SSE Riga Student Research Papers
2024 : 8 (271)

SUCCESSION DYNAMICS IN LATVIAN FAMILY FIRMS: EVALUATING THE IMPACT ON FINANCIAL PERFORMANCE

Authors: Ričards Agapovs
Roberts Andersons

ISSN 1691-4643
ISBN 978-9934-623-22-6

May 2024
Riga

Succession Dynamics in Latvian Family Firms: Evaluating the Impact on Financial Performance

Ričards Agapovs

and

Roberts Andersons

Supervisor: Anete Pajuste

JEL codes: G32, D64

May 2024
Riga

COPYRIGHT DECLARATION AND LICENCE

Names of the authors in full: Ričards Agapovs, Roberts Andersons

Title of the Thesis: **Succession Dynamics in Latvian Family Firms: Evaluating the Impact on Financial Performance**

We hereby certify that the above-named thesis is entirely the work of the persons named below, and that all materials, sources and data used in the thesis have been duly referenced. This thesis – in its entirety or in any part thereof – has never been submitted to any other degree commission or published.

In accordance with Section 1 of the Copyright Law of Latvia, the persons named below are the authors of this thesis.

Pursuant to Article 40 of the Copyright Law the authors hereby agree and give an explicit licence to SSE Riga to deposit one digital copy of this thesis in the digital catalogue and data base at SSE Riga Library for an unlimited time and without royalty. The licence permits SSE Riga to grant access to the duly deposited thesis to all users of the catalogue and data base without royalty and limitations to downloading, copying and printing of the digital thesis in whole or in part provided we are indicated as the authors of the thesis according to Clause 4 Section 1 Article 14 of Copyright Law. We assert our right to be identified as the authors of this thesis whenever it is reproduced in full or in part.

_____/Signed/_____ _____/Signed/_____

Ričards Agapovs Roberts Andersons

Date 06.04.2024

Abstract

This is the first comprehensive study done on Latvian family firms and their transitions over the previous decade. In this research, we compare the financial performance of firms after succession depending on the type of transfer: to an outsider or within family, in Latvia during the period 2010-2020. We find evidence that 3 years after the transfer, regardless of the type, the performance is significantly worse in terms of Sales Growth and ROA, yet there is no evidence that this effect would be related to a specific type of ownership change. We document the characteristics of the transfers for both transfer types and notice that for the period 1993 – 2023, there was a steady increase in the number of transfers to outside family up until 2013, after which there has been a rather sharp decline. Interestingly, no such big decrease has been observed for within-family transfers.

STOCKHOLM SCHOOL OF ECONOMICS
SSE RIGA

Table of contents

1. Introduction 5
2. Literature review 7
2.1 Family Businesses 7
2.2 Socio-economic wealth theory 8
2.3 Agency Theory 10
2.4 Succession 11
2.5 The Baltic Region 14
3. Data and methodology 16
3.1 Type of ownership 16
3.2 Family firm and transfer definitions 16
3.3 Data sample 19
3.3.1 Source 19
3.3.2 Variables 19
3.3.3 Sample 21
3.4 Regressions 22
3.5 Robustness Control 23
4. Analysis and discussion 24
4.1 Descriptive Statistics 24
4.2 Results and Discussion 30
4.3 Limitations 34
5. Conclusions 35
6. Acknowledgement 37
7. Reference list 38
8. Appendices 42

STOCKHOLM SCHOOL OF ECONOMICS
SSE RIGA

1. Introduction

It has been observed around the world that the majority (in the range of 70-80%) of the economy consists of family-owned firms (Groysberg and Bell, 2014). European Family Businesses (n.d.) state that those businesses account for around half of all jobs that are available in European countries, which means that even a slight change in the way this part of the economy operates may have serious ripple effects on society at large.

As mentioned by many authors (Alayo et. al., 2016, Wennberg et. al., 2011, Morris et. al., 1996), one of the key events in the existence of a family firm is succession, which in the case of Latvia, is just starting to happen. Klotiņš and Skrinda (2023) in their recent research state, that this is a new kind of process for the region's business environment, for which there is yet to be set-up a proper system to help the businesses successfully transfer the ownership further down to the next family member. Baron, J. (2021) writes in an article for the Harvard Business Review that "on average, the data suggest that family businesses last far longer than typical companies do", and that the "conventional wisdom of the three generations" might not be entirely accurate. Those who have managed to become successful, typically stay wealthy for far longer than just the three generations, which would be the expected lifetime by convention. This means that on average the company that becomes successful lasts significantly longer than the expected 20 years (McKinsey & Company, 2019).

One of the major changes that most businesses go through at some point is a transfer of ownership (Amran and Ahmad, 2010). Family-owned firms typically differ from the rest of the companies in characteristics such as age, adaptability, risk factors, and many others (Vieira, 2014), as they might value emotional wealth more than monetary one. Family businesses are typically smaller, implying that a change of a single person, especially if it happens in the management, will most certainly have an effect on how the rest of the company operates. There appears to be relatively more research suggesting that family–owned firms tend to outperform the rest (Zhou et al., 2017, Lohwasser et al. 2021), however, the evidence does not seem conclusive. Avrichir (2016) also notes that both family firms and non-family firms react differently to various economic shocks or changes in the business environment, leading to possibly diverging decisions given the exact same conditions.

Looking only at the type of company leaves out many potential contributors to the financial results, which is why we attempt to seek answers by looking into how different types of successions impact the performance of the company.

When looking at the existing literature, there seems to be some contradicting evidence in terms of effects after the succession has happened, along with its' many different attempts of explaining them. For example, research from the Asian region seems to suggest a positive impact in cases where the successor is a family member (Chen et. al., 2021, Yeh and Liao, 2021), while Europe seems more neutral or even negative (Cucculelli and Micucci, 2008, Wennberg et. al., 2011). There also seems to be even less research done about what happens after a change in ownership, depending on the type of succession: if the new owner is a family member or an outsider.

It is important to have an insight into what is currently happening in the landscape of Latvia's family businesses to have a better understanding of how to help them develop further, which is why we look into how the financial metrics are affected after a change in ownership depending on what type of successor it is. In this research, we use a method that has been used before for a very similar topic, which focuses on family firms in Sweden (Wennberg et. al, 2011). Wennberg et. al (2011) find that profitability measured by earnings before interest and tax (EBITA) as well as sales growth are higher for family-owned companies. To be more precise we use EBIT margin in our research.

The Baltic region with Latvia as our target country is quite young, as no business was privately owned prior to 1991, which means that we are currently just starting to see the first generational transfers. Importantly, there also appears to be no previous research on the differences in financial performance, based on ownership type, in Latvia, which is why in this paper we add novelty from our side, by filling this gap in the literature through exploring our main research question:

Does the type of successor (family member or outsider) have a significant impact on the financial performance of family firms in Latvia?

2. Literature review

To find out if there are differences in firm performance, we take a look at existing research for firm characteristics in the case of it being a "family firm." For this, we look into theoretical framework via such concepts as the "Socio-Emotional Wealth" (SEW) theory and "Agency Theory". Then we look into research regarding the differences in financial performance after a change of ownership for firms, depending on its type in other countries. After that, we explain the novelty by providing reasons as to why Latvia might have its unique challenges when exiting the business from the owner's perspective.

2.1 Family Businesses

Family-owned and controlled businesses generally make up most of the countries' GDPs, in Europe that is somewhere in the 70-80% range (Groysberg and Bell, 2014). It is also these types of businesses that provide most of the jobs (European Family Businesses n.d.). Interestingly, most often it is not a group of big companies, but rather a large collection of small or medium enterprises (further SMEs) that compose the bulk of the European economies. The precise description of how we classify "family firms" and the different types of ownership transfers can be seen in section 3.1.

In terms of differences in performance, depending on the firm's type, Zhou et al., (2017), and Lohwasser et al. (2021) suggest that generally family firms tend to outperform the rest of the companies. However, conclusions should be drawn carefully, as Zhou et al., (2017) indicate that in different conditions, family and non-family firms might react differently to economic shocks or changes.

One of the major differences for family businesses is the tendency to fall into nepotism, which gives an advantage in the form of favoritism to relatives over other candidates during the hiring or promotion process (Bertrand and Schoar, 2006). They state that while this is beneficial in some way to the owner of the company, as they "derive utility from seeing relatives involved in the business", it might act as a demotivating factor for the employees at a lower level. Dyer (2018) also comments on this issue that nepotism is something that prevents the company from

successfully expanding, as not having professional management that is equipped with the necessary skills to move the business further, can lead to worsening the firm's performance. He points out that the more family members are associated with the management, the worse the financial performance gets.

In his research Perez-Gonzalez (2006) finds that appointment of a related "Family CEO is associated with about an 18 percent decline in return on assets and a 14 percent decline in market-to-book ratios in the three-year window after the succession event". Perez-Gonzalez (2006), also does point out that the reasons for differences might be explained by such factors as education of the firm's current decedents or the general structure of how the company is run. On a similar note, Bertrand and Schoar (2006) also attempt to bring clarity as to which factors might be at play when determining the company's success after succession, suggesting that "the cost of wanting to build a family legacy" might be the loss of financial performance "today". They mention that preserving family control at any cost is often the strategy, thus leading to potential financial problems eventually.

We notice that there are many opinions as to whether family control is beneficial or troublesome, as even the reasoning is sometimes completely different for those who argue for the same effect. This suggests that true effects might be more nuanced than just the association with being related to the founder/current owner.

2.2 Socio-economic wealth theory

It must be acknowledged that typically these types of businesses have slightly different core values than the rest of the field. The socio-economic wealth (SEW) theory is one of the theories that attempts to explain how those differences impact the firm's financials. One of the main differences is the focus on the long-term goals and the survival of the company, rather than trying to make as much profit as possible in the short term (Gallizo, 2017). In their research, they look at Spanish businesses, and they find that the SEW theory indeed still stands: the companies are willing to give up their profitability at the cost of keeping control, prestige, or reputation and having much higher prioritization on keeping the business "personal".

