

Family businesses, Corporate Governance and the Portuguese *SPQ*

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Abstract:

Purpose of this paper: This paper identifies some alternatives that may be used in order to adapt the articles of association of the Portuguese Sociedade por Quotas SPQs to a family business. However, it also identifies corporate governance problems common to all incorporated family businesses.

Design/Methodology/Approach: The paper is part of a wider research that aims to create a good- and bad practices manual for SME's. The research group has send questionnaires to lawyers and business associations and organized a meeting in Coimbra to identify the main problems that family SPQs face in their legal environment.

Findings: Portuguese Company Law doesn't give special attention to family businesses. However, it has many rules that are not mandatory, and therefore the articles of association may be used as a tool to avoid future frequent problems in family businesses.

Value: The paper identifies many solutions for typical corporate governance problems in family businesses. It may be used as a manual of good practices for those who have to write the articles of association of a Portuguese SPQ. The paper may interest anyone who wishes to understand the problems that are common to all family companies.

Keywords: family business/corporate governance/articles of association/sociedade por quotas/limited liability company

1. Introduction

"All happy families are alike; each unhappy family is unhappy in its own way."

Lev Tolstoi (Anna Karénina)

The Portuguese SME is frequently a *sociedade por quotas* (SPQ, similar to the German Gesellschaft mit beschränkter Haftung – GmbH - and with quite a few resemblances to the Spanish Sociedad de Responsabilidad Limitada) and, in many cases, a family business¹. Some of the problems that emerge in those companies concerning the balance between family/enterprise/ownership² can be solved by the appropriate use of the legal alternatives available.

Many of those alternatives are analysed in this text. In fact, we identify ways that will allow Portuguese SPQ to use the legal regime to protect themselves as family businesses. For instance, the use of special rights, the right to be informed, veto rights, and so on, may have a role to play.

The alternatives must be studied taking into consideration that all families are different³. And inside each family the relationships between parents and sons are also different from those between grandparents and grandsons or between brothers and cousins. Affection and professionalism don't always walk side-by-side. And if the founding members want to maintain the company in family hands, they probably must transfer to the younger ones the family values and principles⁴. Some authors speak about a "Wir-Gefühl" (M. Binz and G. Mayer, 2012). Many times, it is necessary to conclude that the firm may no longer exist as a family business...

In this paper, we will only address corporate governance problems. All of them are of a general nature: they are not Portuguese problems. But the solutions contained in Portuguese law and how they should be interpreted may inspire those who, in other countries, are willing to improve their legislation, and maybe it will give some clues on how to interpret other laws.

Of course, family businesses don't have only corporate governance problems to deal with. Tax Law, Labour Law, Family and Succession Law raise also very interesting questions. Those issues are being studied by other members of the research team.

The Portuguese Company Law (PCL/Código das Sociedades Comerciais) had a strong influence in the laws of Angola, Mozambique and Cape Verde. Many of the problems that will be identified here were also exported to those other countries.

The PCL emerged in a particular context: Portugal had just become a member of the European Economic Community. The PCL had to respect the *acquis communautaire*, but the fact is that this one didn't give a special attention to family businesses at that time. And the PCL also ignored them.

In order to identify some of the most relevant corporate governance problems that family SPQ have to deal with, data was collected from inquiries that were sent to business associations and lawyer's firms and from a meeting held at Coimbra putting together entrepreneurs, lawyers and Law Professors (Abreu, J., and Martins, A., 2016).

This paper is only a small part of all the work that is being done by a research group including Law Professors of the Law Faculty of the University of Coimbra (Portugal). That group is in the process of identifying the difficulties that SMEs deal with in their legal environment. The work has been divided in three main parts: data collection (1); one international conference that took place in Coimbra (2); a good- and bad practices Guide for SMEs, planned for 2018 (3). The lines below will be included in that Guide.

