Cerradinho decided to dispose of the Potirendaba and Catanduva plants in 2011. The sale of those non-strategic assets to the Noble Group allowed Cerradinho to repay large parts of its debt and regain creditor confidence without giving up ownership rights to another company.

4.3.5 Motivations

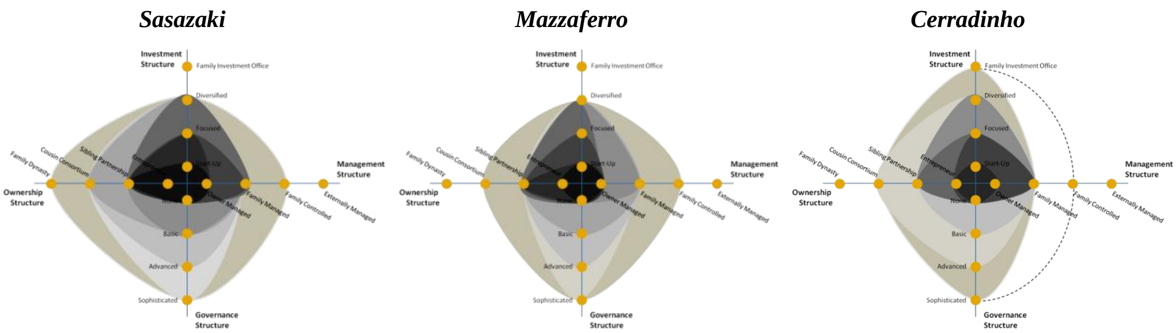
The implementation of corporate governance practices was essential to the company in order to restructure and thus be able to close a partnership that helped equating existing debt and realize investments for the desired expansion.

Cerradinho grew steadily between 2002 and 2009 and has invested in expanding its business through the construction of two additional plants that virtually tripled its production capacity. Given the complicated financial situation during the financial crisis the company set out to find a strong partner to rebalance its capital structure, remedy the cash flow deficit and continue its expansion. The first step was the renegotiation of debt with BNDES and other private banks. Among the requirements of the banks to extend loans were the improvement of Cerradinho´s corporate governance system and the capitalization of the company. In parallel to renegotiating debt with its creditors, Cerradinho sought a business partner that would solve the resource requirement through a capital injection. At that moment, the Fernandes family realized that improving governance practices helps maintain the confidence of banks and attracts potential partners. The separation of family and company assets as well as the new business structure would allow for a direct entry of strategic investors into the sugar and alcohol business and thus help Cerradinho regain its financial stability (IBGC, 2011, pp. 57-75).

5 Results

The three cases presented in this study highlighted different motivations for the adoption of governance practices for the organization and the family. The oldest of the three case companies Sasazaki is already in the third generation of ownership and fulfilled several steps to reach its current mature corporate governance environment. Various management successions, two shareholder´s agreements and the process of establishing an advisory board that was turned into a statutory supervisory board as well as the presence of independent board members underline the statement of the International Finance Corporation (IFC) that “corporate governance is a journey”. The case of Mazzaferro illustrated the transition from the first to the second generation. Specifically, it showed the role of the entrepreneur in creating the business and then passes on the baton to the second generation. It further illustrated how the change of command brought about new management practices as well as governance requirements. Finally, the youngest of the three case companies, Cerradinho, demonstrated the importance of corporate governance in increasing the confidence of creditors and investors.

Figure 47: Cross Case Comparison



Source: Author´s own illustration

Figure 47 shows each company´s developmental footprint over time in a cross case comparison. The darkest color shape in the center marks the inception of the respective company, whereas each developmental step is shown in a lighter grey tone. In other words, the lighter the color the closer the respective development is to the presence, with the exception of the last period which in all three cases is the largest shape. This color coding allows for a sequential analysis of each developmental step on the four axes. It is important to note that within any given phase a company could move on several axes at the same time. Therefore, each color coded phase is considered one developmental step, independent on how many axes a company progressed.

