

# Corporate Governance of Family Businesses in Croatia Legal Framework and Open Challenges

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## Corporate Governance of Family Businesses in Croatia – Legal Framework and Open Challenges<sup>2</sup>

■ **ABSTRACT:** *The importance of family businesses in the Croatian economy is well known. In this respect, Croatia is part of the larger picture in which family businesses are considered of fundamental importance to the European Union's economy. The most specific feature that sets Croatian family businesses apart is that they are all relatively young, as they were mostly established in the 1990s. This is due to the socio-economic development of Croatia as a country that was part of the former Yugoslavia. In this regard, although the traditions of certain crafts and products are significantly older, the modern legal vehicles through which such business is conducted, that is, Croatian companies, are only around thirty years old. This fact contributes to the hypothesis that governance issues related to family businesses are an underdeveloped legal area. However, the need to address the specific needs of Croatian businesses is on the rise, as a significant number of the founders are now retiring, and the issue of successful transfer of these businesses has never been more important. The goal of this article is to question whether available legal instruments for enhancing the governance of family businesses from comparative law and practice such as family constitutions and family councils can be applied in Croatian practice as well. To this end, this study analyses the most significant legal forms in which a family business can be established in Croatia: crafts, family farms, and all types of commercial companies (with an emphasis on limited liability and joint-stock companies). Analysis of the Croatian legal framework from the perspective of family businesses will contribute to the comparative discussion regarding the specific legal needs and challenges of such businesses.*

■ **KEYWORDS:** Croatian family business, family governance, corporate governance, family constitution, family council.

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## 1. Introduction

There are no official statistics on the number of family businesses in Croatia.<sup>3</sup> However, it is undisputed in literature and practice that family businesses are among the most significant types of businesses in Croatia, with the prevailing opinion that they fall in the category of small-and medium-sized enterprises.<sup>4</sup> At the EU level, analyses have shown that at least 60% of all types of enterprises fall under the category of family businesses.<sup>5</sup> Thus, it is no surprise that family businesses have been the topic of EU documents, analyses, recommendations, etc.<sup>6</sup> However, all EU sources represent soft-law mechanisms for improving the framework for family businesses, while the extent to which these measures should be adopted is left entirely to the disposition of the member states. The corporate governance of family businesses is recognised as a specific type of corporate governance with specific challenges in both practice and literature.<sup>7</sup> However, the awareness of these issues as well as the development of practical solutions vary greatly throughout the member states. In this paper, the author elaborates on the soft law mechanisms that are most commonly applied in comparative practice to address the challenges of family businesses, such as family constitution and family council. The goal is to question the legal framework of available legal forms for conducting businesses in Croatia to determine whether these mechanisms can be applied to improve corporate governance. Analysis of the Croatian legal framework from the perspective of family businesses will contribute to the comparative discussion regarding the specific legal needs and challenges of family businesses.

## 2. Overview of the most commonly used corporate governance instruments for addressing the challenges of family businesses

Specific challenges for family businesses arise from the overlapping of ownership, family, and business.<sup>8</sup> Potential conflicts among family members threaten the existence of the entire business.<sup>9</sup> To address these new challenges, many authors have argued that corporate governance of family businesses should be divided into business governance and family governance,<sup>10</sup> where governing the family gains equal importance

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3 The Croatian Bureau of Statistics does not recognize family business as a separate category of business in Croatia.

4 CEPOR, 2012, p. 5

5 See, for example, European Commission, 2009, p. 8.

6 For a detail overview, see Braut Filipović, 2020.

7 See, for example, Kormann, 2017; Eisenmann-Mittenzwei, 2006; Hougaz, 2015; Botero, I. C. et al., 2015.

8 See Lansberg, 1983, p. 40.

9 Kormann, 2017, p. 98.

10 See Koeberle-Schmid, Kenyon-Rouvinez, and Poza, 2014, p. 11.

as governing the business of the company. Within family governance, literature and practice most often call for the application of soft-law mechanisms, with the most popular are the creation of family constitutions, family councils, and family offices.<sup>11</sup> In this paper, the author provides only a brief overview of these instruments, as the primary goal is to examine their possible use in Croatian commercial companies and other available legal forms for conducting business.

Family constitutions are documents developed by family members, who are usually shareholders of the same family business. They are often described as the main strategy of the family for governing both the family and the business, with the goal of ensuring harmonious family relations and successful business across many generations of the family.<sup>12</sup> It should be emphasised that family constitutions are usually not legally binding but serve as a starting point from which agreements achieved in that document are transferred, for example, to the articles of associations of the company, which then become binding for the shareholders of the family business.<sup>13</sup> Some have even argued that a family constitution should be used to interpret the constitutive acts of commercial companies, as they incorporate shareholder tendency or intent on a certain issue.