Gallizo (2017) also highlights that the decisions made may not always make financial sense, as there might be cases where in the need of protecting the reputation of the family, financial losses must be taken. Bozer et al. (2017) state that this does not inherently imply bad management, but rather an assessment of benefits and drawbacks. As they further point out, many perspectives, such as "cohesive culture", legacy perseverance, and reputation must be taken into account when talking about "success" in terms of keeping the family-owned business running.

However, we also find literature that suggests that there is still some grey area that needs to be explored, as SEW theory would suggest an inferior financial performance for family firms, yet it is not necessarily always the case. For example, Martin and Gómez-Mejía (2016) in their work point out, that "paradoxically, several reviews and empirical studies show that if anything, family-controlled firms tend to outperform non-family-controlled firms". Martin and Gómez-Mejía (2016) suggest that while some aspects of the SEW, that are related to self-esteem or reputation, might impact the firm's finances negatively, others, such as commitment or vision, might bring a positive effect.

Dyer (2018) in an article even says that family and non-family businesses are not really comparable. He stresses the point that family CEOs (Chief Executive Officers) would see the enterprise as successful if the "socio-economic wealth" is high, even if the finances are modest. He also mentions that some aspects such as "Identification of the firm with the family" or "emotional attachment", while characteristic for family firms, might ultimately be positive drivers of the firm's performance nonetheless.

Another reason mentioned by Dyer (2018) that is potentially helpful to the family firms is that when the companies grow, they naturally need more people employed, which means more people need to be aligned, which is often costly as mentioned by Kallmuenzer (2015), yet if the family works together and can solve issues "in harmony", they tend to outperform their counterparts in specific circumstances. The implication is that it is still not a guarantee that the performance will always be significantly better for family firms, yet now there are opportunities for that to happen.

2.3 Agency Theory

Another theory that is often listed in research regarding family businesses and attempts to explain the reasons for inefficiencies in firms that would be classified as family-owned is the Agency Theory. Kallmuenzer (2015) describes this theory from a couple of viewpoints. He alludes to the theory as trying to understand "problems of cooperation, such as asymmetric information, uncertain outcomes, the question of the usability of incentives, and the identification of risks in decision-making." He notes that with every additional person that works for the business, there is a risk of additional agency costs, which are costs that arise due to the management and the employees, or the founder and other family members, not being aligned in terms of higher level goals and ways of achieving them. Perez-Gonzalez (2006) suggests that it could be agency costs, that can seriously affect the company's financial performance, as having the CEO appointed as a family member would eliminate the need for "aligning" the interests. Conversely, in his own research Perez-Gonzalez (2006) finds that it is only the unrelated CEOs, that get appointed, who correlate with positive returns 3 years after the succession.

Lim et al. (2010) in their work also point out that the reasons why some of the operating inefficiencies might arise might be connected to ownership dispersion. They state that in the case of "Sibling partnerships" or "Sibling rivalries", where the ownership is dispersed approximately in equal proportions, troubles might arise when big and important decisions need to be made, as there often is not a "clear controlling owner" who would have the final say. The structure of the company often is set up in a way where efficiency is not a consideration, as mentioned by Bertrand and Schoar (2006).

It also might be the "information asymmetries", which also play a role when making decisions about the business (Zogning, 2017). It is often the case that shareholders who are not within the family circle are not competent enough to "know whether a transaction will serve their best interests or those of the managers" (Zogning, 2017). Such incompetencies and lack of knowledge would likely be lower in cases when the owner is a family member who understands the business well.

Again, we see that there seems not to be a clear answer from these theories either. To try to bring some clarity on this issue, we look at the evidence in the Latvian market and how it might be different from more developed Western countries.

2.4 Succession

Prior studies around the world during at least the last 30 years are in agreement that the transfer of ownership to the next generation, known as succession, is one of the most important events in the life of a family business (Handler, 1994, Aladejebi, 2021, Alayo et al., 2016). The aim is to ensure that the business can survive beyond the founder and bring wealth to the family owning the business.

It is often the case that family firms often neglect succession planning (Bozer et al., 2017) as it does not appear necessary while everyone is busy doing their daily duties. This can be problematic in and of itself, as the succession is not always a planned one. Especially in cases where the founder dies and there is not a clear plan set up of how to act, keeping the business running can prove to be a challenge. Morris et. al. (1996) state that while the succession planning is not always formal, it does not mean it does not exist. They find that sometimes companies feel that formalizing those plans may affect personal relationships negatively. Still, it cannot be ruled out that such processes are avoided because they are not pleasant.

According to Klotiņš and Skrinda (2023), the issue of succession in Latvia is exacerbated by the fact that the systems that should be helping the companies to go through this process, have not been developed to the level that would be proficient yet. Consequently, this can influence the short-term (a couple of years) financial performance as the main focus is on transferring ownership, not developing the business itself.

Research that focused on "studying the impact of the founder–chief executive officer succession in a sample of Italian firms" by Cucculelli and Micucci (2008) concludes that keeping the management within the family actually decreases the performance metrics. In their work they look into the differences between two types of family-owned companies: those who are still run by the founders (founder-run companies) and those, who are owned by a family, but no longer

have the founder in the management (others). They suggest that the family firm's superior performance conclusions from other research might be primarily driven by the founder-run companies, which in turn balance out or even outweigh the negative effects that are associated with family management. Cucculelli and Micucci (2008) do note that there might be a "market for corporate control" that could help deal with problems not recognized or ignored on purpose, which would suggest introducing a CEO from outside the family, relating to the Agency theory described in section 2.3.

At the same time, a relatively newer work on Swedish companies done by Wennberg et. al (2011) that focuses on the change of ownership instead of management, finds that intra-family transfers lead to considerably higher survival rates than those who are transferred externally. They also find that family ownership is a major factor that impacts the financial side of the company. In their research, they not only provide evidence that their chosen metrics of profitability: EBITA (in our research we use EBIT), and sales growth, seem to be higher for family firms, but also note that the variance of those metrics is significantly higher.

While both Cucculelli and Micucci (2008) and Wennberg et. al (2011) in their research use a rather limited amount of control variables and acknowledge that their work might not be completely free of biases, which might result in distortions in the conclusions, it appears that succession still might be of vital importance for the company's success and still is a topic that should be explored deeper.

While we focus on the previously mentioned research the most, other researchers have come to different conclusions on which type of succession is best, each having a slightly differing characteristic, yet all of them attempting to answer the same question. To better understand the existing literature, 8 of the previous works have been summarized in the table below (*see Table 1)*. In all of the research the method of choice for analysis after the initial data collection has been regression analysis, where authors in almost every case used difference in differences approach to see if the variables are systematically different in the period after the change depending on the type of succession the companies went through.

Table 1. *Previous research and key findings*

Author (year)	Region (sample)	Key relevant variables	Key Findings
Cucculelli and Micucci (2008)	Italy (229)	ROA, ROS (return on sales)	"Inherited management within a family negatively affects the firms' performance, and this decrease is concentrated among the good-performing companies"
Wennberg et. al. (2011)	Sweden (3280)	EBITDA, sales growth, variance of EBITDA, variance of sales growth	"Survival seems to be lower for firms transferred externally, and their performance is also more variable."
Lohwasser et. al. (2021)	Inter-national (142)	Type of leadership (democracy, autocracy, anocracy), ROE, ROA, sales growth	"Generally positive relationship between family involvement and firm performance"
Chen et. al. (2021)	China (348)	ROA, OROS (operating return on sales), sales growth	"Family members as successors can acquire the founder's specialized assets via pre-succession internal managerial experience, which, in turn, enables them to outperform other successors"
Arosa et. al. (2010)	Spain (369)	ROA, sales growth	Outsiders on board have a significant impact only during the tenure of the founder-CEO. Every generation that survives, is a proxy for good management, thus decreasing the need for outside ownership to help with financial performance
Yeh and Liao (2021)	Taiwan (424)	ROA, ROE, longterm-investments (R&D, capex)	Family members as successors typically focus more on long-term investments significantly more than non-family members. In the short term, non-family members might achieve better financial performance
Perez-Gonzalez (2006)	U.S. (335)	ROA, OROA, R&D	"Strong evidence that promoting family CEOs in publicly traded corporations significantly hurts performance even after controlling for firm and industry characteristics and aggregate"
Chang and Shim (2014)	Japan (945)	OROA (operating return on assets), sales growth	"This study finds substantial performance improvement for family firms that convert to professional CEOs, but not for firms that opt for family heir succession". "Professional managers do not perform to potential when outgoing family CEOs stay in firms in a capacity to supervise them"

Note: table created by the authors.

2.5 The Baltic Region

The Baltic states, with Latvia as our main point of interest, have historically been affected by the Soviet Union's occupation during the 20th century. This means that up until 1991 all of the businesses were under state ownership and supervision, which means that the Baltic region's history of privately owned businesses started only after the collapse of the Soviet Union. From this, we extrapolate that in comparison to countries with rich family business histories, where the transfers there are not that many traditions and local examples in Latvia of how the process of having a family-owned business should look like and what is the best way of transferring ownership further.

In terms of regional challenges, Hogeforster (2014) conducted research trying to find the most troublesome aspects for innovation in the Baltic region, in which they noticed that among others, there seems to be a problem with a qualified workforce and a lack of entrepreneurship. Both of those missing aspects could be potential reasons for current owners being a bit more conservative when it comes to giving away their business ownership. This further could be linked to the situation talked about by Klotiņš and Skrinda (2023) – that the change of generations in terms of transferring ownership is happening very slowly in Latvia. It is hard to predict how exactly those aspects affect the company's performance after the succession, yet we believe the effect should be visible, because generally, the companies are not very big, thus a change of the main decision-maker, should have a considerable impact on the performance.