The first finding is that all three companies consistently progressed on each axis over time. Interestingly, none of the case companies moved backwards on any given axis. This is surprising because Gersick et al. (2006), the authors of the initial framework, reported that companies move through periods of business and ownership expansion and contraction. Even Cerradinho which sold two plants as a result of financial distress, or Sasazaki which divested its agricultural business after a period of severe frosts did not re-focus their business on one single activity but remained diversified.

All three case companies faced one important challenge throughout their development that catalyzed the development of their governance practices. While for Sasazaki and Mazzaferro the succession to the second generation was the motivating factor, it was the need to obtain external capital and to restore creditor confidence for Cerradinho. Therefore, it can be deducted that corporate governance is necessary to increase ownership transparency and align a diversified shareholder base when the command over the company is shared or external capital is needed.

In addition it was found that the creation of holding structures including family holdings often served as a basis for the implementation of additional governance practices. Both, Sasazaki and Mazzaferro implemented the holding structure before their first movement on the governance axis occurred. Cerradinho, however, only implemented the holding structure when it was already advanced on the governance axis, out of the need to increase transparency in order to receive external funding. This late adoption of the holding structure can be explained by the comparatively smaller shareholder base of Cerradinho and the two unplanned successions the company faced throughout its development. A holding structure becomes necessary when the shareholder base grows more complex and active and inactive shareholders exist to facilitate the inheritance of shares.

Further it was found that the initial developmental focus of the case companies lay on business expansion. For both, Sasazaki and Cerradinho the first developmental step involved focusing on one business activity. For Mazzaferro this type of focusing the business was the second developmental step, after the company was transformed into a sibling partnership. This finding underlines that in the founding years it is most important for the companies to create a sustainable business model in order to compete in the market.

It was also found that next to a focus on business expansion the taking on of additional family members is an important aspect in the initial years. Apart from Sasazaki which started as a sibling partnership, the other case companies took on additional family shareholders within the first two developmental steps and thus developed into a sibling partnership. While

Mazzaferro and Sasazaki became a sibling partnership in the first generation, Cerradinho only became a sibling partnership when the second generation entered the business. This finding underlines the fact that after focusing the business on one business line and subsequent growth additional managers (preferably family managers) are needed to run the business. In addition, as the company has proven its sustainability by surviving the critical start-up phase, it becomes more interesting for siblings to enter the company.

The most important finding for this study is that a development on the corporate governance axis only took place in the fourth or fifth developmental step, when the businesses were already mature. By the time the first governance institution was implemented all three case companies were already family managed sibling partnerships with a diversified business profile. This developmental footprint can be considered the necessary condition for the implementation of corporate governance. The finding may be explained through the gradual increase of agency costs caused by inefficient decision making of a growing shareholder base. In order to reduce these costs corporate governance is implemented, institutionalizing the decision making process. While it took Sasazaki 59 years to implement the first governance institution, it took Mazzaferro 49 and Cerradinho 33 years. This finding supports the argument of many academics that corporate governance only becomes important to privately held family businesses once the business grows more complex and the command over the company is shared, i.e. when agency costs increase. Before reaching this state of maturity, governance is usually neglected.

In addition, the case companies diversified their business portfolios early on in their development. While Cerradinho and Sasazaki moved towards diversified on the investment axis in their fourth developmental step, Mazzaferro accomplished this already in the third step. For all three companies the fifth step was a movement on the governance axis towards basic. Hence, there is a causal relationship between the investment and governance axes.

Interestingly, once the first movement on the governance axis occurred, governance practices were very quickly developed. For Mazzaferro and Cerradinho the development went directly from basic over advanced towards sophisticated within two additional sequential steps, whereas Sasazaki needed three developmental steps to reach sophisticated. In terms of time it took Sasazaki 8 years, Mazzaferro 5 years and Cerradinho 5 years to progress from basic towards sophisticated on the governance axis.

