FREE NETWORK

#AcademicsStandWithUkraine

POLICY BRIEF SERIES

Anete Pajuste, Stockholm School of Economics in Riga, BICEPS, ECGI, and Boston University Questrom School of Business
May 2024

Succession Dynamics in Latvian Family Firms

This policy brief examines the emergence, succession, and performance of first-generation family firms in Latvia, highlighting the unique challenges and achievements of these businesses since the early 1990s. Following Latvia's independence, many family firms were established, providing a natural setting to study succession issues. Key findings reveal that initially, nearly half of these firms did not have a majority stake held by the founding family, but within the first few years after founding, families accumulated majority ownership. It typically took seven years for family ownership to exceed 75 percent. However, 23 years later, only 16 percent of the sample firms have second-generation shareholders. Notably, around 80 percent of these firms remain majority-owned and managed by their founders. Furthermore, family firms outperform non-family firms by 3.1 percent in return on assets (ROA). The findings underscore the need for policies that support effective succession planning, incentivize family-owned business sustainability, and provide targeted training for future generations to maintain the robust economic contributions of these firms.

Introduction

Family firms, where key decisions are controlled by individuals linked by blood or marriage, are the predominant organizational form worldwide. These firms face critical challenges, (e.g. leadership transition, generational differences, emotional ties to the business, and estate planning tax considerations) particularly during ownership succession, which is the transition from the first to the second generation of family members. This issue is especially relevant in Eastern European countries like Latvia, where the shift from a planned to a market economy in the 1990s created the first generation of family firms now approaching generational change.

Understanding how family firms manage this transition is crucial for policymakers, business leaders, and researchers. This policy brief highlights the key findings of a study (Pajuste and Berzins (2024) on Latvian family firms, focusing on ownership succession patterns, the involvement of the next generation, and the impact on firm performance.

Succession Patterns and Ownership Evolution

In Latvia, many family firms began with founders holding minority stakes, reflecting financial constraints and economic uncertainties. Over time, families gradually increased their ownership stakes, demonstrating resilience and strategic planning. On average, it took seven years for family ownership to exceed 75 percent. This gradual ownership increase helped families navigate the challenges of economic transitions and limited access to external capital. The study also reveals that 23 years after being founded, only 16 percent of the sample firms have second-generation family members as shareholders.

Involvement of the Second Generation

The emergence of the second generation in family firm ownership is a pivotal phase. Succession planning and the transmission of familial values, knowledge, and entrepreneurial ethos are crucial during this period. By 2022, only 14 percent of the sample family firms had significant second-generation involvement (defined as the second generation holding a majority of the family shares and having a board seat).

More specifically, in a sample of 266 family firms, 20 percent had involved the second generation in ownership by 2022, with significant involvement in 71 percent of these cases. At the same time, 80 percent of the firms were still majority-owned and managed by the founders. This slow involvement of the second generation highlights the challenges of succession planning and the need for a strategic approach – both from a company and a legal perspective – to ensure a smooth transition from the first to second generation.

Importantly, despite this slow transition, family firms tend to perform better than non-family firms, with a 3.1 percent higher return on assets (ROA). However, within family firms, the involvement of the second generation does not significantly impact firm performance.

Policy Implications and Recommendations

The findings of this study have several important implications for policymakers, business leaders, and researchers.

Support for Succession Planning

There is a need for policies and programs that support succession planning in family firms. This includes providing resources and guidance for families to develop succession plans, ensuring the continuity of family businesses. Ensuring some form of succession, whether within the family or through external parties, is crucial to prevent these firms from closing. Facilitating succession and supporting the survival of these firms would not only protect jobs, but also have a positive economic effect as family firms outperform their non-family counterparts.

Financial Support and Access to Capital

Another way to enable smoother transition and growth for family firms is to improve their access to capital to help them overcome financial constraints. Financial institutions and government programs should focus on providing tailored financial products for family businesses. By doing so, they not only support the longevity of these businesses but also help in maintaining employment levels and preventing the economic fallout from family firm closures.

Education and Training

Educational programs and training for the next generation of family business leaders are essential. These programs should focus on leadership, management, and the unique challenges of family businesses, preparing the next generation for successful transitions.

Awareness and Best Practices

Raising awareness about the importance of succession planning and sharing best practices can help family firms navigate generational transitions more effectively.

Research and Data Collection

Continued research and data collection on family firms and their succession patterns are crucial. This helps in understanding the challenges and opportunities faced by family businesses, informing policies and practices that support their continuation and success.

Conclusion

Latvian family firms, like their counterparts worldwide, face significant challenges during ownership succession. This study highlights the gradual and strategic increase in family ownership stakes, the slow emergence of the second generation in ownership, and the need for comprehensive succession planning. Policymakers, business leaders, and researchers must work together to support family firms in navigating these transitions, ensuring their continued contribution to the economy.

Effective succession planning is crucial for sustaining family businesses across generations, preserving their legacy, and promoting economic growth. By addressing the unique challenges faced by family firms, we can create a supportive environment that fosters the longevity and success of these vital enterprises.

Acknowledgement

This brief is based on an academic article *Family firm succession: First-generation transitions in Latvia* co-authored with Janis Berzins and forthcoming in Finance Research Letters. We acknowledge financial support from the EEA research grant Global2micro (S-BMT-21-8, LT08-2LMT-K-01-073).

References

Pajuste, A., and Berzins, J. (2024). Family firm successions: First-generation transitions in Latvia. *Finance Research Letters*, 64, forthcoming.

Anete Pajuste

Stockholm school of Economics in Riga
anete.pajuste@sseriga.edu
https://www.sseriga.edu/pajuste-anete

Anete Pajuste is a Professor at the Stockholm School of Economics in Riga, a Research Associate at the Baltic International Centre for Economic Policy Studies (BICEPS), a Research Member at the European Corporate Governance Institute (ECGI), and a Visiting Professor at the Boston University Questrom School of Business. She holds a PhD in Finance from the Stockholm School of Economics (Sweden). Her main research focuses on corporate governance and controlling shareholders.

FREE NETWORK