Another challenge that potentially could impact the region's succession process is the emigration away from the country. According to the Central Statistics Bureau of Latvia (n.d.), during the last 20 years, the migration balance has been negative for every single year except for 2022, which indirectly shows the population's desire to look for a "better life" outside the country.

Having looked at what kind of work has been done before, it is important to remember that most of the previous literature and research has been done in countries, in which the businesses have existed for many generations, thus it would also be beneficial to know if Latvian

family-owned companies are similar or different from "what has already been seen" around the world.

Knowing that the Baltic region is relatively young in terms of businesses operating there, and acknowledging that it can be expected that when a person from outside the family (further referred to as "outsider") would take over the operations, in 3 years those firms would financially outperform the firms for which the transfer of ownership happens within family. This would partially be in line with Wennberg et. al (2011) results, who showed that sales growth 3 years after the ownership transfer would be higher for firms transferred externally. We believe the rest of the financial performance metrics would follow a similar pattern for Latvian family firms. To find out if family firms in Latvia follow similar patterns of Western companies in terms of financial performance after succession, we have chosen previously used variables: for efficiency, we take Return on Assets (ROA), while for profitability we look at EBIT/SALES, and for growth we take Growth of Sales. All of those have been used when studying the effects of ownership transfer but also changes in CEOs in other countries' family firms. To add another dimension of analysis in terms of company's risk profile, we introduce the Net Debt to Assets (ND/A) variable. To empirically test our assumptions about the profitability we put forward hypotheses: **H1-H2**

H1: *Companies, for which the successor of the founder is an outsider, are associated with higher Growth of Sales ratio than companies for which the successor is a family member*.

H2: *Companies, for which the successor of the founder is an outsider, are associated with higher EBIT/SALES ratio than companies for which the successor is a family member.*

To test our assumptions about the operating efficiency we put forward a hypothesis: **H3**

H3: *Companies, for which the successor of the founder is an outsider, are associated with higher ROA ratio than companies for which the successor is a family member*.

Another metric that is widely used when determining how the company is doing is in terms of risk profile, and one of the instruments for that is Net Debt to Assets (ND/A – calculation explanation in Table 3) ratio. While having more debt can help the company invest in growth opportunities, it inherently comes with additional risk, which family owned businesses

would be expected not to do if possible, as they would much rather keep their SEW over high profit margins (Gallizo, 2017). This is why we put forward the final hypothesis: **H4**

H4: *Companies, for which the successor of the founder is an outsider, are associated with higher ND/A ratio than companies for which the successor is a family member*.

3. Data and methodology

3.1 Type of ownership

There are several ways of signalling that the firm's ownership has changed: a change in the executive position (CEO) or a change in ownership. In our analysis, we look into the change in ownership of the firm's equity. In contrast, Cucculelli and Micucci (2008) in their research analyze the changes by looking at the changes in the CEO position, however, we believe that Wennberg et. al (2011) way of tracking changes is more precise for the following reasons:

- The CEO position in family firm cases might not even exist, as those businesses work more informally;
- It is practically much harder to collect data on such changes even if they are available
- The CEO is chosen by the board of directors or owners, which means that they would most likely delegate a CEO who would simply do the job for them, which indirectly could be seen as just an extension of the existing leadership.

To get to data we need for comparing the different types of companies and successions, we used the primary source of information for Latvian firms, from the publicly available dataset provided by the Register of Enterprises of the Republic of Latvia, which holds the historic financial and equity ownership data for all registered companies.

3.2 Family firm and transfer definitions

Very rarely is it mentioned explicitly, how the researchers classify family vs non-family firms, which is why for our analysis, we use the following classification for a family firm at the date of foundation:

1. If one of the founders is a natural person with a majority of shares in the firm – more than 50%.
2. If people with the same last name collectively have a majority of shares in the firm – more than 50%.

The rationale for the first point in the classification is that a person can create the firm for different purposes, yet being the majority stake owner and the main beneficiary, they can still transfer these benefits, whether that being in monetary or SEW terms, through a transfer of ownership to a family member later. The rationale for the second point of how to classify family firms is self-explanatory, as in cases where the business is owned by people with the same last name, we assume that these people are related and are a family creating and operating a firm.

Table 2. *Ownership classification matrix*

Ownership type (TYPE)	Family firm	Family lead	Explanation/Criterion	Firm leader
Person sole owner (S)	Yes	Yes	A firm has a shareholder which is a person and they have more than 50% of shares.	The sole owner with a majority stake.
Company sole owner (CS)	No	No	A firm has a shareholder which is a company and it has more than 50% of the shares.	The sole owner with a majority stake.
Family shared (FS)	Yes	No	A firm has a group of people with the same last name (family members) that have more than 50% stake in it, and there are two or more people with equal shares	Family members who have an equal ownership stake.
Family authority (FA)	Yes	Yes	The firm has a group of people with the same last name (family members) that have more than 50% stake in it, and within the group of people, there is a person who has the leading shares.	A person who is within the family and has the leading share.
Shared (SH)	No	No	There is no entity or group of people with similar last names in the firm who would have at least 50% ownership.	No one.

Note: table created by the authors.

After the first step of classification between family and non-family ownership types, we believe it is not sufficient, as within the family ownership, the structure can be quite different among the family members. It may result in the majority ownership stake of the family being divided without a single authority within the majority stake of the family. Or there can be a single family member who has more percentage ownership than the other family members - creating a family authority. Using the information of the main owner or family lead we find the ownership's firm leader, which is either the majority owner or main owners in the family share. Using this knowledge of the type of ownership for a firm, we classified firms into five different types and set the main leaders of the firm summarized in *Table 2* above.

Using the definition of the five different ownership types and the definition of who leads the companies, we define the first transition type by comparing the ownership information at the date of foundation and following ownership structure to find the first transition information. To define the transition as "within the family" we looked at the firm leaders during the transition of the family firm, for more detailed examples see *Appendix 1*, and checked the following criteria:

1. The new firm leader or leaders share the same last name as the founding owner or owners, so if the new family authority's last name differed from the previous family authority, it would not count as "within the family".
2. The new firm leader has to be the only firm leader, either as the sole owner of the whole firm (having >50% of the total shares) or as a family leader, meaning cases where the family owns the majority in total, and the leader has more than 50% of the family's ownership.

The classification of "transferred to an outsider" applies otherwise, which would include if the transition happened between two families or a family and an unrelated party that does not share the same last name. Such a system is built upon the assumption that the family-related entities are people that share the same name and are not companies.

In our work, we focus only on the first such transfer that is happening, as that is the most robust way of making sure that our initial classification of "family firm" is correct. Otherwise, it would be very difficult to quickly distinguish the different forms of ownership, as even if the

majority owner is a single person, he might be already the second or third owner and therefore be classified as a non-family firm. Manually this could be checked however it would leave out the possibility of looking at very many companies in an automated way.

3.3 Data sample

3.3.1 Source

For our intended analysis, we have chosen to look at company-level data for Latvian companies specifically, acquired from the Register of Enterprises of the Republic of Latvia, which has a dataset containing the financial data for firms from their annual balance sheets and income statements, as well as the number of employees. It provided us with a beginning sample of financial data for 229'046 firm-years – currently still active, liquidated, and restructured - in the span from 2008 to 2023 in Latvia. The starting point of the year 2008 is chosen as prior to that the financial data is not available thus we cannot connect information regarding ownership transfers and financial performance.

From the given data we used are able to select the necessary list of firms, for which ownership data is collected using the 'Application Programming Interface' (API) of the Latvian Register of Enterprises, where for each of the firms we retrieve the shareholder identification information and the percentage of shares they own, starting from the first day of registration of the firm to the present day. Afterwards with a Python script the given data was transformed to present ownership per year for each firm, and afterwards was merged back to the financial data that was originally gathered. Thus, getting the samples for further research and refining.

3.3.2 Variables

We introduce a binary variable that is a change of ownership (D_{Change}), which we define as 0 for the point in time 1 year before the change and 1 for the point in time 3 years after the ownership transfer (defined in section 3.2) between different entities has happened. Each year also has its own dummy variable defined as $t + n$, where t is the year of the change and n is the consequent years after the change (1,2,3). Regarding the possibility of having another change

within the 3 years after a change: we are keeping them in our sample if the financial data is available, as it still shows the effect of the ownership change in one of the following years of the firm. This is used to see if there possibly is an effect earlier than the 3 years after succession. This would help better understand the short (1 year) and medium (3-5 years) term effects depending on the type of change. We do not look at more than 3 years after the year when the change happens as the sample size would be too small. To differentiate between the effects depending on the type of transfer we also introduce the binary variable $D_{interfamily}$, which takes the form of 1 if the transfer happened within family and 0 otherwise.

Table 3. *Variables used in regressions*

Variable name	Description	Measurement unit
ND/A	(Current Liabilities + Non-Current Liabilities – Cash – Marketable securities)/Total assets. Variable at year t.	Ratio
ROA	Return on assets at year t calculated as $EBIT_t / TA_{t-1}$ *100	Percent (13.2 would mean 13.2%)
EBIT $margin_t$	EBIT margin at year t (after transition) calculated as $EBIT_t / SALES_t$ *100	Percent
Sales_growth	Growth of sales at year t calculated by $(SALES_t/SALES_{t-1})$*100	Percent
LnAssets	Logarithm of assets at the year of transfer calculated	Natural logarithm
EBIT margin	$EBIT/SALES_t$*100 (EBIT margin in the year of transfer)	Percent
Age	Years since registry in the Registry of Enterprise at the year of transfer	Discrete number
D/A	(Current liabilities + Non-current liabilities) /Total Assets at the year of transfer	Ratio
Employees	Employee count at the year of the transfer	Discrete number
D_{change}	Dummy variable that is 1 for years after transfer	0 or 1
$D_{interfamily}$	Dummy variable that is 1 for firms that had a "within family" change	0 or 1
$D_{t_1;2;3}$	Dummy variable that is 1 for the specific year after the transfer	0 or 1

Note: table created by the authors.