In line with literature it is found that governance structures were developed towards sophisticated before a complete professionalization of the company, i.e. before the company moved towards family controlled. Hence, there is a causal relationship between the management axis and corporate governance. In other words, the further the family leaves the business to an external management, the greater the need for corporate governance. All three case companies (Cerradinho´s movement towards family controlled anticipated) moved towards family controlled right after the governance axis reached sophisticated. This is not surprising, because family shareholders need appropriate governance institutions to be able to leave their operational function and to exert appropriate control over the external management via a supervisory position. In addition, family councils are necessary to ensure that the goals and values of the business are aligned to those of the family when the family shareholder base is diverse and the company externally managed.

Family business researchers claim that governance in family businesses can be more complex than in non-family businesses because it has to take the family and the corporate governance into account. As a matter of fact, all three case companies had a family council in place before they moved towards family controlled. This underlines the importance of family governance next to corporate governance in companies with a large family shareholder base in order to preserve family unity and align the company with family values when the company is managed by professionals.

Furthermore, it was found that each case company was already a cousin consortium before it reached sophisticated on the governance axis. This means in principle that at least the third generation was a shareholder before corporate governance was fully implemented. Hence, it can be inferred that there is a causal relationship between the ownership axis and corporate governance. In other words, the more dispersed the shareholder structure the more important governance institutions become to ensure equitable decision making. This finding is in line with the PAT and the need to curb agency costs that arise through a diversified shareholder base via control mechanisms.

It was also found that usually the ownership axis moved before the management axis. This finding indicates that a growing shareholder base motivates the company not only to implement corporate governance but also to professionalize the company. With ensuing generations more family members hold an interest in the company. As management positions are scarce not all family members can be employed by the company. This may not only disturb the family unity but could also endanger unanimous decision making. Therefore, all three case companies began planning a professionalization of the company once they grew towards a cousin consortium.

Besides, Gersick et al. (2006) postulated that a balanced development on all axes would be necessary for the healthy development of the firm. Graphically this means that the closer the shapes are to a circle the healthier the company should be. Whereas Sasazaki and Mazzaferro show a very balanced footprint in the last state, Cerradinho has an elliptical form. Theoretically, this finding could explain the financial trouble the company was facing recently. As Cerradinho is further developed on the governance and investment axes, one could argue that the company is over-governed and over-diversified.

All in all, the initial years of the case companies were focused on business expansion and the creation of a “real” family business with many family shareholders. However, as time passed and the companies progressed in the framework, the focus shifted more and more towards governance in order to align a diversified family shareholder base and to control an externally managed company. The case companies´ needed between 30 and 60 years to implement the first governance institution. Considering their voluntary adoption of corporate governance it can be deducted that governance only became necessary when the companies were already mature, i.e. family managed sibling partnerships with diversified portfolios. The transition towards a cousin consortium (entry of the third generation) marked an important point in the case companies´ development. The growing family shareholder base induced the companies to professionalize the business, which in turn made sophisticated governance mechanisms necessary. In order to move towards family controlled at least an advisory board and a family council was considered necessary by the companies in order to safeguard a sustainable future development.

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6 Conclusion

The objective of this study was to better understand and illustrate the process and the motivations for corporate governance implementation in family businesses by making use of a developmental framework. It was the goal to analyze which axes of the framework evolved first and whether the development of one axis induced the development of the governance axis.

In order to reach this objective a qualitative research approach was chosen. A framework that captured family business development over time on the four dimensions ownership, investment, management and governance was created to analyze the development of corporate governance and its dependence on the other dimensions over time. The application of this framework to three Brazilian case companies allowed for the identification of temporal developmental steps that helped to better understand what drove the governance implementation in each of them.

While more than 400 Brazilian companies listed on the stock exchange are obliged by law to implementing corporate governance practices, around 15 thousand privately held businesses with revenues above BRL 100 million increase their adhesion to corporate governance in a silent movement. Motivated by the need to curb agency costs, the case companies seemed to implement corporate governance only when it was needed. Whereas for two of the three case companies the succession to the second generation was the main motivating factor to enter into the world of corporate governance, it was the need to attract external investors out of a position of weakness that motivated the third.