Family councils are special bodies established within family businesses, usually in the case of commercial companies such as joint-stock and limited liability companies, which serve as the point of connection between the family members and the management of the company.<sup>14</sup> These bodies do not replace management or other formal company bodies. They are established voluntarily, and their scope of the duties, role, and composition is typically provided for in the constitutive act of the company, such as the articles of the association. However, it has been argued that these bodies can be established contractually, whether through family constitutions or shareholders' agreements.<sup>15</sup> Decisions made by family councils are generally not legally binding but can heavily influence the management and business strategy of a company, primarily through the family members who, as shareholders, transfer family council decisions by voting for them in the company's shareholders' meetings.<sup>16</sup> The influence of the family council is greater if they include managers of the company as their members, which *de facto* provides a way for the shareholders, that is, family members, to express their will through an informal body to the management of the company.

Finally, in comparative legal systems, especially in the USA, members of the family business have developed so-called family offices that can serve the different needs of the family members but the primary role of which is managing their private

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11 See Koeberle-Schmid, Kenyon-Rouvinez, Poza, 2014, p. 11.

12 Baus, 2016, p. 107.

13 See Braut Filipović, 2018, p. 543. For such a conclusion regarding comparative German practice, see Schween et al., 2011, p. 13.

14 See Lächler, 2016, p. 814.

15 See Sanders, 2017, p. 963.

16 Haagen-Eck, 2016, p. 690.

assets, which they presumably gained from the successful family business.<sup>17</sup> The need for such services arises when the family business is successful for a longer period of time, allowing for family offices to be established as a separate asset management company that manages the portfolio of family members.<sup>18</sup> In other words, family offices become asset managers, and family members become investors.<sup>19</sup>

These soft-law mechanisms for improving the corporate governance of family businesses are known in various comparative legal systems, particularly Germany, the USA, and Spain.<sup>20</sup> There are additional initiatives to boost the development of these instruments in practice by raising awareness about them at the EU level through adoption of soft-law corporate codices and others.<sup>21</sup> As family businesses are of crucial importance for the economy of member states, the author considers that both political participants who draft the country's development strategy and private entrepreneurs who manage family businesses should continuously be reminded of the special challenges that family businesses face and possible instruments that could boost the success of family businesses for generations.

### **3. Possible application of corporate governance instruments on the various legal forms for conducting business in Croatia**

To the best of my knowledge, there are no family constitutions, family councils, or family offices established in Croatian practice. The author considers the lack of introduction of these instruments detrimental to the development of Croatian family businesses who currently find themselves in a peculiar period – the transfer of the business.<sup>22</sup> The preferred solution for the founders of a Croatian family business is to transfer their business to their children.<sup>23</sup> To do this successfully, entrepreneurs should develop a long-term plan of how to connect the family and business before the business is transferred based on soft-law instruments such as family constitutions and family councils that have been proven to help in comparative jurisdictions. The author examines Croatian legal framework regarding various legal forms available for conducting business in Croatia, as family businesses exist in various legal forms and sizes,<sup>24</sup> to determine whether it is possible to introduce family constitutions and family councils in Croatian family businesses.

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17 Wessel, 2013, p. 2.

18 Decker and Lange, 2013, p. 301.

19 Zetzsche, 2017, p. 156.

20 For an overview of existing studies, see Matherne et al., 2013. See also Fleischer, 2017, p. 104.

21 See, for example, the German Governance Kodex für Familienunternehmen from 2004 and the Slovenian Corporate Governance Code for Unlisted Companies from 2016.

22 See Alpeza, Grubišić, and Mikrut, 2015, p. 21; Senegović, 2015, p. 181.

23 Mezulić Jurić and Alpeza and Oberman Peterka, 2020, p. 19.

24 Smith, 2017, p. 14.

### ■ 3.1. Available legal forms for conducting business in Croatia – a brief overview of practice

Commercial companies and crafts are the two main categories of legal vehicles for conducting business in Croatia. The types of commercial companies are strictly regulated and provided for in the Croatian Companies Act,<sup>25</sup> while crafts are regulated by the Croatian Crafts Act.<sup>26</sup> Crafts are traditionally very popular in business practice, and they represent more than 30% of all business subjects in Croatia.<sup>27</sup> Within the category of commercial companies, the most common form for conducting business is the limited liability company (*društvo s ograničenom odgovornošću*),<sup>28</sup> which represents more than 55% of all business subjects in Croatia.<sup>29</sup> As previously mentioned, there are no official statistics on the number of family businesses in Croatia, partially due to the fact that there is no definition of a family business.<sup>30</sup> However, as the limited liability company is considered the most popular legal form for conducting business in Croatia, most of the family businesses in Croatia can be presumed to be established as limited liability companies.<sup>31</sup>