In addition, for the classification of within-family firm change, we do not discern between the differences of first to second generational transfers from second to third generational transfers as in the Baltic region those would be very uncommon cases for a region whose oldest

businesses are ~30 years old. Currently, we only investigate the effects that arise after a change has happened and see what is the effect depending on the type of succession: either keeping the business within the family or selling it to an outsider.

3.3.3 Sample

To narrow down our dataset, we filter out companies that at any point have not had revenue above 1 million euros from the original sample of nearly 300 thousand firm year observations. For firms that existed prior to 2014, we convert the currencies (LVL to EUR) using the fixed exchange rate of 0.708204 LVL/EUR (Latvijas Banka, n.d). To avoid troubles discerning between different types of legal entities, we leave in only 'Limited Liability Companies' ('SIA'), since for other types of types of legal enterprises (such as 'AS', 'EIB', etc.) the information about historic ownership is often not available in the registry. Using this information we can receive the annual ownership information of the company and the data regarding any transfer of ownership between different entities. This allows us to further work with the following variables: type of a firm (Family or non-family-owned), time of change in ownership (year), and years after change (to synchronize the financial data to 3 years after the change).

After dealing with filtering and data availability, we are left with a starting sample of 11'043 companies, whose financial data spans from 2008 to 2023 and whose sales have reached at least 1 million EUR and have not been under 10 000 EUR at any year. However, in our analysis, we compare the performance one year before and three years after the year, when the first change of ownership happened, which results in a period of at least 6 years of which 5 years are used for our models. In our analysis we focus on transfers of ownership during the years 2010-2020. This means that the effects of change are looked at from 2008 through 2023. To prepare the dataset for our intended analysis we filter out the companies that are not considered family-owned by our classification (6009 family firms) and whose first ownership transfer falls into the 2010-2020 time frame, which decreases the sample to 3853 firms in Latvia. Furthermore, due to a lack of financial data for at least 6 years around the first transition (as for the calculation of Sales Growth and ROA for year t-1 we need closing values for assets and sales

from year t-2), this also decreased our sample to 614 firms. In cases where the only missing variable was ROA, we used end-of-year assets in our calculations for imputing the missing values, so as not to lose observations, adding back 207 companies.

To further avoid biasing the whole dataset without losing observations, we use the "conventional" 5% and 95% percentiles for the winsorizing method. We do this for all the financial metrics to minimize the extreme distortions in our analysis. While we acknowledge that there might be other stronger tests to control for distortions, we see our employed measures as good enough to provide reasonably accurate insights.

The final sample consists of 821 family owned companies with ownership change during 2010-2020, out of which in 653 cases the transfer has happened to an outsider and 168 cases where there has been a within-family transfer of ownership.

3.4 Regressions

Our research method is inspired by existing works done by Wennberg et. al (2011), and Cucculelli and Micucci (2008), and employs similar regression analysis as they do. In their research, for regression analysis, they mainly looked into changes in certain financial ratios after the internal change in the firm, while also looking into the difference in the effects for two groups. In our research we will use similar regressions:

$$(1)\ y_{it} = \beta_0 + \beta_1 D_{Change} + \beta_2\ D_{interfamily} + \beta_3 D_{Change} * D_{interfamily} + \beta_4 X_{it} + u_i$$

$$(2)\ y_{it} = \beta_0 + \beta_1 D_{t+n} + \beta_2\ D_{interfamily} + \beta_3 D_{t+n} * D_{interfamily} + \beta_4 X_{it} + u_i$$

To test our **H1-H2,** as our dependent variable (y_{it}) we use Growth of Sales and EBIT margin for profitability for the i firms in the three years after the succession, as profitability and growth are two of the key indicators of how the company is doing financially. To test our **H3** regarding operational efficiency we look at ROA, while for risk level we test **H4**, measured through Net Debt to Assets ratio.

The binary variable D_{t+n} is a modified version of the first (1) regression's D_{Change} that looks at the effect of the change after succession for each of the years separately, instead of collectively for all 3 years after the change like the regression (1).

Our main independent variable is the interaction term β_3 between the $D_{ownershipChange}$ and $D_{interfamily}$ in the first regression (1) and between D_{t+n} and $D_{interfamily}$ in the second regression (2), as it shows the additional effect of the firm being kept within the family after the change and a change happening in general. The effect of the change alone is explained by binary variable D_{Change} and coefficient β_0.

To account for other relevant effects as much as we can in our sample, we also include a matrix of control variables with X_{it}. We follow similar methodologies as used by Cucculelli and Micucci (2008), Amran and Ahmad (2010) by controlling for age of the firm. In our control variable list we also include the natural logarithm of assets and employee count as proxies for company size. We also look at the pre-transfer Debt to Assets ratio and pre-transfer EBIT/SALES ratio to control for already struggling or well-positioned companies' trajectories. To account for global trends, we implemented year as a control variable to control for periods when the change of ownership had happened.

To make sure that our data would not be distorted, we employ multiple tests and procedures for control. First, to check for potential correlations between the independent variables, we run the variance inflation factor (VIF) tests. For our research a baseline value for this test is used as 5, meaning that if the value of the test is lower than 5, no correlation is assumed between the variables.

3.5 Robustness Control

To assess whether the coding for both acquiring the data as well as preparing for analysis has been done properly we have manually checked through random companies and compared whether our classification has been done accurately to the real data.

Removing the companies for which the ROA was imputed as to not to lose observations, the overall results do not change significance for the main variables and the control variables.

STOCKHOLM SCHOOL OF ECONOMICS
SSE RIGA

To make sure our results are not biased by the year in which the transition happened, we test our analysis and see that the results are also robust in case we do not use the transition year for the comparison of before and after succession performance. This means using only t_{-1} and not including t_0. While the significance levels as well as coefficients change a little bit, the magnitude of those changes are not enough for us to believe that there is a significant effect in case t_0 is omitted.

4. Analysis and discussion

4.1 Descriptive Statistics

The final dataset consists of 821 companies and the differences between within-family transfers and transfers to an outsider for the time period 2010-2020 can be seen in *Table 4* and *Table 5*. Each company here has data for 5 financial years: one before the transition, the transition year, and three years after the transition. Summary statistics specifically for the time of transfer can be seen in *Table 6*.

Table 4. *Summary statistics for the full sample of financial data 2008-2023*

Variable	N	Mean	Median	SD	Min	Max
Year	4105		2016		2008	2023
EBIT margin	4105	5.603	3.534	10.821	-15.346	32.713
ROA	4105	21.387	10.811	35.486	-31.045	119.142
LnAssets	4105	12.826	12.794	1.284	10.393	15.289
D/A	4105	0.712	0.709	0.347	0.144	1.541
ND/A	4105	0.566	0.587	0.417	-0.225	1.452
Employees	4105	19.166	9.000	31.063	0.000	441
Age	4105	7.409	5.000	6.096	0.000	31
2nd sample						
Sales growth	3070	41.124	12.355	93.478	-53.63	364.495
ROA	3070	21.014	10.206	35.294	-31.045	119.142

Note: table created by the authors. The total amount of firm-year observations is 4105, which is the 821 companies each having 5 years of data. Sales growth data is missing for some of the companies, thus for sales growth we have 614 companies for this analysis. 2nd sample is the sample without imputed values for ROA. For sales growth imputation could not be justified, thus not implemented.

Table 5. *Summary statistics for transfers for 2010-2020 (821 firms, 5 years of data)*

Variable	Total	Outside family	Within family	T-stat.
N	4105	3265	840	
Age	7.41 (6.10)	6.85 (5.76)	9.57 (6.83)	-10.611***
LnAssets	12.83 (1.28)	12.80 (1.28)	12.92 (1.28)	-2.447**
D/A	0.71 (0.35)	0.73 (0.35)	0.66 (0.34)	5.322***
Employees	19.17 (31.06)	19.09 (31.69)	19.48 (28.50)	-0.347
EBIT margin	5.60 (10.82)	5.33 (10.79)	6.67 (10.88)	-3.195***
ROA	21.39 (35.49)	21.36 (36.22)	21.49 (32.51)	-0.103
ND/A	0.57 (0.42)	0.58 (0.42)	0.52 (0.41)	3.695***
N	3070	2395	675	
Sales growth	41.12 (93.48)	43.80 (96.53)	31.63 (81.10)	3.296***

Note: table created by the authors. The total amount of firm-year observations is 4105, which is the 821 companies each having 5 years of data. T-stat is the value from the t-test, when testing for the significance of differences of the mean values. The number outside the brackets is the mean and inside the brackets is the standard deviation. Sales growth data is missing for some of the companies, thus for sales growth we have 614 companies for this analysis.

To gain an insight into the overall performance of the companies, including before and after transition characteristics, we look at the 5 years of data for all 821 companies as mentioned above. In *Table 5* from our sample, we see that on average companies that at some point undergo an ownership change and keep it in the family, are older by about 2.7 years, while also having a higher deviation – more companies have existed for much longer than the average when compared to outsider transfers. Companies that keep the ownership within the family after the first transition typically are slightly larger in terms of assets. While assets are slightly higher, there seems not to be a significant difference in the number of employees working for each kind of company, which indicates that family-owned and preserved companies typically would manage more assets with the same amount of people employed. Zero people employed in *Table 4* refers to the cases where owners are not counted as employees and work on their own for the company. The large maximum values for D/A and ND/A are likely due to misreporting, despite the winsorizing method being applied.

In line with theoretical reasoning, those who keep the ownership within the family, on average, use less debt than their counterparts as seen in *Table 5* from the Debt to Assets ratio

(0.73 vs 0.66) and also the Net Debt to Assets ratio (0.58 vs 0.52). In terms of profitability, if at some point they transfer the ownership within the family, we see that firms in Latvia are typically doing considerably better than their counterparts, measured by EBIT margin (5.33% vs 6.67%). Interestingly, operating efficiency, measured by ROA, does not seem to differ much between the types of transfers for Latvian firms. It is important to also see that the median ROA is 10.81% for the whole sample (*Table 4*), yet because of a relatively few high ROA observations, the mean value is twice as high. Sales growth, however, seems to be a lot better for companies that at some point decide to transfer the ownership externally.

