Analysis of key challenges of family businesses: the Croatian context

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Abstract

Family business represents the most common form of the company ownership and makes around 70% to 90% of all firms around the globe depending on the definition one uses. It is estimated that worldwide, family firms account for about 40% to 70% of employment and GDP. The aim of this paper is to provide an overview of main characteristics of family business in general and to analyze key challenges family businesses generally are facing today. Additional aim of the paper is to provide an overview of research on family business in Croatia and to analyze characteristic and challenges of family businesses in Croatia. Paper provides brief overview of key trends which can have negative implications on companies, their owners, as well as for a wide network of stakeholders such as family members, customers, suppliers, employees, banks, local government and the national economy in general. Some of the challenges discussed in the paper could be relevant to all types of firms. However, with reference to family business these challenges may be more salient than in nonfamily firms or they may need to be addressed differently.

Keywords: family business, Croatia, challenges

JEL Classification: L26, D10, D21 [Max 5 Classifications]

1. Introduction

Family business represents the most common form of the company ownership and makes around 70% to 90% of all firms around the globe depending on the definition one uses. It is estimated that worldwide, family firms account for about 40% to 70% of employment and GDP (Zellweger, 2017). Across Europe, about 70% to 80% of companies are family businesses which account for an important part (about 40% to 50%) of European employment (Austrian Institute for SME Research, 2008). They range from sole proprietors to large international companies. Big or small, listed or un-listed,
family businesses play a significant role in the EU economy (European Commission, no date).

The 2019 EY and University of St Gallen Global Family Business Index (2019) provides significant insights into the world’s largest family-owned businesses, ranked by revenues. On the frontend of top 500 list for 2019 were Wal-Mart Inc. (Walton family), Volkswagen AG (Porsche family), Berkshire Hathaway, Inc. (Buffet family), EXOR SpA (Agnelli family) and Ford Motor Company (Ford family) indicating that family firms are not only prevalent among small firms but as well among large ones.

Kružić (2016) states that the economic reality of the world’s economy is characterized by the dominance of family businesses, which leads to increasing interest of scientists, managers, consultants, lawyers, psychologists and family counselors, focused on the complexity of issues facing family businesses and family businesses.

The challenges faced by today’s family businesses are perhaps greater than ever: competing in a more turbulent environment dominated by pluralistic social values, intensified competition, a global economy and rapidly changing politics and regulation. Compounding such challenges are the complex relationships that exist between family members and the delicate balancing act required to combine family and work relationships. Moreover, there is no one rule that governs all – every family business is unique, deriving its personality from generations of family and business heritage (Deloitte, 2012).

The aim of this paper is to provide overview of main characteristics of family business in general and to analyze key challenges family businesses generally are facing today. Additional aim of the paper is to provide overview of research on family business in Croatia and to analyze characteristic and challenges of family businesses in Croatia. Paper provides brief overview of key trends which can have negative implications on companies, their owners, as well as for a wide network of stakeholders such as family members, customers, suppliers, employees, banks, local government and the national economy in general. Some of the challenges discussed in the paper could be relevant to all types of firms. However, with reference to family business these challenges may be more salient than in nonfamily firms or they may need to be addressed differently.
2. Family business: definitions, advantages and limitations

2.1. Family business definition

Intuitively, it appears rather easy to recognize the meaning of the term family business as its main determinants are family and company (business). However, in reality, the determination of the precise definition is rather difficult which confirm diverse approaches in defining the term family business (Kružić, 2016).

As Hoy (2017) states, there are many dilemmas in attempting to define family business such as:

- Must more than one family member work in the business?
- Must more than one generation be involved to qualify as a family firm?
- If partners cohabit but are not legally related, is their business family-owned?
- If the owners of a business are not related, but their children are employed in the company, has it become a family enterprise?
- When family members turn over the management of the business to non-family employees, does it cease being a family business?
- If a business that was solely owned by a family becomes a publicly traded company, can it still qualify as a family business?

In search of such demarcation line between family and non-family business many have tried to assign some cutoff level in the dimensions of ownership and management. The underlying assumption behind such an attempt is that a minimum level of family involvement is required above which a firm is defined as family firm and below which the firm is non-family (Zellweger, 2017).