From the agricultural sector, the most popular form for conducting business is family farms,<sup>32</sup> which is an additional legal form created solely for the agricultural sector and regulated by the Family Farms Act.<sup>33</sup>

The choice of legal form for family businesses depends on many factors, particularly taxes and legal framework. Within the legal framework, the most influential issues are the simplicity of the company's establishment and functioning, freedom to tailor the legal relations within the company, and the liability of the members towards third persons.<sup>34</sup> With the development of soft-law instruments for governing family businesses, the possible introduction of these instruments into the legal framework may also be taken into account in the process of establishing or restructuring a company. Considering the aforementioned data, the author analyses how family constitutions and family councils can be integrated into Croatian commercial companies, crafts, and family farms.

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25 Official Gazette, No. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15, 40/19.

26 Official Gazette, No. 143/13, 127/19, 41/20.

27 See Croatian Bureau of Statistics, 2020.

28 Jurić and Braut Filipović, 2020, p. 70.

29 See Croatian Bureau of Statistics, 2020.

30 See the proposal for the definition of a family business in Croatia, which is in accordance with the proposal on the EU level by the Expert Group in the aforementioned *Overview of Family-Business-Relevant Issues: Research, Networks, Policy Measures and Existing Studies*, in CEPOR, 2012, p. 7.

31 See, for example, Orbico Group Ltd, <https://www.orbico.hr/en/about> (16.2.2021.); Gavrilović Ltd, <https://www.gavrilovic.hr/en/> (16.2.2021.); AutoZubak, <https://www.autozubak.hr/> (16.2.2021.). For related findings for Austria, see Kalls, 2017, p. 22.

32 Croatian Farmers register, 2020.

33 Official Gazette, No. 29/18, 32/19.

34 For similar considerations, see Lieder, 2017, p. 31.

### ■ 3.2. *Croatian commercial companies – the possible introduction of family constitutions and family councils*

There are five types of commercial companies that can be established under the Croatian Companies Act: general partnerships (javno trgovačko društvo), limited partnerships (komanditno društvo), economic interest groupings (gospodarsko interesno udruženje), limited liability companies, and joint-stock companies (dioničko društvo).

The general and limited partnerships are among Croatian law types of commercial companies that have legal personality but have their origin in contractual partnerships,<sup>35</sup> which leads to their main feature – a high level of autonomy in determining relations among members.<sup>36</sup> Between these two companies, the limited partnership is characterised as a type of general partnership<sup>37</sup> with the main distinction that the liability of some members towards third persons can be limited.<sup>38</sup> Consequently, limited partnerships are minimally regulated, and provisions of general partnerships apply to limited partnerships as well unless otherwise provided by the Companies Acts or by the members in partnership agreements.<sup>39</sup> For this reason, the author analyses the possible combined use and implementation of the family constitution and family council to these companies. Notably, these legal forms are rare in Croatian practice, compared to other types of commercial companies. However, they can be used in the case of family businesses as they can be drafted according to the needs of their founders.

Both general and limited partnerships are established by registering a partnership agreement in the court registry.<sup>40</sup> As these partnerships enjoy high contractual autonomy, the prevailing number of provisions of the Companies Act regarding the legal relations among members are dispositive in nature,<sup>41</sup> meaning that members can arrange their relations rather freely, with the exception of a small number of mandatory provisions (for example, the members' right to information regarding the business of the company)<sup>42</sup> and the general limitation of the contractual freedom (all contracts must comply with the Constitution of the Republic of Croatia, mandatory laws, and the morals of society<sup>43</sup>).<sup>44</sup> On the contrary, the liability of the members towards third persons is a mandatory provision stating that all members of the general partnership<sup>45</sup> and general partners of the limited partnership<sup>46</sup> are liable for the obligations of the partnership unconditionally regarding all of their assets.