Figure 1. *(Sales growth from t-1 to t+3)*

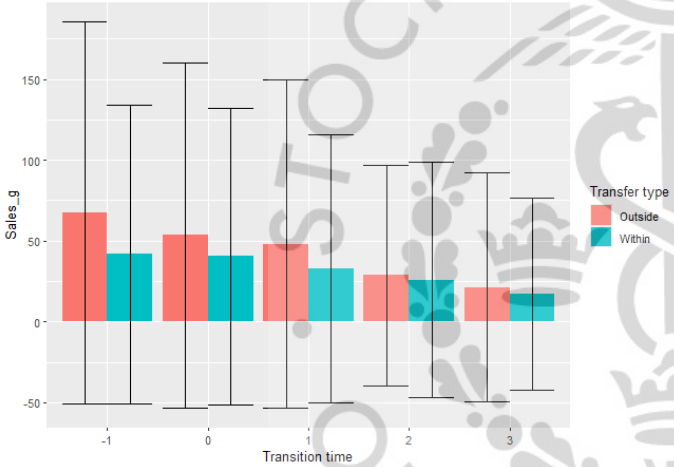


Figure 2. *(EBIT/Sales from t-1 to t+3)*

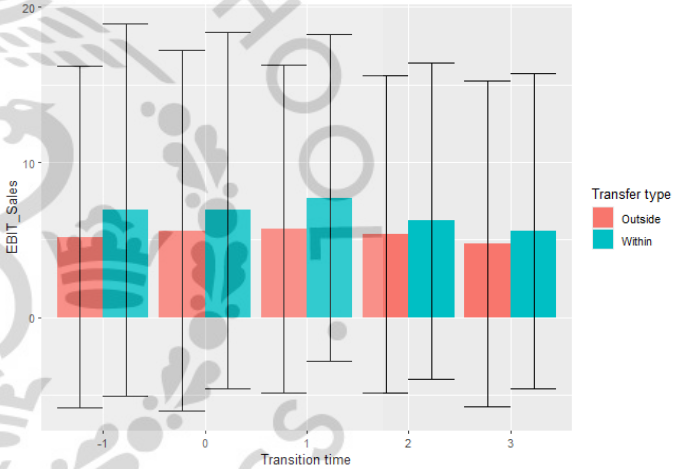


Figure 3. *(ND/A from t-1 to t+3)*

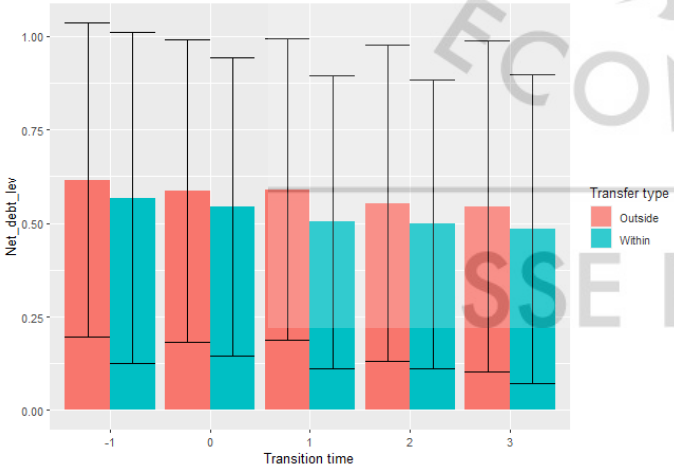
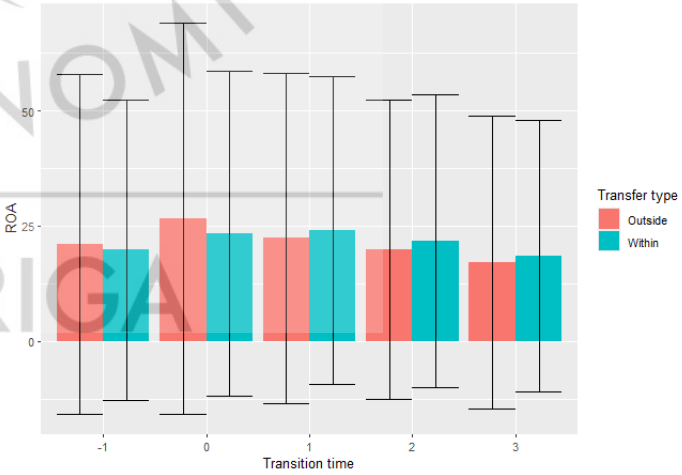


Figure 4. *(ROA from t-1 to t+3)*



Note: created by the authors. The columns in these figures represent the levels of the variables not the ranges. The black parentheses indicate the mean value +1 standard deviation (sd) and -1 standard deviation.

It has to be kept in mind that those differences are for the general performance of the firms within the 5 years around the transfer (t-2 to t+3) and not for the specific time of transfer. Visually our main financial variables are seen in *Figures 1-4*.

From *Figures 1-4* We see that EBIT margin as well as ND/A levels do not visually converge or diverge depending on the type of succession and are not affected by the change of ownership in general. We do, however, see that the sales growth shrinks in general after the transfer of ownership and ROA is also affected negatively, although at a lesser scale than sales growth. Visually it does seem that the absolute values for sales growth are becoming very similar for both types of transitions. From *Figure 2* it does seem that the companies that are doing better prior to the transfer and during it, keep being more profitable (EBIT margin). It also seems that for Sales Growth and ROA the volatility measured in standard deviations decreases with every year after transition, although for Sales Growth the explanation might be connected to the fact that in general companies in Latvia are young and the decreasing rate of growth is to be expected with every passing year. Another possibility is that fast growing companies are not managed properly after ownership transfer, thus decreasing the growth, however, we do not have evidence for such a claim. To see the descriptive statistics for the specific year of transfer, see *Table 6*.

Table 6. *Summary statistics for transfers within and outside the family at time of transfer (821 firms)*

Variable	Total	Outside family	Within family	T-stat.
N	821	653	168	
Age	6.41 (5.93)	5.85 (5.59)	8.57 (6.69)	-4.847***
LnAssets	12.63 (1.24)	12.60 (1.23)	12.78 (1.25)	-1.669*
D/A	0.72 (0.32)	0.73 (0.32)	0.67 (0.33)	2.104**
EBIT margin	5.78 (12.76)	5.49 (12.81)	6.92 (12.54)	-1.309
Employees	15.04 (16.95)	14.67 (16.76)	16.49 (17.65)	-1.205
ROA	25.90 (41.07)	26.53 (42.44)	23.42 (35.27)	0.976

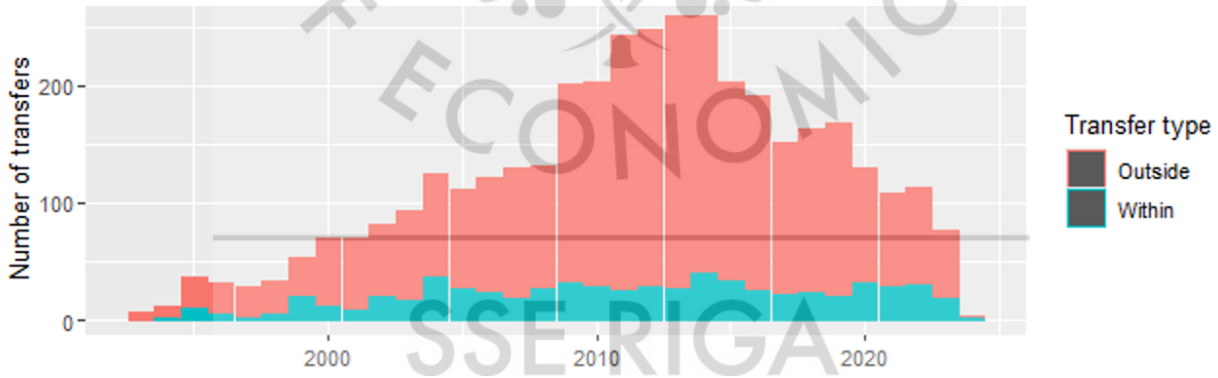
Note: table created by the authors. T-stat is the value from the t-test, when testing for the significance of difference between mean values. The number outside the brackets is the mean and inside the brackets is the standard deviation.

When it comes to the differences at time of transfer, we see a similar, yet slightly different situation to the one described in *Table 5*. The age difference and significance of the difference has not changed in comparison to the previous table, yet the significance of the differences for sizes in assets has decreased. This means that at the time of transfer, the companies are more similar in terms of size than in the 5-year period around the transfer collectively. While the significance has decreased somewhat, there still is a difference between the amount of indebtedness for the companies (0.73 vs 0.67), which makes sense.

Important to note that when looking at the specific year of transfer, the profitability aspect does not seem to differ much whether the firm is kept within the family or sold to an outsider. Such a result is can be explained by the standard deviation being higher, as there is only one year of data for each company to use in the analysis.

To better understand what has been the situation regarding the number of transfers by type, we look at the breakdown of the number of companies having specific types of transfers over the years *(Graph 1)*.

