Executive Master Thesis

Family business succession in Latvia

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Table of Contents

Abstract

Since succession is a defining feature of a family firm (De Massis, Chua, & Chrisman, 2008), researchers have been focusing inter alia on factors that are preventing family business successions. Family foundations have started to receive attention from researchers.

Latvia is entering a first ever succession wave in the history of its entrepreneurship since transition to the market economy. There are no traditions and heritage regarding family businesses successions in Latvia, and therefore it is very relevant to answer a research question as to what factors would support family business succession in Latvia. A purposeful sample of nine family businesses was selected to collect qualitative data through semi-structured interviews. Based on De Massis et al (2008) five factor structure on potential failures in family business successions, family business owners were questioned on the extent of succession planning, internal and external factors affecting family businesses and whether the respondents would be interested to set up a structure to safeguard their family business succession.

While the interviewed sample is aware of the succession as such, they do not treat it as a systematic process and there are no effective succession plans. Family business owners are treating process factors as a succession and encouraging competence for successors, however disregarding other individual factors, as well as relation, financial and context factors. While the lack of knowledge about succession planning calls for education of family business owners, absence of a legal framework for family foundations is preventing succession planning and effective family business succession in Latvia.

1. Introduction

Family businesses are the most prevalent type of business organization in any global economy (Rovelli, Ferasso, De Massis, & Kraus, 2022). Family businesses are the third largest contributor to the world economy by revenue (Robertsson, 2021). According to European Family Businesses (n.d.), these types of organizations constitute a large portion of companies in Europe, ranging from 65% to 80%. On average, they provide employment for 40% to 50% of all job seekers in Europe.

Kārlis Krastiņš, member of the Baltic Family Firm Institute board, states that “family-owned firms make up cornerstone of Baltic economies” (Stockholm School of Economics in Riga, 2022). PhD Candidate, entrepreneurship researcher Aivars Timofejevs (Unified News Portal of Latvia's Public Television and Radio Services, 2018) notes that “family-owned companies have always been an essential part of the economies of the Baltic countries and have proved to be successful and resilient.” There are 5225 family-controlled enterprises with revenue above EUR 2 million or total assets above EUR 2 million and revenue above EUR 1 million (excluding banks and holding companies) in the Baltics with 1878 firms in Estonia, 1629 in Latvia and 1718 in Lithuania (Baltic Family Firm Institute, n.d.). Furthermore, the Baltic Family Firm Institute (n.d.) reports that there are 11 single-family-controlled firms among Top 100 largest companies in the Baltics. Family firms constitute more than 30% of all the firms incorporated in Latvia (Veldre & Ancāns, 2022).

Professor Anete Pajuste points out that “one of the main challenges for family businesses is succession. It is becoming more complex due to changes in family, management and governance systems” (Stockholm School of Economics in Riga, 2022).

According to research conducted in various countries, only around 30% of family businesses reach the second generation and a mere 10% of family businesses endure to the third generation (Scheffold, 2014). Although not every failed succession leads to business closure, 30% of business closures are attributed to transfer failures (Ip & Jacobs, 2006).

At present moment family business succession becomes an important issue in the Latvian entrepreneurial environment since it is facing the first ever transfer of family businesses to the next generation. Professor Anete Pajuste highlights that “the first generation of entrepreneurs is nearing retirement” (Stockholm School of Economics in Riga, 2022). Many family business founders of the 1990s are still holding their business ownership title and for them the time has come to decide whether to pass their business on to a younger generation within the family or seek alternatives for further business continuity. To the authors' knowledge, there is no legacy or experience in family business succession in Latvia since it was merely illegal to conduct private business during the Soviet times in Latvia.

Forbes (Eizentals, 2021) reports that in Latvia business owners are also performing operational functions of businesses, thus creating a key person risk (strategic development, most valuable business contacts, know-how and intellectual property is being controlled by one person), which in case of an unforeseen event can trigger value loss for a long-built business. Eizentals (2021) suggests that all enterprises must have a succession plan in place to help an entrepreneur’s family to deal with unexpected occurrences. In addition, Jānis Endziņš reports that succession in Latvia occurs in small number of cases (Latvijas Tirdzniecības un rūpniecības kamera, 2023).

Groysberg and Bell (2014) have raised a legitimate concern about 80% of businesses worldwide being family-owned and only 70% of such businesses lasting only a single generation.

Substantial research has been carried out regarding family businesses as proved by the existence of specifically dedicated journals to family business research such as Family Business Review, Journal of Family Business Strategy and Journal of Family Business Management (Rovelli et al, 2022). However, limited research has been conducted about the issue in Latvia.

The aim of this research is to explore these issues by answering the following research question: **What factors would support the family business succession in Latvia?** To the authors' knowledge, no such research has been carried out in Latvia. In order to answer the research question, the authors have studied the factors supporting family business succession. The examination was supported by literature review on family business, family business succession and family business governance, and determining what are the challenges in family business succession. The researchers utilized a qualitative data collection method – interviews with selected family business owners in Latvia to understand necessities in family business succession planning.

It is common that a simple inheritance process might stop the business succession. Hence the wealth splitting process might go through the family crisis, unresolvable disputes and create complex shareholding relationship structure not supporting further business succession (Matthias, 2016). Testamentary inheritance in Latvia does not provide solutions for family business owners since wills cannot address succession and can even be disregarded if the heirs prefer so. Based on the authors' research, family business foundations, family offices and family trusts are most commonly used to support family businesses and wealth accumulation within the defined family circles and enhance economic potential to next generations (Schickinger, Bierl, Leitterstorf, & Kammerlander, 2021) (Panico, 2016) (Schillaci, Romano, & Nicotra, 2013) (Uhl, 2022).

2. Literature review

2.1. Definition of a family business

The Japanese company "Kongo Gumi", established in 578, holds the title for the oldest family business, closely followed by the Japanese "Hoshi Ryokan", which was founded in 718. The French "Château de Goulaine", established in 1000, takes third place, while the Italian "Fonderia Pontificia Marinelli", founded in 1000, ranks fourth (Schillaci et al, 2013).