35 See Barbić, 2019, p. 399.

36 See Jurić, 2020, p. 7.

37 See Barbić, 2019, p. 565.

38 Article 131 of the Companies Act.

39 Article 132 of the Companies Act.

40 Articles 133-134 of the Companies Act.

41 Article 71 para. 2. of the Companies Act.

42 Article 84 para. 2 of the Companies Act.

43 Article 2 of the Croatian Obligations Act, Official Gazette, No. 35/05, 41/08, 125/11, 78/15, 29/18.

44 See Barbić, 2012, p. 485.

45 Article 94 of the Companies Act.

46 Article 131 of the Companies Act.

The content of the partnership agreement is not expressly regulated, but it can be derived from some of the provisions of the Companies Act. However, the analysis shows that the mandatory content concerns only basic information regarding the company, such as the identification of the company's members, the company's name, and the place of business.<sup>47</sup> The lack of any other information in the partnership agreement can be substituted by the application of the default provisions of the Companies Act.

Such findings clearly lead to the conclusion that members of the general and limited partnerships can introduce nearly any mechanism of corporate governance to improve the relations among them. As there is no obstacle for members to conclude contracts among themselves outside of the partnership agreement, they are free to draft a family constitution as well.

It remains to be discussed whether a partnership agreement is the only legal act for arranging legal relations among members with an obligatory effect for the partnership. Although there are very few mandatory provisions that must be set by the partnership agreement, the Companies Act expressly states that the legal relations among members are to be arranged in the partnership agreement.<sup>48</sup> In particular, the management of the company can be freely determined by the members, but variation from the Companies Act is valid only if implemented via the partnership agreement.<sup>49</sup> Thus, the author concludes that any decision pertaining to legal relations among the members of a general or limited partnership reached outside of the partnership agreement, such as, for example, within the family constitution, should be implemented via the partnership agreement to ensure the obligatory effect for the members and for the partnership.

As for introducing a family council in the partnership, one must consider that general and limited partnerships do not have organs. All or some members manage the company.<sup>50</sup> However, they can establish a body that is not an organ but can be tasked with advisory, supervisory, or other functions in the company.<sup>51</sup> It cannot represent or manage the company (regardless of whether it consists only of members),<sup>52</sup> as only members are permitted, whether all or only some of them are provided for in the partnership agreement. Thus, it is possible to establish a family council in both general and limited partnerships but only as an advisory body.

Further, as there is no requirement that any additional body should be established in only the partnership agreement, there are no obstacles to establishing the family council via the partnership agreement or outside of the partnership agreement, for example, via the family constitution.<sup>53</sup> However, if members want to ensure that the

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47 See Barbić, 2019, p. 405.

48 Article 71 para. 1 of the Companies Act.

49 See, for example, article 78 para. 2 of the Companies Act.

50 Articles 78 and 136 of the Companies Act.

51 See Barbić, 2019, p. 471.

52 For the same view in comparative German legislation for *Personengesellschaften*, see Sanders, 2017, p. 966.

53 It is a common practice to establish the family council first via the family constitution. See Smith, 2017, p. 636.



role of the family council is respected by all current and future members rather than only those who have signed the family constitution or some other contract outside the partnership agreement, they should provide the establishment, the role, the composition of the family council, and other elements via the partnership agreement.

To conclude, internal governance of both general and limited partnerships is mostly left to their members. Thus, members are free to arrange their relations and improve the functioning of the company by introducing additional instruments of corporate governance, which, for family businesses, could mean the introduction of the family constitution and family council.

An economic interest grouping is a legal vehicle introduced at the EU level,<sup>54</sup> which has the goal of facilitating and improving the economic activities of its members across different member states.<sup>55</sup> The Croatian legislature implemented Regulation No. 2137/85 in its Companies Act. This type of company is not relevant to the challenges of family businesses, as it represents a company of which the members are entrepreneurs who conduct their main business through other legal vehicles but use the economic interest grouping to promote their business. The members of these companies can only be those whose economic activities are connected with the activity of the economic interest grouping,<sup>56</sup> and the inheritance of membership is discouraged.<sup>57</sup> Thus, this will not be further analysed in this study.

The joint-stock company is the most heavily regulated type of company with the highest number of mandatory provisions under the Companies Act. The relationships among the members and the functioning of the company through division among ownership, management, and supervision are strictly regulated, with additional requirements if the company is listed on the stock exchange.<sup>58</sup> As family businesses are constituted and operate through the legal form of the joint-stock company,<sup>59</sup> it is important to determine the extent of shareholders' autonomy in the arrangement of their relations.

The joint stock company's constitutive act is the articles of association (referred to as a "statut" in Croatian), and the company is established after registration in the court registry.<sup>60</sup> The mandatory content of the articles of association is expressly determined by the Companies Act.<sup>61</sup> In the articles of association, shareholders can deviate from the provisions of the Companies Act only if such a possibility is expressly provided

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54 Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), OJ L 199, 31.7.1985, p. 1–9.

