

THE CASE OF MERCK: CULTIVATING A GOVERNANCE SYSTEM FIT FOR A DYNASTY

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LOCATION: Darmstadt, Germany

EMPLOYEES: 58,000

NUMBER OF GENERATIONS: 12+

INDUSTRY: Healthcare, Life Sciences, Performance Materials

ANNUAL REVENUE: EUR 17.5bn

FOUNDING YEAR: 1668



How does one keep a group of 170 family shareholders, dispersed across the globe, unified and aligned? Over the course of 350 years and 13 generations, the Merck family has developed a deep understanding of the requirements of effective family governance. Its family governance system allows for transparent decisions, fosters active engagement, nurtures strong family relationships, and systematically builds ownership competence.

Started by a young pharmacist by the name of Friedrich Jacob Merck in the small town of Darmstadt in 1668, a local pharmacy grew into a global conglomerate that today employs nearly 58,000 employees in over 60 countries. The Merck family, which has been stewarding the company for 13 generations, has experienced similar growth. Today, the family counts more than 280 family members, over 170 of which are family shareholders. What is the family's secret to keeping its many family shareholders united, aligned, and connected to the business?

By 1995 Merck had grown into a rather complex organization with multiple divisions and subsidiaries spread across the globe. Driven by a CEO who married into the business family, the family decided to fundamentally revisit its organizational and governance structures. The family listed roughly 30 per cent of the shares of Merck KGaA on the Frankfurt Stock Exchange, with the objective of reducing debt, raising capital, and increasing transparency. The family-controlled holding company, E Merck KG, has no shares in the listed company, but retains firm family control with over 70 per cent of the equity. Given the increased scrutiny this change brought, it was time to revisit the family's governance system.



The Merck Family Governance System

It is important to highlight the family's conviction that they are, in fact, the stewards of the family enterprise, rather than its owners, which shapes both their identity and the way in which they design their family governance. The Merck family governance system has been – quite literally – centuries in the making, with the first version of their family constitution dating back to 1888. The question that guided the family's thinking ever since was *"How can a mechanism be devised that is fair, objective and has a buy-in from everyone?"*

The Merck family simultaneously uses several governance bodies to align the family and facilitate decision-making, and to effectively manage the interface between the family and the business. The family uses a three-tier system: the larger family group selects family members for the family board, who select candidates for the board of partners, who select candidates who represent the family in the boards of the holding and listed companies. Family members are elected through a rigorous process into each one of these bodies:

- The roughly 170 family shareholders (this includes spouses) elect the 13 members of the family board [Familienrat], which is primarily concerned with representing the family interests in the business and keeping strategic oversight on the business (e.g., any acquisitions, divestments, or financial transactions above half a billion Euros require the approval of the family board). The family board is also tasked with nominating five of its members for the family board of partners (see below), one member for the executive board of the holding company, and four members for the supervisory board of the listed company. The family board meets between six and 10 times a year. Family board elections happen every five years, and the process includes a stringent evaluation process and a training program for incoming board members.
- The board of partners [Gesellschafterrat] acts as a quasi-supervisory board to the executive management team and exercises day-to-day operational control over the business. The board of partners is also responsible for electing two of its members to join the executive board of the listed company. These family representatives *"play a crucial role in providing strategic direction to the business in alignment with the family's long-term vision"*. The board of partners counts nine members in total, five of which are family members and four of which are independent experts.

The heads of the Familienrat and the Gesellschafterrat represent the highest instance of family leadership as a dyarchy. The head of the Familienrat is the official head of the Merck family and acts as a link between the family and the business, the public, and a liaison to all family members.



In addition to these formal decision-making governance bodies, the Merck family also relies on its family constitution to ensure that family members understand their rights and responsibilities as stewards of the family enterprise. The constitution, whose contents the family views as sacrosanct, has been continually adjusted to reflect both changes in the family and in the wider society over the years. Family members' only opportunity to exit arises every 10 years, when the constitution is renewed – however, they “*can only transfer their equity participation to another family member [at a] discount of 20 per cent of the market value of the shares of the listed entity*”. Besides formal means of governance, the family also relies on informal means of governance, nurturing relational quality, living the values, and ensuring ownership competence.

The Merck family realized early on that without strong family relationships, the family was bound to fall apart in time. They regularly create opportunities to spend time together both socially (as a family) and formally (in the context of the business). In addition to the annual general meeting, the family meets several times each year.