As a matter of fact, the implementation of corporate governance in family businesses is a continuous process that has no clear-cut guidelines. Put simply, the reality of family businesses is as they grow more complex, formal systems are developed. Causal relationships between corporate governance and the ownership, investment and management axes were identified. Hence, all three axes had a valid influence on the implementation of corporate governance in the three case companies. The more complex the companies grew on each of the three axes, the more important corporate governance became for the family businesses.

During the first years the developmental focus lay strongly on the business and family ownership expansion. Only after the family businesses have reached the necessary maturity, i.e. family managed sibling partnerships with a diversified business profile, which took them 30 to 60 years, corporate governance practices began to matter. Decision making that was done by the entrepreneur when the businesses were still small suddenly needed to be institutionalized. It had to be assured that the firms were more than just the entrepreneur by creating holding structures, depersonalizing the business. Corporate governance became especially fundamental to the case companies when siblings and cousins entered the business and obtained voting and cash flow rights. In preparation of their entry, governance was developed very quickly during a period of five to eight years in order to account for the development towards a shared command over the company.

The fact that privately held family businesses are not forced to implement corporate governance allows them to make selective use of the practices they need and most importantly when they need them. Hence, the degree of implementation of corporate governance can be considered ideal when it correlates with the degree of maturity of the respective company. The gradual implementation becomes more and more important the further a family business evolves on the four-dimensional framework. Logically, a start-up managed and owned by the entrepreneur has differing governance needs from a family-controlled sibling partnership. While agency costs are not a major concern in the nascent family business, they increase almost exponentially the further the business evolves, whereas a cornerstone in this development is the first generational change. In conclusion, increasing agency costs incurred through inefficient decision making of a diversified family shareholder base mainly drive the implementation of corporate governance. Most probably, there can be no sustainable business growth on all dimensions without accompanying governance practices to provide control and order.

Of course this study has some limitations that are worth mentioning. First, the three case studies are only to a limited extent representative. The case studies were pre-selected by the IBGC, an institution that promotes corporate governance and advises companies on its implementation, and therefore has a vested interest in presenting case studies to the public that demonstrate the different stages of governance implementation in order to promote the services it can offer. Consequently, it cannot be assumed that the case studies are representatives of usual family businesses, but rather ideal cases. In addition, from analyzing the development of corporate governance within only three companies it cannot be expected that the same results hold true for other companies. And as the case companies are all from Sao Paulo, Brazil the findings may not be generalized to family businesses from other countries, or even other states of Brazil. Second, the developmental framework limits the representativeness of the findings. The framework only allows a schematic assessment of the corporate governance development according to four dimensions, but there may very well be additional factors, or even dimensions, that also drive the implementation of corporate governance. For instance, oftentimes the heirs of family businesses bring knowledge about corporate governance and its benefits to the company that the patriarch did not have, as was the case at Mazzaferro. In addition, tax implications oftentimes drive the adoption of corporate governance. In Brazil, for instance, a change in taxation during the last fifteen years made the creation of *Sociedades Anónimas* with holding structures and the subsequent corporate tax to be paid more favorable than the individual taxation that comes with other corporate structures (Ministério de Fazenda, 2014).

Besides, the measurement of corporate governance on an axis poses some difficulties, as the different organs are not always implemented in the same order. Unlike the other two case companies, Mazzaferro created a family council before it even had an advisory board in place. Therefore, the categorization on an axis has to be performed subjectively to a certain extent. In general, potential disadvantages that may arise from corporate governance were not considered. Often operational costs arise from the implementation of committees, audits etc. Thus, it is not possible to draw conclusions from this study to whether the implementation of corporate governance was beneficial from an economic standpoint.

Future research could be directed towards extending the analysis to additional states within Brazil in order to assess whether the findings hold true for all Brazilian family businesses. In addition, the analysis could be performed on family businesses from countries where other governance models prevail, in order to evaluate whether different governance models have an effect on the development over time. Lastly, researchers could engage in the assessment of the family businesses´ financial performance over time and show how it is affected throughout the developmental steps of corporate governance.

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