55 For the main features of this company, see Barbić, 2019, p. 683.

56 See Article 584 of the Companies Act.

57 See Article 598 para. 2 of the Companies Act.

58 For particularities when the family business is a joint-stock company listed on the stock exchange, see Oppitz, 2017. For a Croatian perspective, see Čulinović-Herc, 2003.

59 A Croatian example is the family business Vindija, established as a joint-stock company which is currently in the process of transition to the next generation. See <http://www.vindija.hr/en-GB/About-us/Business-System-Vindija/Vision-and-mission.html?Y2lcNjI%3d> (16.2.2021.).

60 See Barbić, 2013a, p. 153.

61 Article 173 para. 43 of the Companies Act.

for by the relevant provisions of the Companies Act.<sup>62</sup> Examples of what can be modified by the articles of association are restrictions regarding the transfer of shares, such as pre-emption rights<sup>63</sup> and changes in the management or representation of the company.<sup>64</sup> Thus, mandatory provisions are a general rule for joint-stock companies, while any modification by shareholders is an exception that must be expressly allowed.

On the other hand, shareholders are free to enter into agreements among themselves outside the articles of association. They can even make agreements with the goal of arranging their relations within the company, the most common example of which is shareholder voting agreements. However, these agreements are not legally binding for the company, that is, for the functioning of its organs and decision-making processes. In other words, the obligations enacted by such a contract cannot be enforced on the contractual party when it acts as a shareholder in the general meeting of the company or in another capacity within the company. They can, however, be binding on the basis of the obligations law, meaning that the party in breach may be liable for damages to other contractual parties.<sup>65</sup>

Thus, if shareholders draft a family constitution and arrange their relations as family members, these provisions are not legally binding for the joint-stock company or shareholders. However, family members as shareholders can transfer some of the rules of family constitution by implementing such provisions in the articles of association or through shareholders' agreements.<sup>66</sup> Even if it is not legally binding, the family constitution does not lose its primary role as a starting point for arranging the relations among the family members.

Regarding the introduction of the family council, a joint-stock company has organs, and its functions are strictly regulated to protect the balance between shareholders (owners) and management.<sup>67</sup> Consequently, any introduction of a new body cannot influence or replace the scope and duties of the existing organs, such as the general meeting, management, and supervisory board. However, in practice, joint-stock companies often establish additional bodies, usually with advisory or supervisory roles, to support the work of management or supervisory boards.<sup>68</sup> Thus, the introduction of an additional body such as a family council is possible. In fact, in the comparative practice of family businesses listed on stock exchanges, the introduction of an additional advisory body that would enhance the connection among shareholders, management, and supervisory boards is seen as desirable and necessary.<sup>69</sup> Family councils can be established in articles of association or contractually by shareholders.

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62 Article 173 para. 4 of the Companies Act.

63 Article 227 para. 2 of the Companies Act,

64 See articles 240 and 241 of the Companies Act.

65 See Barbić, J., 2013a, p. 163.

66 Zellweger, 2017, p. 72.

67 For an overview of the one-tier and two-tier board systems available in Croatia, see Maurović, Gonan Božac, and Grgorinić, 2009.

68 See Barbić, J., 2013a, p. 164.

69 Kormann, 2017, p. 232.

In comparative practice, they are often provided in family constitutions.<sup>70</sup> However, if they are established outside of the articles of association, it will affect only those shareholders who entered into that contract. Thus, in the author's opinion, such a body should be introduced in the articles of association, together with the regulation of its scope, composition, and role, to avoid any uncertainties regarding its possible effect on the work of the company's organs.

To conclude, family constitutions and family councils are viable mechanisms for improving the corporate governance of joint-stock companies, regardless of the fact that these companies are rigidly construed as having the possibility of only modest changes in the legal relations between the company and shareholders. They serve primarily as a starting point for arranging the legal relations among family members.

Finally, the author analyses the most popular company type in Croatia and in comparative practice – the limited liability company. As in partnerships, members of the company enjoy a high level of autonomy in arranging their legal relations within the company, which is one of the most important considerations for family businesses.<sup>71</sup> However, a limited liability company retains the main advantage of a joint-stock company – the members are not liable for the company's obligations towards third persons.<sup>72</sup>

The constitutive act of a limited liability company is termed *društveni ugovor*, which, literally translated, means a partnership agreement. However, it differs from the partnership agreements of general and limited partnerships. Specifically, it is not necessary that all members agree to the modification of the agreement,<sup>73</sup> and the mandatory content is expressly determined with a much higher number of mandatory provisions. Although it bears a different name, it has the same role as and is more similar to the articles of association (statut) of a joint-stock company. Several authors have proposed that the constitutive acts of both joint-stock and limited liability companies should be referred to as articles of association (statut), while partnership agreements (*društveni ugovor*) should be reserved for partnerships.<sup>74</sup> Thus, in this article, the author uses the translation of articles of association to mark the constitutive act of the limited liability company.