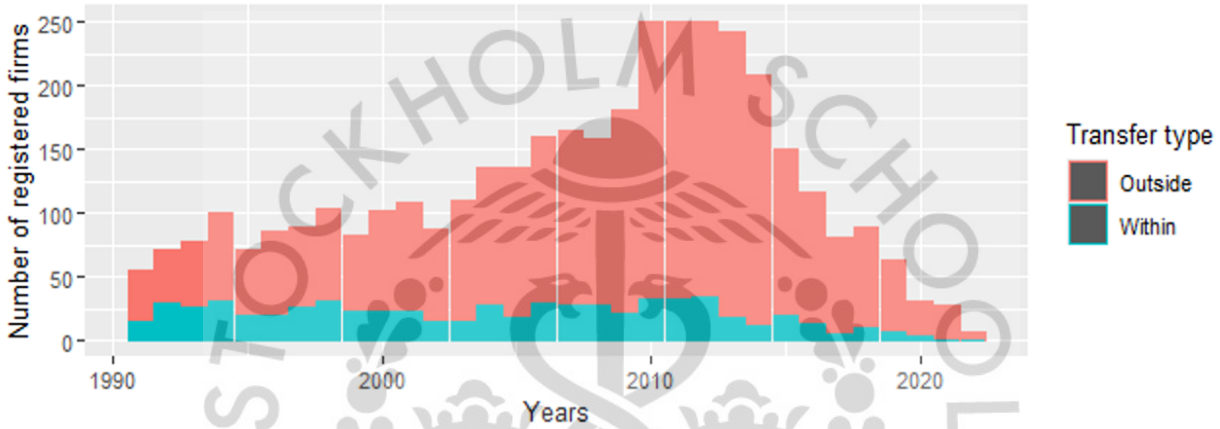
Graph 1. *Ownership transfers by type*



Note: created by the authors. Number of first ownership transfers over the period 1991-2022 by type. This graph includes all the 3853 companies that are classified as "family" and has had the first ownership transfer since 1991. Each bar represents the number of transfers that year by type

We can clearly see that the within-family transfers have been very slowly rising, while the transfers to outsiders increased up until around 2014, after which it has been on a rather sharp decline. One reason for the decrease could be the consistent increase in companies liquidated during the timespan 2014-2019 (Latvijas Sabiedriskie Mediji, 2024).

Graph 2. *Registration date of within and outside transfer firms since 1991.*



Note: created by the authors. This graph includes all the 3853 companies that are classified as "family" and has had the first ownership transfer since 1991. Each bar is the number of registrations that year

Table 7. *Ownership transfers by type, detailed breakdown, 821 total transfers*

Transfer type (Old – New)	Within family	Outside	Total	Within family as a share of total
FA-FA	1	0	1	100.00%
FA-FS	4	0	4	100.00%
FA-S	3	6	9	33.33%
FA-SH	0	5	5	0.00%
FS-FA	8	0	8	100.00%
FS-S	9	9	18	50.00%
FS-SH	0	6	6	0.00%
S-FA	18	7	25	72.00%
S-FS	37	2	39	94.87%
S-S	88	471	559	15.74%
S-SH	0	147	147	0.00%

Note: Table created by the authors. Type specification can be seen in Table 2. S – sole owner, FA – family authority, FS – family shared, SH – shared (outsider). First ownership – new one. 821 total transfer, 168 of that is within-family

Another potential reason that we find, that could explain the recent decrease in ownership transfers, is the reduction of new family firms (that at some point undergo ownership transfer by our definition) registered as of 2014 as shown in *Graph 2*. For more detailed breakdown of industry specific transfers, see the ownership transfer by industry over the years 1991-2022 in *Appendix 2*.

We also note that the vast majority of the transfers types have been sole owner to sole owner according to our classification and can be seen in *Table 7*. It has been the case that most of the within-family transfers (20.46% of 821 total transfers) have happened either from a sole owner to a new sole owner (52.38% of all within-family transfers) or from sole owner to "family shared" (22.02% of all within-family transfers), which means to multiple people with the same last name.

4.2 Results and Discussion

To test our hypothesis **H1-H4** we run the regressions (1) and (2) and the outcomes can be seen in *Table 8* and *Table 9* respectively. We go through most of the variables to see if the ones labelled control line up with general principles of how different aspects affect a firm's performance. After running the first regression (1), in *Table 8* we see that in general a change in ownership is associated with a negative effect on the firm's sales growth (-26.1 percentage points (pp) sales growth) when compared to sales growth before the change of ownership.

For every year that the company has existed, the negative effects of change on the Growth of Sales are -2.05pp. This is likely due to the company being older and having more assets, thus a change is not as big as for smaller companies that have more possibilities to expand and grow. A similar idea can be seen from the coefficient before asset size (-4.84): more assets are associated with lower future growth after the change as every next increase is relatively less meaningful than the previous. Good EBIT margin at the time of ownership transfer is associated with a better future sales growth rate (0.633pp increase for every pp of EBIT margin at time *t*). In this model, there seems to be a negative correlation between sales growth and ownership transfer within the family from the variable D_interfamily, yet the main interaction term is insignificant.

Table 8. *First regression output.*

Variables	Dependent variables			
	Sales growth	*EBIT margin*	*ROA*	*Net Debt*
D_interfamily	-10.695 *	0.881	-0.875	-0.010
	(6.377)	(0.565)	(1.990)	(0.019)
Post	-26.099 ***	0.0126	-6.796 ***	0.015
	(4.131)	(0.356)	(1.255)	(0.012)
at_t_Age	-2.054 ***	0.0325	-0.634 ***	0.0004
	(0.304)	(0.027)	(0.095)	(0.0009)
at_t_LnAssets	-4.844 ***	0.370 ***	-4.344 ***	0.011 **
	(1.592)	(0.140)	(0.493)	(0.004)
at_t_DA	8.127	-3.040 ***	-20.057 ***	0.850 ***
	(5.966)	(0.526)	(1.854)	(0.017)
at_t_EBIT margin	0.633 ***	0.369 ***	0.658 ***	-0.0003
	(0.160)	(0.014)	(0.048)	(0.0005)
at_t_Employees	-0.280 **	-0.050 ***	-0.0145	0.001 ***
	(0.109)	(0.010)	(0.037)	(0.0003)
D_interfamily:Post	11.557	-0.370	3.506	-0.029
	(8.116)	(0.720)	(2.536)	(0.024)
N	3070	4105	4105	4105
R squared	0.0531	0.2498	0.1581	0.4468
F stat.	21.241	169.201	95.450	410.44
P value	0.000	0.000	0.000	0.000
FE year & sector	YES	YES	YES	YES

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Note: table created by the authors. Panel data regression with year and sector fixed effects. Each of our dependent variables has been regressed on our control variables and the main coefficient of interest for us is D_interfamily:post, which shows the additional effect of change of ownership for within family transfers. The number in the parentheses is the standard error of the coefficient

In the second regression for profitability, EBIT margin is not affected by the firm's age at the time of transfer, which implies that profitability is not affected by age. Employee count seems to only be correlated with a lower EBIT margin by 0.049 pp for every employee, which makes sense as a higher headcount, ceteris paribus, directly lowers the EBIT margin. EBIT margin at the time of transfer again is a good predictor for better EBIT margin in the future, which would mean that firms that are already doing well, keep being more profitable also after the change. With every extra pp of debt relative to assets, the EBIT margin is expected to

decrease by -3.04pp, which shows that the profitability is affected by the amount of debt the company has taken. As for our main variable of interest, the interaction between a transition and the firm being family owned is insignificant, the model suggests no additional effect of the type of ownership.

In this model, ROA is negatively affected by change in general, being lower by 6.8pp in comparison to the pre-transfer level, but also not having any additional effect from the type of transition the company undergoes. The coefficients regarding the company age (-0.634), and asset size (-4.344) are all negative just like for the EBIT margin after the change. Interestingly, the companies that are doing well profitability-wise at the time of transfer, also do well in terms of efficiency measured by ROA. The coefficient 0.658 indicates that for every pp of EBIT/SALES that the company has at time t, ROA is higher by 0.658pp.

Finally, the firm's risk assessment through the variable ND/A also seems not to be connected to the type of ownership change, as the only variables explaining it are ln(Assets), D/A ratio and number of employees at the time of transfer.

As this model does not provide any evidence of the interaction term being significant, thus leaving us with no evidence that **H1-H4** are true, we now look at the second regression (2) to see if there is a difference when the effect is divided by years after transfer. While the explanatory power measured by R^2 has increased just a little bit, we see that there is still a lot of unexplained variance for the financial performance measurements.

From the results in *Table 9,* we see that a change itself has a significant effect on the Growth of Sales and ROA, starting from the first year after succession, but not so for EBIT margin and ND/A. We see this from D_t_1, D_t_2, and D_t_3 becoming negative for 2 of our target variables. This effect shows that the pure effect of a change is negatively associated with financial performance after the change of ownership in general. To further add to the significance of the change: the effect seems to become more pronounced as years go by: sales growth for years 1, 2, and 3 after the succession is lower by -11.77%, -32.3%, and -39.68% respectively, while for the ROA it results in decreased efficiency in the years 1, 2 and 3 as -2.93%, -7.81% and -11.58% respectively.

Table 9. *Second regression output*

Variables	Dependent variables			
	Sales growth	*EBIT margin*	*ROA*	*Net Debt*
D_t1	-11.767 **	0.408	-2.934 *	0.020
	(5.223)	(0.450)	(1.581)	(0.015)
D_t2	-32.298 ***	-0.048	-7.808 ***	0.007
	(5.382)	(0.464)	(1.632)	(0.015)
D_t3	-39.677 ***	-0.607	-11.584 ***	0.019
	(5.645)	(0.488)	(1.717)	(0.016)
D_interfamily	-10.642 *	0.888	-0.830	-0.010
	(6.356)	(0.564)	(1.984)	(0.019)
at_t_Age	-2.097 ***	0.0319	-0.638 ***	0.0004
	(0.303)	(0.027)	(0.095)	(0.0009)
at_t_LnAssets	-4.707 ***	0.358 **	-4.425 ***	0.011 **
	(1.587)	(0.140)	(0.492)	(0.005)
at_t_DA	8.437	-3.030 ***	-19.992 ***	0.850 ***
	(5.947)	(0.526)	(1.848)	(0.017)
at_t_EBIT margin	0.631 ***	0.368 ***	0.657 ***	-0.0003
	(0.159)	(0.014)	(0.048)	(0.0005)
at_t_Employees	-0.283 ***	-0.049 ***	-0.013	0.001 ***
	(0.108)	(0.010)	(0.036)	(0.0003)
D_interfamily: D_t1	3.647	0.440	3.591	-0.047
	(10.829)	(0.964)	(3.390)	(0.032)
D_interfamily: D_t2	16.376	-0.571	4.638	-0.019
	(10.841)	(0.965)	(3.391)	(0.032)
D_interfamily: D_t3	14.778	-0.929	2.645	-0.020
	(10.867)	(0.966)	(3.395)	(0.032)
N	3070	4105	4105	4105
R squared	0.0605	0.2515	0.1639	0.4470
F stat.	16.238	113.696	66.348	273.563
P value	0.000	0.000	0.000	0.000
FE year & sector	YES	YES	YES	YES

*** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$.

Note: table created by the authors. Panel data regression with year and sector fixed effects. Each of our dependent variables has been regressed on our control variables and the main coefficient of interest for us is D_interfamily:post, which shows the additional effect of change of ownership for within family transfers.