Consistently living their values is another important pillar of Merck's family governance. One such important value is modesty – “*the family is opposed to displays of material wealth*”. Ensuring that family members understand and embody the family's core values is an important step in ensuring family cohesion and alignment.

One important way to ensure the family's ability to make good decisions for the business and the family is to invest in family members' ownership competence. Merck has a sophisticated ownership development program that begins at an early age and covers multiple areas, from company-specific knowledge to general business skills, interpersonal abilities, and knowledge about family dynamics and the family history.

Ownership Competence Development in the Merck Family

One informal mechanism of governance that the family has adopted is to develop the ownership competence of current and future generations. The Merck family has an educational program that ensures that family members are knowledgeable about the business, the family history, and develop their decision-making capabilities. Their educational program relies on nine building blocks:⁶⁴

1. Two next-generation program for family members aged 15–23 and 24–35 are offered every year. These programs last two and a half days and focus on business and family. On the business side, children and young adults learn about, for example, the business strategy, innovation strategy, or digitalization strategy. On the family side, they learn about the family constitution, governance structure, and family history.
2. On several occasions each year, “fireside chats” are organized in different German cities that family members and spouses can attend freely – these events provide an informal way of getting to know each other and are led by family council members.



3. Every two years, family members can participate in family bonds, a two-day peer-to-peer learning event where members of six large German business families meet and exchange best practices in managing and meeting the demands of a growing business family.

4. The business family academy is offered by INTES, an association for business families – members of the Merck family can participate and receive funding from the family to do so. The program focuses on different issues relevant to members of business-owning families, usually in two-day segments.

5. The Merck Family University has only happened once so far (2017/2018) and was designed for family members who expressed an interest in joining the family council or family shareholder council. Participants attended five modules that lasted 15 days each. The whole program took 15 months to complete and covered both Merck-specific and general business topics. The family plans to offer the Merck University to interested family members before every family board election, every five years.

6. Family assessments are provided for those family members that consider participating in a governance role. The assessment is done by an external service provider who then recommends customized educational activities for each family member.

7. The annual Merck Family Day is open to all family members and always takes place at one of their facilities. The day centers around business highlights, peer-to-peer learning from other business families, and lots of family interaction.

8. The extraordinary shareholder assembly has been held for over two decades and aims to inform the shareholder group about recent developments in the business – not to make decisions. It is also used to prepare family shareholders for any upcoming big business decisions.

9. Lastly, the family engages family members in committee work and invites family members to expert-led talks and lectures with senior executives from in and outside the business.

These nine building blocks support three objectives: (1) familiarizing the next generation with key topics in business management and family governance, (2) generating a large pool of interested and competent family members who may decide to engage in one of the family governance structures or activities, and (3) ensuring family members have ample opportunities to connect and engage with one another, thereby ensuring the growing ownership group remains aligned over time.



Learnings from the Merck Family

The case of Merck is frequently discussed in the popular press as a best practice example in family governance and ownership development. Over the course of 12 generations and across 170 shareholders the family has dedicated significant resources to ensure that the family members develop and maintain the ability to make decisions together.

Prior research shows that families benefit from investing in these capabilities at an earlier stage, and for smaller groups, as it sets a strong foundation for building ownership unity, alignment, and actionability. The Merck family believes that educated owners form the foundation for a successful, long-lived enterprise and a functional, aligned shareholder group. The family governance system rests on the belief that only if owners are informed and engaged do they become capable of making and supporting good decisions that acknowledge the reality and constraints of the business, and those aligned with the family values and objectives.

What is more, the Merck family offers family members a variety of ways to connect with the family and the business, formal and informal, family-centric and business-centric: they use all four elements of cohesion simultaneously. This ensures that in case of an economic downturn, such as the recent COVID-19 Pandemic, which often leads to a weakening of the financial-business cohesion mechanisms, family members remain connected to the family enterprise through a variety of alternative mechanisms, ensuring the system's stability and continuity.

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- For exemplary articles on the Merck family governance and educational curriculum, see <https://cmgpartners.ca/mercks-commitment-to-family-governance/>, <https://www.tharawat-magazine.com/triumph-family-business-governance/>, <https://isbinsight.isb.edu/350-years-of-family-business-lessons-from-merck/>