Whilst there are several definitions used to define family business and how to distinguish it from a non-family organization, authors have observed that there is no common definition of the term "family business". The existing definitions can be classified based on the components of the involvement approach, in the essence of an approach or on the combination of aforementioned (Steiger, Duller, & Hiebl, 2015). The most common ground is that a family business consists of three elements: ownership, business and family which was first introduced in 1982 by Tagiuri & Davis (1996) and is known as the 3-Circle model (Figure A.1). This model also illustrates the relationship layouts between the family and non-family owners and employees.

In 2009, the European Commission formalized the family business definition as follows:

> "A firm, of any size, is a family business, if: (1) The majority of decision-making rights is in the possession of the natural person(s) who established the firm, or in the possession of the natural person(s) who has/have acquired the share capital of the firm, or in the possession of their spouses, parents, child or children's direct heirs. (2) The majority of decision-making rights are indirect or direct. (3) At least one representative of the family or kin is formally involved in the governance of the firm. (4) Listed companies meet the definition of family enterprise if the person who established or acquired the firm (share capital) or their families or descendants possess 25 per cent of the decision-making rights mandated by their share capital" (European Commission, 2009, p. 10).

During the literature review process, the terms "family business" and "family firm" have been acknowledged to have the same meaning. Finally, family business can have single family and multi-family ownership structure.

2.2. What is family business succession

To ensure family control over LVMH (LVMH Moet Hennessy Louis Vuitton SE) in the long term, in July 2022 Bloomberg (Rascouet, 2022) reported that its founder and chairman Bernard Arnault introduced a structure, where Arnault's family business is held equally by his five children. Ellison (2023) suggests that Marta Ortega Pérez, the daughter of the Inditex and Zara co-founder, Armanico Ortega Gaona, who became the non-executive chair at Inditex in April 2022, was arguably in the business from the womb and that her path to succession was set a long time ago.

When entrepreneurs plan to exit their business, they have three options: sell it to a third party, liquidation, or transfer ownership to a successor. For family businesses, the most common option is to transfer ownership to the next generation, ensuring continued family control. However, research shows that succession often fails, due to a variety of personal, emotional, and structural factors, such as the unsuitability of successors, governance issues, or unfavorable financial and tax conditions. To avoid such failures, it is crucial to plan and establish a formal or informal strategy for succession, which can identify and address potential problems early on (Csizmadia, Makó, & Heidrich, 2016).

Maintaining transgenerational control of a family-owned business through successful management succession is essential for the family to achieve their objectives and safeguard the financial and non-financial benefits that come from owning the company (Daspit, 2016). Therefore, succession is one of the most important elements that impacts the longevity of a family business (Mathews & Blumentritt, 2015).

Succession planning is a deliberate and systematic long-term process aimed at enabling the smooth transfer of ownership and management authority to the next generation of a family business (Duh & Primec, 2022).

Succession planning is the development of a plan for when an owner steps down from their ownership and leadership role in a business, whether voluntarily (retirement) or involuntarily (death or incapacity). In closely held family businesses it involves determining future ownership and leadership, considering who will own shares and who will take on leadership roles and documenting and communicating the plan to relevant parties. It is suggested to work on a succession plan as early as possible and to involve as many family members as possible in order to have a common understanding and goals (Lansberg, 1988). This plan helps to ensure a smooth transfer of the business to the next owners when the current owner exits, either by choice or circumstance (Saymaz & Lambert, 2019). Scholars and business consultants emphasize the importance of such a plan. However, many businesses neglect this process and leave the succession planning to a chance (Sharma, Chrisman, & Chua, 2003).

2.3. What are the challenges of family business succession

There are many different factors that contribute to family business succession failure. These factors include insufficient preparation and planning, the absence of capable successors, reluctance of business owners to transfer control and the nature and viability of the company (Gagné, Marwick, Brun de Pontet, & Wrosch, 2021). Many of the reasons for unsuccessful or non-occurring successions have psychological roots which initially motivated the owner to start the business and have several meanings:

(1) Studies suggest that typical entrepreneurs often has unresolved conflicts with a father, leading to discomfort with being supervised. This can motivate them to

start their own business both as a way to surpass the father and to escape the authority and competition of more dominant figures;

(2) An entrepreneur's business is both their "baby" and "mistress". Those working with and for them are often seen as tools in shaping the organization. If any of these individuals aspire to hold power themselves, they may soon find themselves excluded. This is why many organizations decline after the departure of their founder, either due to aging or death;

(3) For entrepreneurs, business is a reflection of themselves, serving as a means for personal satisfaction and accomplishment. If they consider the future of their business beyond their own presence, it typically takes the form of considering the legacy they will leave behind (Levinson, 1971);

(4) the business strengthens a founder’s connection to his or her business and reluctance to face the reality of aging, death, or incapacity (Handler & Kram, 1988).

The research on the succession plan execution failures reveals several reasons. It is possible to divide unsuccessful business successions with the negative outcome (succession does not take place) into five categories: 1) individual factors 2) relation factors 3) context factors 4) financial factors 5) process factors (De Massis et al, 2008).

2.3.1. Individual factors. Reasons that stem from the factors operated on an individual level:

(1) Potential successor’s low competence (Chrisman, Chua, & Sharma, 1998). If successors lack necessary skills to manage the business, succession may fail due to their refusal to accept the position or rejection by the dominant coalition. This aligns with multiple studies that show a positive correlation between a successor's leadership ability and successful succession outcomes (De Massis et al, 2008);

(2) Potential successor’s lack of motivation. Potential successor as an individual has other interests or other plans and does not have an emotional connection with the business (Stavrou, 1999). Lack of motivation might be caused by “The Prince Charles Syndrome” (Bernhard, 2022) described as a situation of being demotivated and old while waiting for a long period of time. Studies conducted indicate that the younger generations have minimal interest or desire to

participate in their parents' businesses (Sieger, Fueglistaller, & Zellweger, 2016);

(3) Unexpected loss of a potential successor. Succession can fail if a potential successor passes away or becomes ill. In a non-family firm, another non-family manager can be appointed. However, in a family firm, if the only potential family successor is no longer available, intra-family succession would become impossible (De Massis et al, 2008);

(4) Divorce, remarriage or birth of new children can affect the succession process and deliver complex inheritance situations (De Massis et al, 2008).