While we see that for the Growth of Sales the coefficient before the dummy variable D_interfamily is barely significant, as seen in *Table 9* (under $p<0.1$), it makes sense, as the mean value for Growth of Sales is lower (*Table 4*) for firms that at some point undergo within-family transfer. The rest of the interaction terms, which are the of the main interest of our study, appear insignificant.

Given our data availability, we are not able to check further years to see if the effect in a longer term would become significant or differ at all. There seems not to be any additional effect on the Growth of Sales, EBIT margin, ROA, and ND/A based just on the type of transfer the company is going through.

Looking at the results, we are not able to accept either of the hypotheses **H1-H4** as none of our models suggest any connection between financial performance and type of ownership change. While this could be partly due to many observations being lost as the data is either missing or quite extreme at times. However if true, this research suggests that there could be other reasons for company performance differences after transferring ownership to a new person, which could be more nuanced than just the classification of within-family transfers versus transfers to an outsider.

4.3 Limitations

We acknowledge that our research has limitations and the results should not be generalized without caution. We lose many observations due to data being available starting from 2008, which does not give us the whole possible dataset for the analysis of ownership transfers. In regards to the ownership dataset, it is quite a bit larger than the financial data, as for most firms it is available since the registration, and yet there are issues with the correctness of the reported data, as firms may change their legal status which affects the ownership disclosure.

When it comes to the beginning phases of the research, there might exist a more thorough way of categorizing the firms both in terms of family-owned or not, as well as defining what constitutes a change. As we are the first ones doing this for Latvia, there is no precise methodology, from which to borrow classification one to one. There is still plenty of room to

explore how different types of transfers within the family might have an effect on the company's financials. Acquiring the characteristics of the successor could also explain the variance in the firm's financial metrics as in cases where the successor has no knowledge about leading a business, it might likely lead to financial troubles down the line.

As many previous researchers have found before, there are systematic differences between the types of successors as company owners. We are unable to check whether and how the performance might differ in cases where the successor is a private equity fund or a venture capitalist or a competitor, and this could further be a field of research. There are also cases, where the company that is taking over is owned by the family, but it is excluded from our analysis to avoid complications in data gathering as the coding that is required for determining the relatedness of people from other companies requires more computing power, which we do not have access to. Additional problems would arise if the acquiring company was not registered in Latvia.

We realize that there also could be some non-linearities for some effects that we are simply not able to capture, as they are not obvious to notice and pin down correctly. In addition, the possible additional effects of a transfer to a family member or an outsider can be studied if additional selection procedures, such as unexpected ownership changes (e.g. death of previous owner), are taken into account.

5. Conclusions

To better understand the situation in Latvia regarding family firm ownership transitions, we look at two types of successions: within the family and to an outsider. The aim of this study is to investigate whether the type of ownership change has an effect on the financial performance metrics regarding profitability, growth, efficiency, and indebtedness.

One of our main contributions is the collection and analysis of an original dataset regarding companies, specifically family firms in Latvia, and their ownership information, including changes from family to family members or to outsiders, which we use to identify the changes in ownership types. We then combine the financial data that we acquire for all

companies from the enterprise register of Latvia with the ownership changes to perform difference in differences regression analysis to find out if there is anything significant.

We then look into the details of the characteristics for the family firms that have gone through a transfer of ownership and see that recently there has been a decrease in transfers in general, likely due to increase of liquidations and decrease of registration of new firms. We note that in the vast majority of cases the transfer has happened from a single ownership to a single ownership type.

When it comes to our main hypotheses **H1 to H4** we do not find any evidence that there is any connection between financial performance measured in our chosen metrics as Sales Growth, EBIT margin, ROA, ND/A and the type of ownership change – to a family member or to an outsider in Latvian family firms. We do, however, find strong evidence that a change in general has a negative effect on Sales growth and ROA, which potentially suggests that there might be problems for family firms that undergo ownership succession.

We notice that while the companies differ in financial metrics when taking 5 years around the time of ownership transfer, the differences visibly shrink when looking at only the year of transfer. This is also confirmed by the regression outputs that indicate no additional effect of the type of change. This means that either the companies are impacted by factors that we are unable to capture in our model, or they do not exhibit significant differences between themselves. As we expected the different types of transitions to lead to different outcomes, such findings sound incomplete to us. The results imply that either both the family successors and outsiders do perform equally well or equally poor, which as the theory suggests, should not be the case on average. Then again we have to keep in mind that we are not able to check longer time periods to see the long term effects properly.

We believe that our proposed way of classification for ownership transfers as well as data analysis can serve as a starting point for further analysis of the Baltic region as a whole because policymakers need to understand the nuances of the different types of businesses to be able to help them more effectively.

In the limitations part we highlight the main potential troubles, that should be explored in more detail to obtain a more complete picture of how succession affects financial performance. We believe that starting with the cases of unexpected successions (death of an owner) would be beneficial for further research as it is not planned and thus shows how the variables are affected.

6. Acknowledgement

The help of AI for this thesis has been used only in the coding part: to speed up the process and eliminate mistakes.

We express our gratitude to Niks Prizevoits for helping us obtain the data from the Latvian enterprise registry with the help of multiple APIs.

STOCKHOLM SCHOOL OF ECONOMICS
SSE RIGA

7. Reference list

Aladejebi, O. (2021). Succession planning: a key to sustainable family business. *Journal of Business and Social Science Review*, *2*(7), 26-38

Alayo, M., Iturralde, T., Maseda, A., & Arzubiaga, U. (2016). Critical factors for successful succession of family firms. *European Journal of Economics, Finance and Administrative Sciences*.https://www.researchgate.net/publication/313599281_Critical_Factors_for_Successful_Succession_of_Family_Firms

Amran, N., A., Ahmad, A., C. (2010). Family Succession and Firm Performance among Malaysian Companies. *International Journal of Business and Social Science*. *1*(2), 193-203. https://www.researchgate.net/profile/Ayoib-Che-Ahmad/publication/228597845_Family_Succession_and_Firm_Performance_among_Malaysian_Companies/links/59dd91330f7e9b53c197da4d/Family-Succession-and-Firm-Performance-among-Malaysian-Companies.pdf

Arosa, B., Iturralde, T., & Maseda, A. (2010). Outsiders on the board of directors and firm performance: Evidence from Spanish non-listed family firms. *Journal of Family Business Strategy*, *1*(4), 236–245. https://doi.org/10.1016/j.jfbs.2010.10.004

Avrichir, I., Meneses, R., Santos, A., A. (2016). Do family-managed and non-family-managed firms internationalize differently? *Journal of Family Business Management*, *6*(3), 330–349. https://doi.org/10.1108/jfbm-02-2015-0014

Baron, J. (2021, September 17). *Do most family businesses really fail by the third generation?* Harvard Business Review. https://hbr.org/2021/07/do-most-family-businesses-really-fail-by-the-third-generation

Bertrand, M., & Schoar, A. (2006). The role of family in family firms. *Journal of Economic Perspectives*, *20*(2), 73–96. https://doi.org/10.1257/jep.20.2.73

Bozer, G., Levin, L., & Santora, J. C. (2017). Succession in family business: multi-source perspectives. *Journal of Small Business and Enterprise Development*, *24*(4), 753–774. https://doi.org/10.1108/jsbed-10-2016-0163

Central statistics bureau of Latvia (n.d.). Iedzīvotāju starptautiskā ilgtermiņa migrācija pa valstu grupām – Rādītāji, Valstu grupa un Laika periods. Retrieved November 25, from:

https://data.stat.gov.lv/pxweb/lv/OSP_PUB/START__POP__IB__IBE/IBE010/table/tableViewLayout1/

Chang, S., & Shim, J. (2014). When does transitioning from family to professional management improve firm performance? *Strategic Management Journal*, *36*(9), 1297–1316. https://doi.org/10.1002/smj.2289

Chen, M., Xiao, J. Z., & Zhao, Y. (2021). Confucianism, successor choice, and firm performance in family firms: Evidence from China. *Journal of Corporate Finance*, *69* https://doi.org/10.1016/j.jcorpfin.2021.102023

Cucculelli, M., & Micucci, G. (2008). Family succession and firm performance: Evidence from Italian family firms. *Journal of Corporate Finance*, *14*(1), 17–31. https://doi.org/10.1016/j.jcorpfin.2007.11.001

Dyer, W. G. (2018). Are family firms really better? Reexamining "Examining the 'Family Effect' on Firm Performance." *Family Business Review*, *31*(2), 240–248. https://doi.org/10.1177/0894486518776516

European Family Businesses. (n.d). *European Family Businesses.* Retrieved October 28, 2023, from https://europeanfamilybusinesses.eu/about-european-family-businesses/

Gallizo, J. L., Molinero, C. M., Moreno, J., & Salvador, M. (2017). Family business and value-added distribution: a socioemotional wealth approach. *Academia Revista Latinoamericana de Administración*, *30*(1), 2–22. https://doi.org/10.1108/arla-05-2015-0099