The mandatory content of the articles of association is set by the Companies Act,<sup>75</sup> although to a lesser extent than for joint-stock companies. Members enjoy more autonomy in arranging their legal relations in the articles of association,<sup>76</sup> although they do not often use it in practice. Instead, they use widespread models – forms of articles of association that usually consist of minimum provisions, while for all other

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70 Baus, 2016, p. 50.

71 The high level of autonomy in limited liability companies is seen as the main advantage for family businesses in comparative laws as well. See Lieder, 2017, p. 57.

72 Jurić and Braut Filipović, 2020, p. 70.

73 Barbić, 2012, p. 500.

74 Jakšić and Petrović, 2016, p. 1142.

75 See Article 388 of the Companies Act.

76 Barbić, 2012, p. 501.

issues, including the relations among the company's members, the default provisions of the Companies Act apply. However, contrary to joint-stock companies, mandatory provisions for members' legal relations are exceptions.<sup>77</sup> Examples of mandatory rules regarding the relations among members include the requirement that each member must retain at least one voting right in the general meeting<sup>78</sup> and members' right to information regarding the business of the company.<sup>79</sup>

Modifications of legal relations among members should be done through the articles of association in order to be legally binding for all members and the company.<sup>80</sup> Examples of when the modifications must be done through the articles of association include the introduction of special benefits for a member,<sup>81</sup> management and representation of the company,<sup>82</sup> restriction of the transfer of a share,<sup>83</sup> and sharing of the profit<sup>84</sup>. It is clear that the members are free to conclude contracts outside of the articles of association, including the family constitution, but it appears that it is highly unlikely that any provision of the family constitution could be legally binding for the limited liability company. The only possible scenario in which a family constitution would be binding for all members of the company is if they would all be parties, that is, signatories of the family constitution, and if they would agree upon a member's right that can be modified outside the articles of association. However, in the author's opinion, this would only be the case for civil law obligations among the members or between the members and the company but not for members' rights.

The introduction of a family council would be possible because limited liability companies can introduce additional bodies within the company<sup>85</sup> under the condition that they do not alter the mandatory scope of obligations of mandatory organs of the company: general meetings and the management board. As previously stated, family councils could be established contractually outside of the constitutive acts of the companies, but it is preferable that their role and composition are determined by the articles of association to ensure their application to all members, current and future, and to determine their interaction with the organs of the company. Additionally, introducing a family council through the articles of association ensures that its existence is more permanent because it cannot be terminated with the sole revocation of the members but, rather, only through a change in the articles of association.<sup>86</sup>

77 Article 405 of the Companies Acts states which provisions cannot be modified by the members of a limited liability company. These are not the only cases, but it declares that mandatory provisions are treated as an exception.

78 Article 445 par 3 of the Companies Act. See Barbić, 2012, p. 502.

79 Article 447 of the Companies Act.

80 Barbić, 2012, p. 509.

81 Article 392 of the Companies Act.

82 Articles 422 and 426 of the Companies Act.

83 Article 412 para. 4 of the Companies Act.

84 Article 406 para. 2 of the Companies Act.

85 Barbić, 2013b, p. 326.

86 For the same view in comparative German legislation, see Sanders, 2017, p. 963.

To conclude, the family constitution and family councils could be introduced to help with the challenges of family businesses when they operate as limited liability companies. As this is the company that enjoys the benefits of both partnerships and joint-stock companies, it represents a vehicle that is most common in practice and thus likely the most relevant for family businesses as well. As the analysis shows, relations among members can be significantly modified, but in order for them to be legally binding for the company and for all members, these modifications must be implemented through the constitutive act of the company – that is, the articles of association. This once again leaves family constitutions and family councils as tools of primarily soft-law spheres, the introduction and enforcement of which are voluntary. It seems that the main task of scholars is to demonstrate the usefulness of these instruments to entrepreneurs and to entice them to use such instruments to improve the governance of their family business in the long term. It is yet to be seen whether these instruments will be recognised in Croatian practice as they have been recognised in comparative jurisdictions.