2.3.2. Relation factors. Literature recognizes a crucial role that relationships between different groups of people play in family business succession suggesting that poor interpersonal relationships can lead to conflicts that hinder succession. Different interdependent relationship-related conflicts are common in family businesses due to emotional attachment among family members (Qiu & Freel, 2020). The main relation related factors are:

(1) Conflict and competition between an incumbent and a potential successor;

(2) Conflicts and competition between family members;

(3) Lack of support and consensus from the family and non-family members for a potential successor (De Massis et al, 2008).

2.3.3. Financial factors. There are several finance-related factors that can affect family business succession:

(1) Inability to bear a tax burden associated with succession;

(2) Inability to bear financial resources necessary to cover an exit of a potential heir in case there are several;

(3) inability to bear financial resources to hire professional managers in case a potential successor is not competent (De Massis et al, 2008).

2.3.4. Context factors. These factors are related to changes in business strategy, business scale and financial performance revealing a potential successor's incompetence or unwillingness to take over the family business (De Massis et al, 2008). Literature research reveals that there is a strong correlation between the size of a business and a successor's willingness to join a company (Stavrou, 1999). Moreover, the future business development and profitability outlook resulting in potential monetary and non-monetary benefits may influence a potential successor’s decision to join the company (De Massis et al, 2008).

2.3.5. Process factors. There are various factors related to the succession process itself resulting in non-occurrence in succession. The process factors can be separated into 3 phases:

(1) Preparation phase. If an incumbent’s responsibilities are not clearly defined during the transition period, it could impede a successor’s ability to gain respect and support both from family members and non-family managers. This could hinder the succession process from occurring. Furthermore, if the potential successors' role in the succession process is ambiguous, it may cause them to lose motivation and potentially decline the top management positions (Lansberg, 1988). It is important to devote enough effort and attention to create a shared vision among the family members and other stakeholders to avoid any misunderstandings and potential conflicts and communicate them well in advance (De Massis et al, 2008);

(2) Development of a successor. Due to lack of formal training, a potential successor may not be adequately equipped to take on a top management position, potentially leading to the failure of the succession process (Morris, Williams, Allen, & Avila, 1997) (Lansberg & Astrachan, 1994). This also refers to evaluating potential gaps in the successor’s needs and abilities (De Massis et al, 2008);

(3) Successor selection. Choosing a successor based on rational and objective criteria is essential. Failure to formalize the criteria for selecting a successor may lead other family members or non-family managers to perceive the process as unfair, resulting in conflicts that could derail the succession process (De Massis et al, 2008).

2.4. Family foundations

De Massis et al (2021) suggest that entrepreneurial families tend to extend their operations across multiple businesses and this complexity is rarely addressed in family business research, where the main focus is on the family business. Researchers and practitioners should look beyond the entrepreneurial family and its assets by moving away from the conventional approach that primarily concentrates on the family's operational businesses (De Massis et al, 2021). There are various types of organizations that are related to family businesses and are ensuring the continuity of family businesses. De Massis et al (2021) has named these “family boundary organizations” that exist in “a family-related organizational ecosystem”. Family firms, family business foundations, family foundations, family offices, family holdings and family investment companies are among the family boundary organizations.

For the purpose of this research authors must distinguish between a family firm (or a family business) and other types of family boundary organizations, especially family business foundations, that shall be emphasized further in this study. While a family firm once established is designed to represent a family business, one needs to understand that a shareholding structure beyond a family firm determines possibilities for a family business succession. While family holdings, family investment companies and family offices are focusing mainly on family's wealth preservation and investments (De Massis et al, 2021) and family foundations are designed for charitable purposes (Lungeanu & Ward, 2012), family business foundations are entities where the donor is a family-owned corporation (De Massis et al, 2021). Literature review on family business foundations and family foundations reveals that both terms are used interchangeably. Since legislative enactments in various countries only use the term “family foundations” and legal scholars tend to use the terms “shareholder foundations” and “commercial foundations” (Koele & Feldthusen, 2020) when referring to family business foundations, for the purposes of this work the authors will use the term “family foundation” when referring to a “family business foundation”.

Literature review on family business succession discloses family business succession by utilizing family foundation. In Germany family foundation has been named the “queen of succession planning” (Uhl, 2022). The first concepts of foundations in civil law countries emerged as early as the Middle Ages with the archbishop of Ravenna questioning ownership of a monastery abandoned by monks and arguing that the walls of the monastery would then own the monastery itself (Panico, 2016). According to Panico (2016), family foundations have evolved as wealth planning and asset protection tools designed to assist family members in the transfer of property to future generations. Block, Jarchow, Kammerlander, Hosseini, and Achleitner (2020) point out that owners of family firms in Europe demonstrate an increasing tendency to transfer their equity to family foundations, thereby creating a specific form of succession. Companies like Aldi, Bosch, Carlsberg and Ikea all have family foundations at the core of their ownership structure (Block et al, 2020). Germany, Austria, Switzerland and Scandinavian countries are examples of succession planning within family businesses being carried out through foundation-owned firms to avoid family conflicts and continue the development of companies after a founder's death (Block et al, 2020). Furthermore, Germany plays a significant role in the practice of family foundations (*Familienstiftungen*) and their use has become a widespread practice in important business sectors since the nineteenth century, for instance, Carl Zeiss AG as owned by Carl-Zeiss Stiftung established in 1889 and nowadays employing around 30,000 people (Panico, 2016). While family foundations have been recognized under the German Civil Code (*Bürgerliches Gesetzbuch*, BGB) since 1900 and used to exist even in the former German Democratic Republic (Panico, 2016), Liechtenstein’s legal framework on family foundations can be regarded as a groundwork and an example to any regulations adopted by family foundations in other civil law jurisdictions.

For the purposes of this study the researchers have made the distinction between family foundations and trusts, while focusing on the former for the reasons mentioned below.