Zellweger (2017) states that in the case of ownership control, some argue that a majority stake is required for a family to exert a decisive influence on a firm. Others suggest that control is possible even without a majority ownership stake as in publicly listed companies where significant minority ownership may be enough to control important strategic decisions in a firm.

According to Miller et al. (2008) defining family firms may vary according to the context of the research. For example, ownership percentage is essential in defining family firms listed in the stock market, while family involvement is important when investigating small family businesses.

The definition of the European Commission (no date) suggests that 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. The European Commission (no date) also states that to qualify as family business at least one representative of the family or kin is formally involved in the governance of the firm.

Family businesses in Croatia are not regulated by law nor are distinguished as a special type of company. None of the terms family business, family enterprise or family company are recognized in the systematization of companies in Croatia used by the Companies Law, nor it is the subject of any other law or any official classifications within the Republic of Croatia. Family business as the term itself does not provide an answer to the question of what type of company it is, nor prima facie reveals what lies beneath the family part of the term. Considering the absence of the definition of family business in theory and in practice, monitoring these companies is considerably more difficult. Due to different criteria used, different results on their number, structure and impact on the Croatian economy are collected (Braut Filipović, 2017).

2.2. Advantages and limitations of family businesses

Family businesses differ from non-family enterprises – as do business families from other types of family. Family firms enjoy unique advantages: their shared family vision, values and commitment can inspire employees and drive business performance; they’re seen as stable, reliable organizations; and they have the opportunity to be long-term oriented. But family companies are also prone to challenges: they can be inward-looking and resistant to change; they often face difficulties around succession and transitioning to the next generation; and they must recognize psychological, family-based, emotional dilemmas that, unchecked, will interfere with the company’s decision-making (IFB, 2019).

Kružić (2016) states the following advantages of family firms:

- family connection and desire to keep what is acquired;
- family readiness to renunciation, for the purpose of company’s prosperity;
- maintenance of work place humanity by expressing a high level of concern for individuals;
- orientation on long term because staying in family is for a long time, if not permanently;
- emphasizing the quality in order to keep the tradition of taking care about provided values to the customer/client;
- family business provides identity and the possibility to motivate members and non-members of the family, in their dedication to achieve joint goals;
- family enables leadership that is devoted to long term interests;
family enables education of the existing generation’s children and develops philanthropic feeling, including development of the social significance and contributes in building their respectability.

Furthermore, according to Kružić (2016) the limitations of family businesses usually emerge from:

- reality in which family members are at the same time executors of the family business, managers in the family companies and their owners, which often leads to unprofessionalism and improvisation;
- fact that connection of the members in the family business is not based on professional qualities but by blood relation which often leads to insufficiency of professional, specialist and leadership; knowledge;
- mixing family and business relationships with particular implication on management disorders, difficulties in delegation of duties and responsibilities of some family members and common occurrence of nepotism;
- existence of disagreement between affinities of some family members and family expectations and goals, which can lead to talent suffocation of the individuals and larger problems in cases of family member’s decision to separate from the family and leave the family business;
- high business risk, to which all family members are exposed to – potential possibility of bankruptcy and leaving family members without resources and employment is the reason why family members are exposed to daily stress.

The famous Three-Circle Model helps identify the roles, motivations, expectations and fears of individuals within three groups: ownership; the business; and family members. These three circles overlap (see Figure 1), defining seven categories of people who may want different things at different times – vital knowledge if you are to manage the complexity, role confusion and interpersonal conflicts that can arise in family companies (IFB, 2019).
1. External investors, who own part of the business but who do not work in it and are not members of the family;
2. Non-family management and employees;
3. Owners who work in the business but who are not family members;
4. Family members who own shares in the business but who are not employees;
5. Family members who are not actively involved in the business either as employees or owners;
6. Family members who work in the business but who do not own shares;
7. Inhabiting all three circles are owners who are also family members and who work in the business.