### ■ 3.3. *Croatian crafts – the possible introduction of family constitutions and family councils*

Crafts are a very popular legal form for conducting business in Croatia and the only true rival to the popularity of limited liability companies. They have a long history and tradition in Croatia.<sup>87</sup> The Crafts Act states that craft refers to *‘permitted economic activities performed independently and permanently [...] that are carried out by natural persons with the objective of generating profits by means of activities performed in the market in the field of production, traffic or services.’*<sup>88</sup> Craft does not have a constitutive act, as would be a partnership agreement of articles of association. It is established via registration in the Croatian Craft register.<sup>89</sup> It usually consists of only one person – the craftsman – but it is possible for two or more persons to establish the craft mutually. In that case, the relations between the craftsmen must be determined by a written contract, which is, in its legal nature, a civil law partnership agreement.<sup>90</sup>

Even in cases in which there is only one craftsman, crafts have the potential to become a family business when the founder transfers the business to his/her children or after the death of the craftsman. However, even before the transfer, crafts are traditionally considered family businesses.<sup>91</sup> Thus, the Croatian legislature expressly regulated that members of the family household can help the craftsman conduct the business without the need to conclude an employment agreement,<sup>92</sup> which significantly simplifies the possible introduction of family members into the business. Family members who help the craftsman do not have to register and do not become members of the craft.

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87 See Alpeza, Oberman Peterka, and Has, 2018, p. 39.

88 Article 2 para. 1 of the Crafts Act. See Petrović, 2013.

89 Article 15 para. 1 of the Crafts Act.

90 Article 33 of the Crafts Act.

91 See Crnković Pozaić, 2008, p. 3.

92 Article 30 of the Crafts Act.

Can the relations among the members in a craft be analysed if crafts do not have such relations? Strictly speaking, we can speak of the legal relationship among the members only if there are at least two craftsmen who hold the craft mutually. However, family members are often employees of the craft, and the craftsmen face the issue of transfer of the craft, with which the drafting of the family constitution may help. In family constitutions, craftsmen and their families can state their values, conditions under which the children can be employed in the craft, succession plans, and so on. Thus, family constitutions can have the same role for crafts as they have for commercial companies, regardless of whether the craftsman manages the craft alone or mutually or whether the family members help with the business.

Regarding family councils, the author is of the opinion that, although crafts have no organs, they could be introduced on a contractual basis. However, crafts do not have members, even in cases in which family members help with the business and even if they are permanently employed in the craft. To establish a family council, one should start by determining who would be a party to a contract establishing it, as such a contract would be relevant solely for the contractual parties. As the craftsman is the only one who represents the craft,<sup>93</sup> it could not be altered by the introduction of the family council. However, the possibility of arranging the relations among family members or even introducing a voting mechanism to reach certain decisions regarding the craftsmen or others may make the family council a valuable tool for allowing family members to participate more actively in the management of the craft.

To conclude, crafts are traditionally considered to be family businesses in Croatian practice, despite the fact that they do not have members. However, there are no obstacles to family members and craftsmen concluding contracts or other acts when the possibility of introducing family constitutions and family offices, with the necessary adaptations to the specifics of the relevant craft, could offer valuable new options for craftsmen to include the family members more actively in the business and to reach a more successful transfer of the business to the next generation.

#### ■ **3.4. Croatian family farms – possible introduction of family constitutions and family councils**

Croatian family farms are the most popular legal form for conducting business in the agricultural sector. In fact, 95% of farms in Croatia are registered as family farms, among which the average size of the farm holdings is rather small, that is, approximately 5.6 hectares.<sup>94</sup> Until 2018, the regulation of family farms was fragmented, being covered by various regulations, and they were not recognised as a separate entity with legal capacity for conducting business. However, the Family Farms Act of 2018 corrected this situation. Thus, family farms are now regulated as a separate legal form for conducting business, with more defined relations among members and the position of family farms towards third persons.

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<sup>93</sup> Article 28 of the Crafts Act.

<sup>94</sup> See Lončarić, Lončarić, and Tolušić, 2016, p. 337.

The family farm is defined as the *'organizational form of a natural person (farmer) who, in order to generate income, independently and permanently performs agricultural activity and related ancillary activities, and is based on the use of own and / or leased production resources and on the work, knowledge and skills of family members.'*<sup>95</sup> Family farms can be established only through registration in the Register of Family Farms under the condition that the holder or one of the members has ownership over the production resources necessary for conducting agricultural activities.<sup>96</sup> The basic features of family farms are that they do not have legal personality<sup>97</sup> and that they can consist of one or more members (sole holders of family farms are dominant in Croatia).<sup>98</sup> The holder of the family farm is a person who is a manager of the business<sup>99</sup> and is solely liable for the obligations of the family farm to third persons with all of his/her personal assets, regardless of whether the family farm has one or more registered members.<sup>100</sup> Members can only be natural persons who are part of the holder's household or are the holder's family members,<sup>101</sup> which leads to the conclusion that family farms are construed as conducting family business in the field of agriculture. They face the challenge of transferring farms to the next generation. In a study conducted on Croatian family farms, it was found that around 50% have the chance of successful transfer of family farms to the next holder, and larger farms with only one designated successor (mostly a son) have higher chances.<sup>102</sup>