Whilst the Hague Conference on Private International Law decided to include trusts in its agenda in 1980 (Overbeck, 1984) and the Convention on the Law Applicable to Trusts and on their Recognition (“The Trusts Convention”) was concluded on 1 July 1985, it remains largely a tool used and understood in the United States, the United Kingdom, Australia and other common law jurisdictions. It was the purpose of the Trusts Convention to address the institution of the trust, which was not recognized in the majority of the civil law countries (Overbeck, 1984). According to the Hague Conference on Private International Law (n.d.), a trust is formed when “a person, the settlor, places assets under the control of a trustee in order to fulfill a predetermined purpose or for the benefit of a beneficiary." Nevertheless, the efficiency of trusts should not be neglected. Barker (2023) suggests that Murdoch family trusts, which control such media companies as Fox Corporation and News Corp with USD 27 billion revenue as of 2022, have been effective for nearly nine decades, across five generations and numerous branches of the family in the United States, the United Kingdom and Australia ensuring continuity for the Murdoch family businesses.

Additionally, Latvia is not a contracting party to the Trusts Conventions and along with a civil law country such as Germany does not recognize trusts at all. Therefore, it does not seem feasible to analyze trusts as an instrument for family business succession in Latvia. Panico (2016) argues that trusts and family foundations are different legal models - trusts do not have legal personality, whereas family foundations can own property in their name and can be capable of acting, suing, and being sued.

2.4.1. Role of a founder. A family foundation is a legally autonomous entity established by a founder for a specific purpose, which owns inter alia equity shares of a company donated by the founder (Block et al, 2020). According to the new act on Family Foundations signed by the Polish president on 6 February 2023, Poland has established an effective legal mechanism to ensure protection of family assets and ensure family business continuity (KPMG, 2023) (Figure B.1).

Albeit a family foundation is a legal entity, it has no owners (family foundations have no shareholders) (Panico, 2014). The purpose of the family foundation is the most important aspect of the foundation, which influences its identity, maintenance, benefits and outcomes for its beneficiaries (Panico, 2016). Block et al (2020) indicate that under the German legal system the purpose of a family foundation is to exist indefinitely and typically it cannot be dissolved. In addition, there is an option to rule out the sale of the equity shares of a company belonging to the family foundation, thus leading to a "metaphorical designation of the foundation as the *main morte* (dead hand) of the founder" (Uhl, 2022).

A central role in establishing a family foundation is granted to its founder, who irreversibly transfers the assets into a foundation and terminates any ownership to such assets (Block et al, 2020). The authors will narrow down the transfer of such assets to equity shares of a company owned by the founder. A founder (or founders in multi-founder foundations) is at liberty to set up a foundation that corresponds to his or her wishes (Panico, 2014) by transferring founder's equity shares of a company to the family foundation upon its establishment. Ronovska and Pihera (2022) argue that the rights of the founder are inherently personal, as they cannot be transferred to another individual. Taking into consideration the previously mentioned Lichtenstein's pioneering legal framework for family foundations, it shall be noted that the founder can also be a legal entity. Hence, there is an option for a partnership to be a founder as well. (Panico, 2014). It must be noted that the founder has a vital role in establishing the aim for the family foundation and Panico (2014) argues that these could be regarded as powers related to establishing a constitution for a family foundation. Founders hold rights to appoint and dismiss management bodies of the family foundation, as well as supervisory bodies such as advisory committees and additional controlling bodies, which would supervise whether family foundation's assets are managed and appropriated in accordance with their purposes. When it comes to management bodies, founders are entitled to set strict policies. The Germany's well-known Haniel family (established in 1756 with 680 family members) is an excellent example of a situation where none of the family members are allowed to take direct part in any of the family's business activities since 1917 (Dominique, 2020).

2.4.2. Management of a family foundation. Panico (2014) argues that a council or management board is the most important body in a family foundation. Suess (2014) notes that the family foundation council is one of the most frequently used family governance mechanisms, which involves non-active family members in business matters and facilitates establishment of a family constitution, presides over family meetings, fosters a connection between the board of directors, top management and the family, determines payments to family members, and serves as a platform for managing the family foundation. Suess (2014) points out that a family council consists of a hand-picked group of family members, frequently spanning across multiple generations. Furthermore, the fundamental objective of such a council is to provide a structured platform that gathers information about family's requirements and principles concerning the family business, thereby developing policies that safeguard the family business. The family foundation council has the main responsibility to manage the equity shares of a family company entrusted to the foundation and to achieve the foundation's goal as set by the founder (Panico, 2014). In addition, the lack of shareholders and a very limited role of the beneficiaries in the family foundation creates “control deficit” in foundation's council in civil law jurisdictions, namely operative “foundation governance” structure must be created to guarantee appropriate management of the foundation and the advancement of its intended goals (Panico, 2014). According to Sacristan-Navarro and Cabeza-Garcia (2019), lack of proper family corporate governance lead the El Corte Ingles, a household name in Spain and a prominent player in the large retail store industry worldwide with more than 70 years of experience, to company's valuation problems and conflicts of interest among its family members. Sacristan-Navarro and Cabeza-Garcia (2019) suggest that a family council along with a family constitution would have prevented such problems for the El Corte Ingles. Moreover, it would have transferred the resolution of the principal-agent problems (majority and minority shareholders disputes in this case) at the company's board level to a family council without negatively affecting the company's image.

Suess (2014) supports the view that an establishment of a family council in the family foundation governance structure helps to circumvent principal-agency problems (in family business - type I agency problems: conflicts between owners and managers, and type II agency problems: on conflicts between minority and majority shareholders) and promotes stewardship behavior among family members (in family business - stewardship theory suggests that executives as family members have a strong commitment towards the family business and are highly motivated to promote family's and its business prosperity). Suess (2014) even proposes that family councils should be responsible for drafting a succession plan, selecting the most appropriate successor and be held responsible as to the attainment of succession.

2.4.3. Beneficiaries. Beneficiaries of a family foundation, in the majority of cases, are the founder's family members looking for beneficial interests from the family foundation (Panico, 2014). According to Article 552 of Personen- und Gesellschaftsrecht PGR (the Liechtenstein Company Law, articles 552 to 570 of this legal act are sometimes also referred to as the “Foundations Law”)

> “the beneficiary is deemed to be the natural person or legal entity that with or without valuable consideration in fact, unconditionally or subject to certain prerequisites or conditions, for a limited or unlimited period, with or without restrictions, revocably or irrevocably, at any time during the legal existence of the foundation or on its

> termination derives or may derive an economic benefit from the foundation (beneficial interest)” (Panico, 2014, p. 178).