2. Director(s)

2.1. Appointment

Every company's history is also about power. In Portugal and in anywhere else in the World. And those who control the company want to have power. If someone is an important shareholder, he will want to have a word to say on director's appointment. He may even want to be a director. That will usually be the case if the directors have at least some power to decide about what the future will be.

According to PCL, it is possible to include in the articles of association a special right of a member of the company to be a director of a SPQ. That may be very useful if the father, grandfather or any other family member wants to see «fresh blood» among the company members, but at the same time wishes to keep a place as director for himself. And it is also possible to limit the removal to cases in which there is a breach of duties. A member of the company may have a special right to appoint one or more directors (art. 246.º, 2, and 252.º, 2, of the PCL). This could be a very useful alternative if the founding member wants to transfer shares («quotas») to other members of the family, but still wants to have a word to say on the person who will be a director of the company. That right to appoint directors may even be established for groups of company members. But, of course, if each group has 50% of the shares, it is advisable to avoid deadlocks. The latter is a worldwide known corporate governance problem.

The way how special rights are framed must also take into consideration how they may or may not be transferred. If nothing is agreed upon in the articles of association, a special right to appoint one or more directors is not transferred with the shares of a member of the company. On the other hand, the articles of association may not allow the transfer of the special right to be a director (art. 252.º, 4, of the PCL). But the articles may establish that a special right to appoint directors is transferable with the shares to which they are attached (art. 24.º, 3, of the PLC). And that may be very important for the father who wants to transfer his shares to his son. On the other hand, it is important to call the attention to art. 83.º, 1, of the PLC, because it shows that a member of the company may sometimes be liable towards the company or other company members for what the director he has appointed has done.

The articles of association may also contain the possibility of co-option. In that case, the existing directors will have the right to appoint one or more directors (art. 252.º, 2, of the PCL). The founding members of the company who are also directors may therefore appoint other directors.

If the company has no directors at all, all company members have the powers that directors would have. That will last until new directors are appointed (art. 253.º, 1, of the PLC). The articles of association may also impose on one or some of the members of the company the duty to accept the appointment as director (art. 209.º, 1, of the PLC).

2.2. Qualification

A family business may be subject to pressure coming from family members willing to have one or more of them appointed as directors of the company. And sometimes it is difficult to resist to those pressures. But family businesses also need to have duly prepared directors. Everything becomes more transparent if the articles of association state that the directors must be members of the company, must have a certain minimum age or must have a university degree. It is also possible to ensure that there are independent directors in a SPQ.

Family businesses, however, are in many cases micro-companies. And in those businesses, it may be more difficult to identify who should be leading the way. The «learning process of leadership in micro-organizational settings» depends on «experience» and the «family and social environment of the individual» (Rafael Alé-Ruiz, R., and López, Águeda Gil, 2017).

2.3. Conflicts of interests

One of the main problems involving family businesses is the existence of conflicts of interests. Specially those concerning dealing with the company itself. It is therefore disputed if the SPQ may be subject to art. 397.º of the PLC (Martins, A, 2015). In fact, that article is included in the rules for the «Sociedades Anónimas» (Aktiengesellschaften, sociétés anonymes). According to it, and among other things, the company is forbidden from loaning money or giving credit to his directors and paying their debts. But it is certain that art. 64.º, 1, of the PLC is applicable and it states that company directors must comply with duties of care and loyalty.

3. The right to be informed

Shareholders may have more power inside the company if they are willing to use the right to be informed. SPQ shareholders can control the company better if they are active. When they are also members of the board of directors, it will usually be easy to obtain the information they need. But if they are not, it is very important to

know if they may or may not obtain the information that is necessary to vote. On the other hand, the SPQ may also have many members (many cousins, many nephews...). Specially if it is already in the 3rd or 4th generation. In Portugal, the SPQ members have the right to be informed about everything related with the company's administration (art. 214.º, 1, of the PLC). However, the articles of association may include some rules related with the way how that right may be used. Those rules may be very convenient when the company shares are transferred to the third or fourth generation. Then, it will be probable that many family members are no longer directors and, consequently, will have to find other ways to get information on the issues related with the company.