Groysberg, B., Bell, D. (2014, April 10). Generation to Generation: How to Save the Family Business. *Harvard Business Review*. https://hbr.org/2014/04/generation-to-generation-how-to-save-the-family-business

Handler, W. C. (1994). Succession in Family Business: A Review of the research. *Family Business Review*, *7*(2), 133–157. https://doi.org/10.1111/j.1741-6248.1994.00133.x

Hillenbrand, P., Kiewell, D., Miller-Cheevers, R., Ostojic, I., & Springer, G. (2019, June 28). *Traditional company, new businesses: The pairing that can ensure an incumbent's survival*. McKinsey & Company. https://www.mckinsey.com/industries/oil-and-gas/our-insights/traditional-company-new-businesses-the-pairing-that-can-ensure-an-incumbents-survival

Hogeforster, M. (2014). Future challenges for innovations in SMEs in the Baltic Sea region. *Procedia - Social and Behavioral Sciences*, *110*, 241–250. https://doi.org/10.1016/j.sbspro.2013.12.867

Kallmuenzer, A. (2015). Agency theory and the family business. *Edward Elgar Publishing eBooks*. https://doi.org/10.4337/9781783479665.00011

Klotiņš, I., Skrinda, D. (2023). *Family business succession in Latvia.* Executive Master's thesis, Stockholm School of Economics in Riga, Latvia. Retrieved from: https://drive.google.com/file/d/1s3XR3Svwpv-t1SksgCzQOVuFAExHNhwI/view

Latvijas Banka (n.d.) Latvijas Bankas noteiktie valūtu kursi. Retrieved February 1, from: https://www.bank.lv/statistika/dati-statistika/valutu-kursi/vesturiskie-kursi-lidz-2013-gada-31-decembrim?view=graph&layout=currencypage

Latvijas Sabiedriskie Mediji (LSM) (2024). Latvia saw positive trend in numbers of businesses in 2023. Retrieved February 1 , from: https://eng.lsm.lv/article/economy/business/05.01.2024-latvia-saw-positive-trend-in-numbers-of-businesses-in-2023.a537830/

Lohwasser, T. S., Hoch, F., & Kellermanns, F. W. (2021). Strength in Stability: A Meta-Analysis of family firm performance moderated by institutional stability and regime type. *Entrepreneurship Theory and Practice*, *46*(1), 117–158. https://doi.org/10.1177/10422587211026863

Lim, E., Lubatkin, M., & Wiseman, R. M. (2010). A family firm variant of the behavioral agency theory. *Strategic Entrepreneurship Journal*, *4*(3), 197–211. https://doi.org/10.1002/sej.91

Martin, G., & Gómez-Mejía, L. (2016). The relationship between socioemotional and financial wealth. *Management Research*, *14*(3), 215–233. https://doi.org/10.1108/mrjiam-02-2016-0638

Morris, M. H., Williams, R. W., & Nel, D. (1996). Factors influencing family business succession. *International Journal of Entrepreneurial Behaviour & Research*, *2*(3), 68–81. https://doi.org/10.1108/13552559610153261

Pérez-González, F. (2006). Inherited Control and Firm Performance. *The American Economic Review*, *96(*5), 1559-1588. https://www.jstor.org/stable/30034985

Vieira, E. (2014). The effect on the performance of listed family and non-family firms. *Managerial Finance*, 40(3), 234–253. https://doi.org/10.1108/mf-06-2013-0134

Wennberg, K., Wiklund, J., Hellerstedt, K., & Nordqvist, M. (2011). Implications of intra-family and external ownership transfer of family firms: short-term and long-term performance differences. *Strategic Entrepreneurship Journal*, *5*(4), 352–372. https://doi.org/10.1002/sej.118

Yeh, Y., Liao, C. (2021). Are non-family successors all the same? Inside-promoted vs. outside-sourced. *Journal of Corporate Finance*, *71*, 102122. https://doi.org/10.1016/j.jcorpfin.2021.102122

Zhou, H., He, F., & Wang, Y. (2017). Did family firms perform better during the financial crisis? New insights from the S&P 500 firms. *Global Finance Journal*, 33, 88–103. https://doi.org/10.1016/j.gfj.2017.01.001

Zogning, F. (2017). Agency theory: A critical review. *European Journal of Business and Management*, *9*(2). https://www.researchgate.net/profile/Felix-Zogning/publication/364812853_Agency_theory_A_critical_review/links/635b26578d4484154a3df176/Agency-theory-A-critical-review.pdf

STOCKHOLM SCHOOL OF ECONOMICS
SSE RIGA

8. Appendices

Appendix 1.

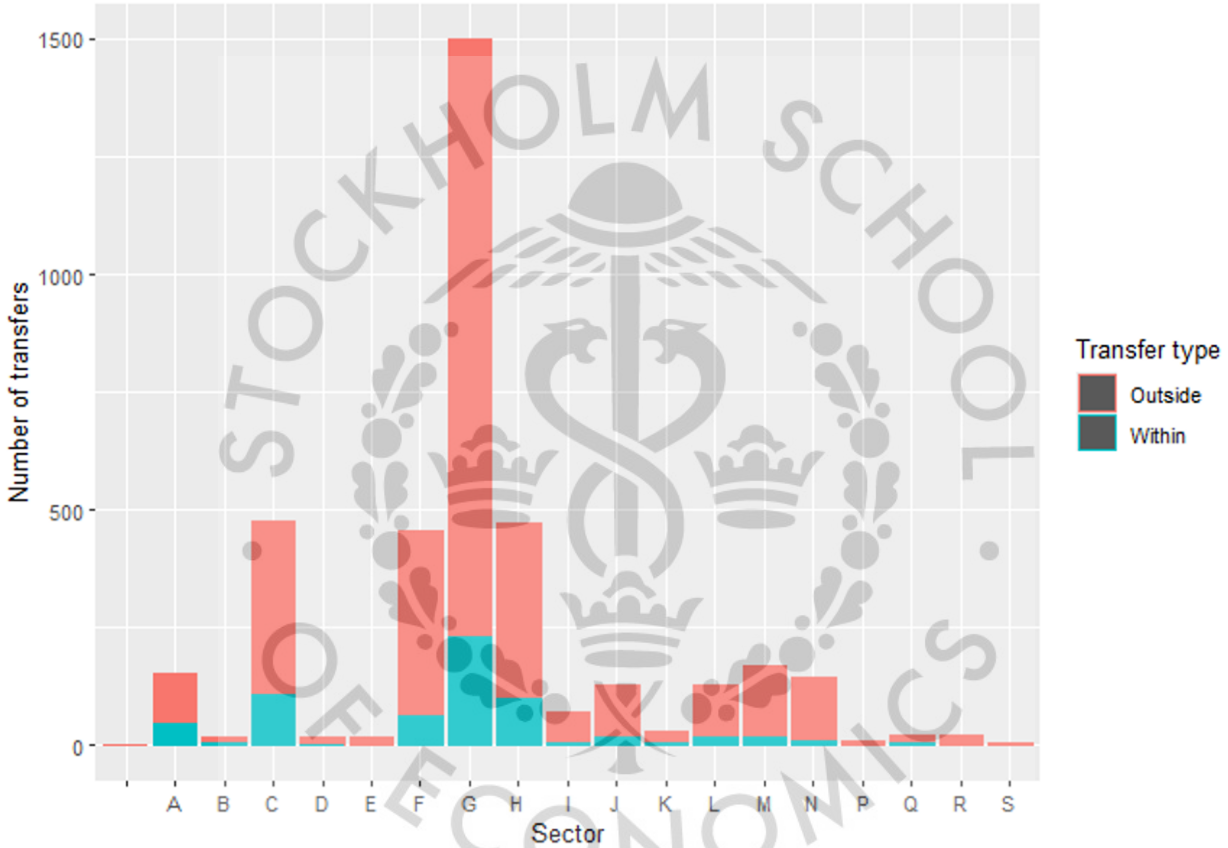
Ownership type examples. S – sole owner, FA – family authority, FS – family shared, SH – shared.

Type of transfer	Example of ownership change (examples of share % after the transfer)	Within family transfer?
S to S	A new person with the same last name owns >50% of the total company	YES
S to FA	A new person with the same last name owns >50% of the family shares AND the all the family members combined own >50%	YES
S to FS	The family still owns >50% collectively, but no one individually has >50% of the family ownership. (If a new family takes over)	YES (no)
S to SH	The family owns <50% in total after the transfer	NO
FA to S	A new person with the same last name owns >50% of the total company	YES
FA to FA	A new person with the same last name owns >50% of the family shares AND the all the family members combined own >50%	YES
FA to FS	The family still owns >50% collectively, but no one individually has >50% of the family ownership. (If a new family takes over)	YES (no)
FA to SH	The family owns <50% in total after the transfer	NO
FS to S	A new person with the same last name owns >50% of the total company	YES
FS to FA	A new person with the same last name owns >50% of the family shares AND the all the family members combined own >50%	YES
FS to FS	A new family takes over – the new family together owns >50%, but no one individually has >50% of the family ownership	NO
FS to SH	The family owns <50% in total after the transfer	NO

SSE RIGA

Appendix 2.

The distribution of ownership transfers, depending on the type, split by the industries, industry classification below.



A	Agriculture, forestry and fishing	H	Transportation and storage	P	P - Education
B	Mining and quarrying	I	Accommodation and food service activities	Q	Human health and social work activities
C	Manufacturing	J	Information and communication	R	Arts, entertainment and recreation
D	Electricity, gas, steam and air conditioning supply	K	Financial and insurance activities	S	Other service activities
E	Water supply; sewerage, waste management and remediation activities	L	Real estate activities		
F	Construction	M	Professional, scientific and technical activities		
G	Wholesale and retail trade; repair of motor vehicles and motorcycles	N	Administrative and support service activities		

STOCKHOLM SCHOOL OF ECONOMICS SSE RIGA