It further derives from the Foundations Law that there can be entitled beneficiaries, prospective beneficiaries, discretionary beneficiaries and ultimate beneficiaries (Article 552 section 5 (2) of the Liechtenstein Company Law). An entitled beneficiary possesses a legal claim to benefit from the family foundation assets or foundation's income, whereas as a prospective beneficiary has a legal claim to acquire an entitlement to a beneficial interest after occurrence of a condition precedent after exclusion of a prior-ranking beneficiary (Panico, 2014). According to the Civil Code of Switzerland governing Swiss Family Foundations, beneficiaries may be entitled to what Panico (2014) call “contingent” beneficial interests such as educational disbursements as support for family members (Peter, 2020). In Germany beneficiary family members can also receive benefits from the family foundation without preconditions (Uhl, 2022). The family of the founder can receive ongoing support through a family foundation, which allows them to benefit from the family business company's dividends (Block et al, 2020). Panico (2014) notes that the beneficial interests are established by the founder and no other body of the family foundation is entitled to change the beneficiaries. The Foundations Law also specifies that a foundation's council can be given power to provide special beneficial interest to discretionary beneficiaries (as specified by the founder), and in case of liquidation of the foundation to distribute remaining assets to ultimate beneficiaries (Panico, 2014). An important concept regarding the beneficiaries is that they do not have

> “proprietary interests in the foundation assets but only the equivalent of a claim in debt or in specific performance, to the extent that such entitlement results from the foundation documents or from a resolution of the competent management and control bodies. As a general rule, the assets of a foundation cannot be attached, seized, or otherwise taken in execution by the creditors of the founder or of the beneficiaries” (Panico, 2014, p. 284).

3. Methodology

This section will cover three crucial aspects of the authors’ research: sample of companies, research method and limitations of the research.

3.1. Sample of companies

Family businesses were chosen for examination. The market consists of several players of large size. Emphasis was put on Latvia's largest and most successful family businesses as they have expertise many entrepreneurs in Latvia are yet to encounter - preparing to transfer the business ownership to their heirs.

The potential company sample was selected based on two main sources: rankings of the wealthiest families in Latvia in 2021 and 2022 according to "Dienas Bizness", a weekly business magazine in Latvia (founded in 1990, primarily covering business and economic news and considered to be one of the leading business publications in Latvia with a significant readership among local business professionals, investors, and decision-makers) (Lapsa & Bormane, 2021) (Lapsa & Bormane, 2022) and the authors' personal contacts.

The researchers have selected purposive (non-probability) sampling to collect data and answer the research question. The number of large and well-established Latvian family businesses that have been operating for decades is limited. Therefore, purposive sampling is the most suitable method for this particular study.

Furthermore, two main criteria for choosing sample companies were taken into account:

- Age of the organization: companies had to be founded in the 1990s to qualify, as newer companies are yet to experience passing their businesses on to a younger generation;
- Well-established organizations: companies with an established brand were chosen for this study - family companies that have been operating successfully for a long period of time ensure accurate and credible data is collected.

The authors used their personal contacts when selecting the sample companies to arrange the interviews as the discussion topic is sensitive and is part of respondents' personal life and family relationship. Moreover, all of the business representatives who agreed to have interviews were ready to do that only under the confidentiality agreement. Authors are not able to disclose any particular details regarding the name and industry of a company represented.

3.2. Research method

Researchers utilized semi-structured interviews as a data collection method and gathered qualitative data from the participants. According to Hammarberg, Kirkman, & de Lacey (2016), qualitative data is required to answer research questions regarding experiences, views or beliefs from a participant's perspective. Thus, qualitative data is subjective in nature and does not represent the general public. Since research attempts to comprehend the approach of each family business towards succession planning and challenges it is facing, semi-structured interviews and collection of qualitative data was a vital part of this study.

The research question is composed of three main areas of study: investigating and evaluating to what extent sample companies have considered or planned succession, how various internal and external factors impact family business and whether the sample organizations would be willing to set up a structure to ensure their family business succession. Based on these areas of study, a number of questions were developed to evaluate the significance of succession planning in various family businesses based on the De Massis et al (2008) factor structure:

(1) Succession planning - approach, the extent to which plans are devised, instilling company's core values in the next generation;
(2) Characteristics of future leaders and selection process. Motivation of the future successor;
(3) The role of the younger generation within the company - how are future owners of the business involved in it today;
(4) How were the other stakeholders (within or outside of family) been involved and communicated during the succession plan execution;
(5) Disagreements within a family business - disputes and suggestions for resolution;
(6) Challenges companies face as family businesses - internal and external;
(7) Importance of the business and brand continuity;
(8) Attitudes toward succession planning model suggested by the authors.

After answering the questions, the authors had the opportunity to ask additional questions to gain better insight about the issues discussed during each interview and for respondents to share any additional information they believe would be meaningful to the research.

Interviews were conducted by meeting with family business founders in person, via video meetings and phone calls. Interview questions were identical for all companies.

3.3. Research limitations

Every research has limitations that may impact its findings and results. In this particular study, the authors have to be wary of businesses attempting to put themselves in the best light and underrate any challenges or threats they face. Another limitation the authors must take into consideration is unwillingness of the interviewed respondents to disclose any information that can potentially portray them in an unfavorable light.

4. Analyses of results

The authors approached nine family businesses and conducted nine interviews with family business owners, who are also board members in their family firms.

The interviews were conducted taking into account the De Massis et al (2008) five factor model that has an impact on potential failure in succession.

4.1. Succession plan

The first questions were asked in order to establish whether the family business owners had developed a succession plan, understand reasons for postponing the succession planning (if that was the case) and learning as to the understanding of a right moment in having a succession plan in place. “I have been thinking about it and on the one hand I could say that I have a succession plan” (Interview 8). Interviews demonstrate that there is a general understanding that family business succession should be addressed. “I have an idea that at some point in time something should be somehow structured with my successors and frankly speaking I have told them about it” (Interview 2). Family business owners are also of the opinion that starting succession planning is related to having a solid and profitable enterprise. “An entrepreneur needs to start planning succession when he understands that his business is worth something.