4. The decisions reserved for the company members

A vital issue in every company is what may or may not be decided by each company organ. If it is not possible to know where the power to decide is, it is also very difficult to identify who is liable for what. On the other hand, knowing who decides what, is all about power once again: shareholder's democracy or *Führerprinzip*? That is the question so many times.

The art. 246.º, 1, of the PCL states that many questions can only be decided by the company members. It also states that the articles of association may expand the list. On the other hand, art. 246.º, 2, of the PCL states that, if the articles of association don't state otherwise, many other questions can only be decided by company members.

Therefore, as time goes by and the members of the new generations decide that they don't want to be directors of the company, it may be desirable to enlarge the list of questions that need to be decided by the company members. If the family members are all shareholders and directors, that list may be shortened.

5. Voting rights and quorum

All men are created equal. But in a SPQ, some men and women are frequently more equal than others...

In a SPQ, each cent of the nominal value of the share gives one vote to its owner. So, if the nominal value of the share is higher, the owner of the share will have more voting rights. The one who has a share with the highest nominal value will be the «most equal of all»...

In Portugal, the articles of association may give 2 votes per cent of the nominal value of the share (double voting rights) if that share or shares, globally considered, don't overcome 20% of the company's capital (art. 250.º, 2, of the PCL). That may be one interesting solution for a founding member that wishes to engage new family members in the company but also wants to keep a comfortable position in what concerns voting rights. It is well known the importance of multi-voting shares in family companies (Cañete, M., and Ruiz, M., 2010).

In general, it is not necessary that a special number of members be present to consider the meeting properly constituted. However, for more important issues art. 265.º, 1, of the PCL states that a resolution must be passed with (at least) assenting votes that represent $\frac{3}{4}$ of the company's capital.

If there is nothing stated in the articles of association, a resolution is considered passed if it obtains the majority of the votes (half of the votes plus one). But the articles of association may establish something different (art. 250.º, 3, of the PCL). This possibility may be used to promote cooperation among different branches of the family. Once again, it may be necessary to avoid deadlocks.

6. Veto rights

Veto rights may be a powerful tool to impose bargaining and, therefore, a broader consensus. Shareholders who have veto powers frequently don't have the enough power to impose the way they think it should be followed. But those veto rights will force the majority to bargain. And a negotiated solution will have a better chance to be accepted or, at least, tolerated.

According to PCL, the articles of association may give a special veto right to a shareholder (art. 250.º, 3, of the PCL). That veto right may be related with particular questions. And this may also be very interesting for the founding member (parent, grandparent, and so on) who wishes that some of the «fundamentals» will remain untouched.

7. Annual profits

Family businesses are not usually used for charity. Those who create them want to have a better future or even to be rich. Or they want to have their sons or grandsons studying in a very expensive private school abroad. Or they want a XPTO yacht... Why not? And if everything comes out as planned (well, luck and Gods may also give some help), profits will come. Sooner or later.

However, a family business has to face the problem that many SME's have to face also: financing. If those firms don't have collaterals good enough, they will have to count with what they have if they want to grow or even if they just want to keep swimming like their competitors do.

According to art. 217.º, 1, of the PCL, the general rule is that at least half of the annual profits that *may* be paid to the shareholders *must* also be paid. That rule may only be disregarded if the articles of association allow it or if the resolution is passed with (at least) assenting votes that represent ¾ of the company's capital in a meeting that takes place after a special notice. And this is something that deserves strong attention. In fact, both financing of the company and the needs of family members must be balanced. The first generation will frequently be focused in strengthening the company. Those family members won't mind to give protection to what they think it can be a better tomorrow. They will have strong reasons to see the profits being kept in the company. Later, there will be a stronger pression to have dividends distributed to the shareholders. Many of the youngsters will be doing something else and are not particularly concerned with the company's future.