Compared to commercial companies, family farms remain rather rudimentary. Family farms do not have articles of association or any other legal act that would govern the legal relations among their members. Although the holder represents and manages the family farm, it remains unclear whether and how the other members can influence its management of the family farm. Relations among the members of a family farm are usually informal; thus, the legislature felt no need to introduce formal meetings of the members or the division of powers between the manager and the members as for commercial companies.

On the other hand, members of the family farm are not prohibited from introducing a more formal mechanism for decision-making processes. For example, it is expressly stated that if the family farm has two or more holders in cases of a jointly held family farm (holders are familially related but do not live in the same family household), the relation among holders shall be arranged via a written contract.<sup>103</sup> The contract is, in its legal nature, a partnership agreement.<sup>104</sup> There is no restriction on

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95 See Article 5, para.1.a. of the Family Farms Act.

96 See Article 31 of the Family Farms Act.

97 See Article 15 of the Family Farms Act.

98 See Article 15 of the Family Farms Act.

99 See Article 5, para.1.i. of the Family Farms Act.

100 See Article 41 para. 1 of the Family Farms Act.

101 See Article 5, para.1.g. and para.1.h. of the Family Farms Act.

102 Žutinić and Bokan, 2011, p. 347.

103 See Article 22 para. 2. of the Family Farms Act.

104 See Article 22 para. 3. of the Family Farms Act. Partnership agreements are governed by the Obligations Act.

members entering into other contracts as well, which resembles the so-called shareholders' agreement, although such a development is unlikely in practice because of the nature of their relationship and the size of the business.

In this type of legal framework, members can introduce family constitutions by which they address business and family issues. As there is no constitutive act, there is no need to discuss the potential relationship between a family constitution and the constitutive act of the family farm. Members of the family farm enjoy greater contractual freedom in governing the relations among members as well as between the manager – the holder – and the members. The only restriction appears to be that the holder is the liable person for the obligations of the family farm towards third persons. In the authors' opinion, the use of family constitutions could be of paramount importance for enhancing the governance of family farms. Additionally, family constitutions could be used to set the criteria for choosing the holders of the family farm to determine issues that should be decided by the members in managing the family farm and other issues for governing the relations among members. If signed by all members, family constitutions have a higher potential to be obligatory for those members. The reason for this is the absence of articles of association or similar legal acts, which means that relations between the management and members can be set in any other act or contract produced by the members, which very well could be carried out through the family constitution if it is accepted by all members.

Further, there is no prohibition on introducing additional bodies, such as family councils. Family councils could enhance decision-making processes within the family and the relationship between the holder and members. As only family members or members of the same household can be members of the family farm,<sup>105</sup> the introduction of a formal body could be seen as redundant. Still, if seen as a tool for including family members more actively in the management of the farm, it could produce long-term positive effects, especially for the transfer of the family farm.

To conclude, family farms are of great importance to the agricultural sector. However, as a legal vehicle, it represents a very simple form of conducting business. The primary goal was to simplify business operation for farmers, allowing them to use household or family members to perform agricultural activities.<sup>106</sup> However, the author believes that introducing additional self-regulation of the relations among members through a family constitution could enhance such relations among the members, especially in cases of the transfer of management to another holder of the family farm.

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105 See Article 28 para. 1. of the Family Farms Act.

106 Household or family members can help with agricultural activities without the need to conclude an employment contract. See Article 25 of the Family Farms Act.



## **4. Conclusion**

The primary conclusion of this article is that there are no obstacles to introducing a soft-law instrument, such as a family constitution and family council, in all of the analysed legal forms for conducting business in Croatia. However, the fact that these instruments have not yet been used in Croatian practice testifies to the lack of awareness of these instruments and their potential use for Croatian family businesses. As many Croatian (family) businesses are currently facing the challenge of transferring the business from one generation to the next, successful planning must begin with establishing a more satisfying governance that connects and balances family and business in family businesses. The aim of this article is twofold: to raise awareness of these instruments among Croatian entrepreneurs and to demonstrate that the Croatian legal framework supports the introduction of instruments developed in comparative practice to enhance the governance of family businesses, namely family constitutions and family councils.

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