There is no point in offering a sinking boat, which your kids would be ashamed of" (Interview 2). In regards to family businesses in Latvia, family business owners point out that having a skillset related to capital formation influences family business succession planning initiatives. "If you are not trying to see opportunities in transferring the business to your children, then the capital will simply not form here [...] we have not had opportunity [due to historical reasons] to facilitate capital formation, and now it is important to maintain entrepreneurial knowledge and skills for further capital transfer" (Interview 8).

All of the respondents had a positive attitude towards succession planning and a sense of how to facilitate it. However, none of the respondents had an effective succession plan in place, which could be implemented to ensure family business continuity. "It has not been written on a paper, but I am acting according to it. There are no detailed regulations in place" (Interview 8). "In fact I would need to do something about it. I will seek an appointment with [...] as my lawyers to discuss the options" (Interview 4). "I have been thinking about it and I am going to see [lawyers] to discuss the succession planning" (Interview 2).

A mere understanding of a family business succession was the introduction of the second generation to family business by either employing the generation at the family firm or facilitating interest by showing a good example of conducting a family business. "We supported this specific profession, introduced and employed our son at the firm, and we supported his choice to join the family business" (Interview 3). Encouraging and supporting relevant education was seen as a factor promoting interest in family business. "Our family business developed because we supported educational choice, which was the same as ours" (Interview 3). "Education is very important. One should also focus on education as a process - what people [your successor] meets and in what environment he is educated" (Interview 8).

All of the respondents admitted having granted at least one member from the second generation a seat at the board level of a family business firm. "My successor is already a board member of a few of the group's companies and also manages several branches" (Interview 5). "My oldest daughter is a board member, and she works very hard" (Interview 2).

However, most of the respondents had not introduced the second generation to the shareholding structure and executed appropriate legal documentation, for example, specific by-laws allowing a clear transfer of the ownership to the second generation. "I have an idea that at one moment [when I pass away] my 60 % shareholding of the company could be split between my three children in equal 20 % shareholding" (Interview 2). "Our Civil Law says something and I assume it will happen accordingly" (Interview 5).

4.2. Five factor analysis

All the respondents have admitted that process factors are the key factors that influence success in family business succession planning. Interviews revealed that family business owners have been identifying and assessing potential successors within a family business by observing their entrepreneurial behavior and assessing their interest in a family business. "I have never pushed any of my kids to be involved in the business, but at some point they realized on their own whether they wished to be involved and whether they were interested in the business specifics" (Interview 5). On the other hand, the motivation for children to get involved in family business stems from being present in conversations from an early age at home regarding the business success and challenges. "Kids were always part of the family discussion regarding the business and early on I had an opportunity to observe which of them had an interest and will to engage" (Interview 4). "Our kids were just in the right entrepreneurship environment to choose our family business" (Interview 3).

Most of the respondents had demonstrated rational and objective criteria for choosing a successor. According to De Massis et al (2008) it is important in order to avoid conflicts and jeopardize the succession process. Interviews revealed that communication and leadership have been identified as the most important skills of a successor. Most of the interviewed family business owners stated that these were the key factors for a successor's involvement in the business - being able to communicate with the stakeholders internally, as well as externally. "I evaluated character, leadership capabilities, and communication skills, [he] had these qualities [...], [his brother] did not" (Interview 3). "I have recognized these qualities in my oldest daughter, who is already a board member. She has communication skills. On the other hand, her sister cannot be a leader" (Interview 2). However, the interviews revealed that the criteria for choosing a successor have not been formalized in any way. According to De Massis el al (2008), it can cause other potential successors to consider the successor's selection process as unfair, thus leading to future conflicts.

The family business owners have admitted that investing a considerable time and effort in the preparation phase for successors is one of the key elements to ensure a successful transition in a family business ownership. “When I sent my son to study in the United States for five years, I recognized that it was also an investment in our future success” (Interview 6). Family business owners entrust specific roles within a company to successors in order for them to learn the craft of a family business, as well as to gain respect in the family business firm from non-family members. “She is very good at procurement, a “procurement girl” as I call her. Our employees see and value it” (Interview 2). “We both saw that she was good at business management, I entrusted her with this role and now she is already running several of our businesses” (Interview 5).

Based on the responses received, the relation factors are of minimal concern to the family business owners as they seem to manage such factors by either making strong declarations or not seeing such factors as risks. “When my son was born, I simply went to the office and told everyone that a new CEO had been born at 6:30 that morning” (Interview 6). Several responses also demonstrate that entrepreneurs do not see a need at all to consult with non-family members as having a family business in itself for them means that decisions are made among the family members only and non-family members are expected to completely respect such approach. “Everyone has their own place and non-family members shall have no say in the family business” (Interview 3). “Only family members make executive decisions; taking into account our age we might resign as board members and appoint a successor [a family member] as a new board member” (Interview 5).

Since Latvian family businesses are facing first generational change, it could be argued that specific risks have not yet materialized and incumbents have not had conflicts of relation factors at all or the conflicts have been easily managed. “Profit distribution and investment in business development have been the most common causes for disputes, I have managed them with my simple majority and my resistance to money spending for personal expenses” (Interview 5). However, it is worth mentioning that respondents foresee further conflicts and competition between family members after an incumbent’s death, which at the same time does not seem to be of a great concern to the family business owners: “There are not only kids, there are grandchildren as well; I do not know, everything is possible, but I do not have any conflicts” (Interview 9). No conflicts and competitions were reported between incumbents and successors during the interviews. The interviewed family business owners were repeatedly referring to great communication skills of their successors. In their opinion, such skill may serve as a risk mitigating factor to solve any succession conflicts after an incumbent's death both between family members and with non-family members.