8. Right of use of company assets

Some rights of use of company assets may be interesting in what concerns assets that were previously family assets. The articles of association may give to the company members special rights related with those assets. Those special rights may be transferred together with the shares of the company member (art. 24.º, 3, of the PCL). But those special rights may only be kept by those who are still members of the company.

It is also possible that the articles of association give a member of the company a special advantage related with the establishment of the company (art. 16.º, 1, of the PCL). Those special advantages may also consist on the use of company assets and they are kept even if those who have received them transfer their shares.

9. Voting with the feet?

As is usually the case in SME's and close corporations, there is in general also no real market for shares in family SPQ. Therefore, the Wall Street Rule doesn't apply and it is also very difficult to «vote with the feet». That is why it is wise to study what can be done to allow the exit voice to those who no longer wish to remain members of the company. If they are kept prisoners of the company, that may destroy the family relationship and lead to opportunistic behaviours.

The articles of association may provide ways for that exit. It may be useful to give the shareholder the right to resign (art. 240.º, 1, of the PCL) under special circumstances: divorce, disease, age, and so on (Ventura, R., 1996). But it is not possible to state that the member may resign "whenever he wants to".

However, the right to resign involves company's duties. Consequently, it may be advisable to make it easier to transfer the shares in certain cases. For instance, if it is not possible for the company to accomplish its duties when the company member wants to resign. The articles of association may also state that the transfer of shares to certain family members doesn't need the company's consent.

It is also difficult to find the shares value. The transaction costs are frequently high (Easterbrook, F., and Fischel, D., 1985-1986, although about close corporations). And when it is difficult to find a buyer, the members of the company may feel forced to accept being appointed as directors (about the problem in close corporations, Bachmann, G., et al., 2014).

10. Conclusion

If something has a problem since it was created, it will usually be very difficult to solve it later. That happens also with family SPQ in Portugal and all over the globe. However, the PCL contains many alternatives that may be used by those who write the articles of association of such type of companies. Family entrepreneurs willing to invest in Portugal must be aware of those possibilities. The same applies to investment in other countries where the law also gives some freedom to choose what the members of the company think it is the best alternative for their family.

The SPQ may be born already with many virtues: it is not necessary to wait three generations⁵. Some of those alternatives have been described here and show that it is possible to improve the expectations related to family businesses and to avoid unnecessary value destruction. The PCL doesn't have many mandatory rules dedicated to SPQ. Consequently, it is possible to adjust the articles of association to many of the family needs. One of the main objectives of this research project is to reduce transaction costs that family businesses face since their beginning. But new beginnings are always possible with the use of knowledge: a very powerful tool for family businesses!

Notes:

¹ A definition of family business may be found at the *Final Report of the Expert Group. Overview of Family-Business-Relevant issues: Research, Networks, Policy Measures and Existing Studies (2009)*

² Renato Tagiuri and John Davis, *Family Business Review*, IX (2), 1996, p. 200, wrote very famous lines on the overlap of family, ownership and management groups.

³ F. Alonso Espinosa, *Revista de Derecho Mercantil*, (2012) p. 58, used the expression "derecho artesanal de sociedades".

⁴ On the subject, *Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - Implementing the Lisbon Community Programme for Growth and Jobs - Transfer of Businesses - Continuity through a new beginning*, COM (2006) 117 final, and "Think Small First". A "Small Business Act for Europe", COM (2008) 394 final.

⁵ «"Couldn't you give me a few more particulars?" asked Weeks. Philip reddened, but, growing angry, did not care if he made himself ridiculous. "I can give you plenty". He remembered his uncle's saying that it took three generations to make a gentleman: it was a companion proverb to the silk purse and the sow's ear» (Somerset Maugham, *Of Human Bondage*).

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