The interviewed family business owners did not see that any financial factors have a potential to intervene with or be any burdens to family business succession. Namely, any inheritance taxes and related costs were not seen as factors that could prevent a family business succession. Although initial responses were that family business owners have not been thinking about such financial factors, more detailed inquiries demonstrated that entrepreneurs are not concerned about taxes and costs applicable in a succession process. “Our tax system is very convenient right now and the state has not paid any attention to issues of succession through inheritance” (Interview 8). The interviewed sample also shows that family business owners have not considered how financial factors would influence succession once some of the heirs would be willing to sell their shares to those heirs intending to stay involved in the family business. In other words, whether and how these heirs remaining in the family business would be able to afford to purchase these shares to prevent selling them outside of the family. Based on the interview data, financial capacity of the heirs is seen as their own responsibility by the respondents, as they have supported all the heirs and respected their choices in regards to the level of involvement in the family business. “It was their decision not to be involved in the family business. They have chosen to do other stuff, which I have supported in other ways both financially and non-financially” (Interview 7). It is essential to note that none of the family business owners in the sample had considered limiting or excluding any of the heirs from participation in the succession.

Based on literature review it was also recognized that individual factors have considerable influence in a family business succession. During the interview process no evidence of any individual factor occurrences were reported by the family business owners. Family business owners either have invested in the education of their successors or have been involving them in different aspects of the business, thus trying to minimize the risk of low competence of the successor. “You need to be a role model, make investments in development of needed skills, involve them in sports to facilitate competition and, of course, education is very, very important” (Interview 8). “While the eldest son is pursuing core activities, I am allowing the youngest one to look into new business opportunities, let's see how it develops” (Interview 6). The common pattern observed in interviews is that the family business owners pay attention to the motivation of a successor, which is one of the main criteria for a successful succession. The interviewed sample shows that motivation tools for successors range from simple words of encouragement and entrusting specific roles within a family business from an early age to board seats at the family business company. “I have a final say in strategic decisions. My daughter has been an empowered board member for 10 years” (Interview 7).

During the interviews there have been no mentions regarding situations with an unexpected loss of a potential successor (sudden death of a successor) and no issues reported about possible divorces, remarriages and new offsprings that could impair succession.

Context factor has not been mentioned during the interviews as a risk factor. The interviewed sample demonstrates that even the companies, which had gone through the business transformation and change of the strategy, had not considered this as an open risk in terms of succession. “I simply have never thought about it” (Interview 1). It was the most common response. The interviews suggest that the family business owners have been mostly focused on business development, presuming that a successor (as already being involved in the business) was less likely to step out due to changes in business or industry. “I just decided to change the business model and it worked” (Interview 7).

4.3. Execution of succession

According to the interviews, there are no objections for an existence of family business in perpetuity, while at the same time there is no evidence from the interviews suggesting that family business owners would be planning beyond a mere transfer to a next generation. There is a clear trend deriving from the interviews that family business owners have been postponing an actual execution of a succession plan and have minimal or no knowledge at all about legal framework, which could be used to execute a succession plan. Throughout the interviews it was clear that there is also no legal astuteness as to risks involved in cases of inheritance process itself and disputes related to such process. Respondents demonstrate a strong understanding in obtaining legal advice shall it be necessary to execute a proper succession plan: “I have not had time yet, but I must do it with the help of my lawyer” (Interview 4). Whilst most of the respondents referred to various family business and related successions in Latvia when speaking about their family businesses, one of the respondents specifically made a reference to a publicly discussed inheritance case, which had triggered a succession planning initiative: “Olainfarm [Olainfarm AS, one of the largest companies in the production of medicines and chemical pharmaceutical products in the Baltic states] situation opened our eyes and we understood that something needs to be done” (Interview 7).

Some respondents demonstrated a general knowledge of family business foundations, while at the same time not being aware of any specific details other than naming family business firms using such legal frameworks for succession planning. “There was a broadcast about Ikea and I understood that they were using the family foundation for succession purposes” (Interview 6). “My colleagues in our industry in Germany at [...] and [...] have these family foundations, I know that they have structured their businesses through family foundations, but I am not aware of how exactly this works” (Interview 9). There were also misleading conclusions about use of the family foundations: “I think they are used for tax avoidance or optimization purposes” (Interview 1). One of the respondents explained that they had established a trust in a remote country to partially deal with succession issues, but revealed that they would definitely use a family foundation structure if that would be possible or they would have more information about it: “The trust is something what we fully do not understand, it is very complex and expensive, but most importantly - registered far away without any tangible touch or feeling” (Interview 7). The interviews confirm a strong willingness for family business owners to pursue implementation of a succession plan through a legal framework of a family foundation, confirming such intentions with saying “I am the first in” (Interview 2), “definitely interested, please send me information” (Interview 7), “I support such structures” (Interview 4), “very interesting, we need this” (Interview 3), “this would very good, interesting … it would not be possible without a law that defines aims for [family foundations]“ (Interview 9). The respondents were given a brief explanation on the legal framework of family foundations and how such foundations can help to ensure family business succession, exemplifying with recognizable companies and brands in Europe like Aldi, Bosch, Carlsberg, and Ikea (Block et al, 2020).

In conclusion the respondents were also asked to comment as to the reasons for struggling in terms of succession in Latvia. The interviewed sample acknowledged that there was no experience and knowledge on the topic. “I simply do not have an understanding on this topic” (Interview 4). “Nobody has ever explained or taught me anything about the business succession, I do not even know where to ask these questions, perhaps a legal office” (Interview 1). Historical aspects were also mentioned as causing low rates of succession: “We do not have any legacy as we have been building our business culture from scratch” (Interview 8). “We simply do not have these traditions yet” (Interview 3). Family business owners also suggested that active social involvement could help to raise awareness about family business succession in Latvia: “I really think that somebody needs to start talking, explaining, promoting and training the business owners on this important topic” (Interview 7). “I am wondering what the ways would be to start a discussion about it … not only in Latvia, but in the Baltics” (Interview 9). The comments from the respondents and final discussions implicated that succession is an important topic for them and may impact family business continuity, as well as prosperity of a family in case a succession is not carried out properly.

5. Conclusions and recommendations

The main aim for this thesis was to examine issues that are impacting family business succession and to identify factors, which would support the family business succession in Latvia. The interviewed sample shows that family business owners are aware of the succession as such. However, they do not treat it as a systematic process. Whilst the family business owners entertained the idea of having their business in perpetuity due to their emotional connection and devotion to the family business, the respondents had not considered the existence of their business in a third generation or beyond. There is no actual succession plan in place for any of the companies in the selected sample. A mere unilateral selection of heirs and entrusting them with various responsibilities in the family business mostly constitutes succession for the interviewed family business owners. Research about the interviewed companies shows that the family business owners demonstrate understanding towards process factors and treat them as succession. The respondents were also content with successors' competence and motivation issues (two of the individual factors) since they had involved successors in the family business and facilitated their education.

Family business owners are disregarding other individual factors (unexpected loss of a potential successor and divorces, remarriages and new offsprings) and underestimating serious consequences of relation factors (conflicts and competition with successors and between family members, lack of support for the successor from the family and non-family members). The interviewed sample also demonstrates that financial factors have not been considered (save for taxation) and these factors are mostly regarded as heirs' individual responsibility. Although context factors (changes in business performance, model and scale) are relevant to succession, the interviewed sample is not suggesting their importance for the family business owners.

The respondents are not prioritizing succession planning and postponing it. Family business owners are also disregarding potential risks of business disruptions in case of their incapability to run the family business or in case of their sudden death.

The authors of this study conclude that the main reasons family business owners in Latvia lack a succession plan are the following:

(1) missing knowledge in the particular field;
(2) absence of a specific legal framework for family business succession planning.

Family firms are one of the most prevalent business forms in the world. Family businesses make up more than 30% of all companies incorporated in Latvia, which indicates that there is a need for specific knowledge in managing the family firms, establishing and executing the succession plans, as well as securing the wealth of the family businesses. The authors suggest that special educational modules in Latvian business schools (or even secondary schools) should be dedicated to this topic in the future.

Instantaneous educational awareness on family businesses is being delivered by the family business institutes established in developed countries, which provide research, education, and knowledge-sharing to family businesses. The authors note that during their research Baltic Family Firm Institute was established in December 2022 to educate family businesses in the Baltics and support their business succession to next generations. Through its activities such an institute is a great start in bringing understanding to family business owners in the Baltics on the importance of succession planning.

Whilst the research on “family boundary organizations” and their effect on family businesses is still scarce, the authors' study suggests that without a special legal framework it is not feasible to consider an effective family business succession. Moreover, the interviewed sample suggests that such a legal framework would even facilitate succession planning for family businesses in Latvia. Namely, a special law on family foundations in Latvia would enable family business owners to initiate succession planning processes and align their current business structures for intended succession, bring protection to family assets, secure growth and safeguard continuity for their family businesses.

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7. Appendices

Appendix A. The 3-Circle model

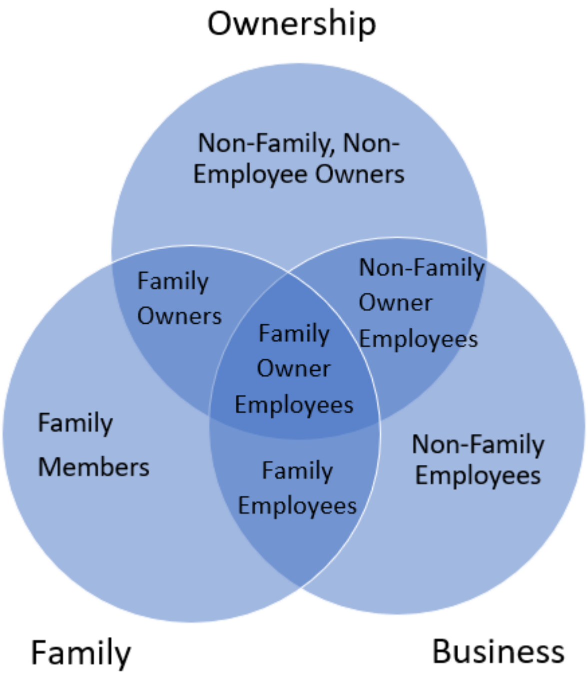

Figure A.1 the 3-Circle Model of the Family Business System (Davis, 2019)

Appendix B. Family foundation setup

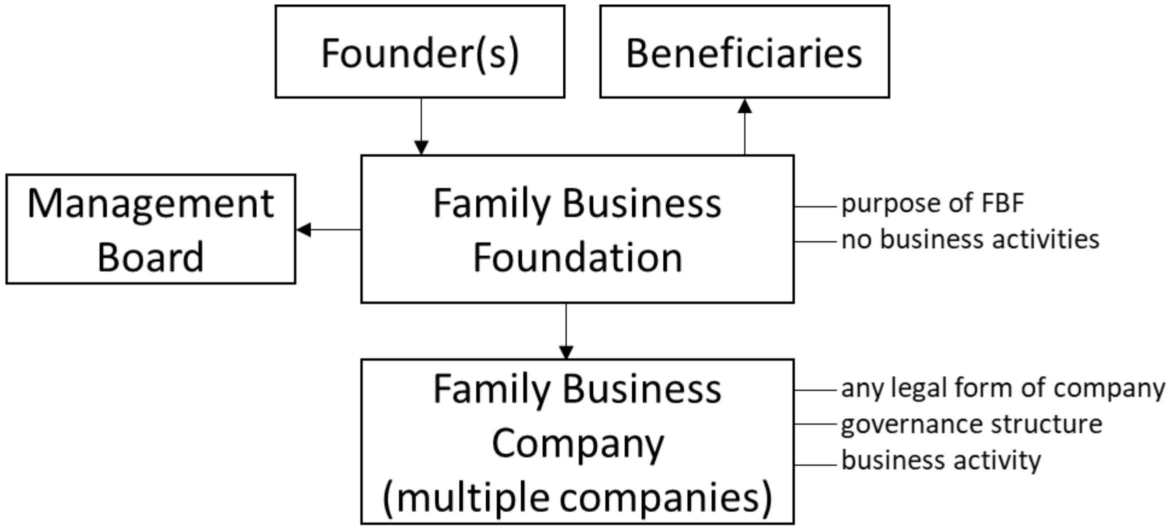

Figure B.2 Structure of a family-foundation owned firm in Poland. Created by authors.