3. Analysis of family business key challenges

The challenges for family businesses in Europe can be divided into three categories (Austrian Institute for SME Research, 2008):
- challenges all businesses are confronted with in a similar way, e.g., the general economic climate, developments on the demand side such as demographic and socio-demographic changes;
- general business challenges which, however, are more severe for family rather than non-family businesses due to their specific characteristics, e.g., accruing financial means for growth or competing in globalizing markets.
- challenges that occur for family businesses only, e.g., coping with family business-conflicts, realizing a successful business transfer to the next generation

In this paper family specific challenge related to succession is further analyzed. Furthermore, general business challenges regarding war for talent, innovation and COVID-19 crisis are analyzed in terms of family business response to these challenges.

Succession. Due to the long-term orientation of family businesses and their strategic objective to pass on the firm from one generation to the next within the family, the issue of business transfer is of greater concern to family rather than non-family businesses (Austrian Institute for SME Research, 2008).

According to an EU survey from 2002, it was estimated that in the 15 member states that made up the EU at the time, average 610,000 SMEs annually expect a transition process, which indirectly affects 2.4 million employees. Research shows that only in 30% of family businesses ownership and management takes over next generation, and that many of these businesses fail soon after (Alpeza i Peura, 2012).
Business transfer is a complex, long-term process which has to be prepared well in advance. Complexity of business transfer is the result of legal, financial, organizational and psychological aspect of this process. Many successful companies reach for major changes when going through business transfer process. In the end those changes can shake the market position of the business transfer, no matter how well their financial situation is and if they have well-established business reputation or competitive product range (CEPOR, 2015). Business transfers can be achieved either by family members succeeding the company, employees acquiring the company or selling the company to the individuals or to the other outside company.

According to Kružić (2016) main challenges of business transfer in the family businesses are:

- how to choose the successor of family business among owner’s children;
- when is the appropriate time to choose the successor;
- which effects leadership change of family business will have on the existing owner and what is the best method to handle this change

When speaking to family business owners, studies show that most of them have the same challenges when it comes to business transfer including emotional connection to the company, challenge of maintaining balanced family relationships, choosing the adequate person to take over the company and the issue of company valuation (CEPOR, 2015).

The STEP Project 2019 Survey showed that seven in ten family business CEOs surveyed do not have a succession plan, even though 47% have a succession emergency plan in case of unexpected events. (KPMG, 2020).

Based on the surveys and conclusions, there are some barriers that can be solved and ease the business transfer process such as: awareness-raising for better planning and preparation, quality of support and advisory services, quality standards related to the functioning of online markets and their inter-connectivity and taxation which includes tax relief (European Commission, no date).

**Innovation.** European family businesses made innovation category at the top of their priorities and they are more focused on it. There is a rapid growth of changes and new technologies which can cause disruption in different industries. Many companies in Europe are actually forced to take drastic changes in order for them to adapt to new market conditions and compete with new business models (KPMG, 2018).
Family businesses can be in some cases more innovative than non-family businesses. They do have a large number of leaders and do not have to convince management when and what they want to innovate. However, family members who are planning business transfer process in the future are more interested in long-term investments (Rondi, De Massis and Kotlar, 2019).

Companies progress together with innovation challenges, actively following signal changes and correcting their decisions to indicate they have the ability to adapt to changes. Family businesses do not only think about innovation but also about strategic investments. Innovation investments are usually part of the daily business operations and not part of the specific department for research and development (R&D) or innovation department. This method of organizing the innovations decisions should not minimize the strategic significance changes (KPMG, 2018).

Majority of the companies lack a culture of innovation, regardless of their years of establishment. Most companies consider the lack of an internal culture for innovation as a very significant barrier against innovation. For more mature family businesses, limited resources are a main challenge (KPMG, 2017).

**War for talent.** War for talents is one of the most significant preoccupations in the family businesses. Rapid growth of demand for new talents represents results of making non-traditional and technical roles needed for activating innovations. Non-traditional and technical roles, that are very important for starting innovation and supporting family businesses in the business context and in the digital economy, are detected as very problematic (KPMG, 2018).

Special skills, that this type of position requires are maybe not available in the family and cannot be developed and adopted through traditional educations and development and this is why family businesses have to look for talents outside of the company. Family businesses are competing more and more with private and public companies that can offer good working conditions to the talents. Contrary to those conditions, they offer creative approach to the compensations, stimulations and benefits while in the same time focusing on the advantages of working in the family owned business. Companies that are the most successful in the attracting and keeping the talent have the strategy that contains enjoying and accepting the core values of family owned business (KPMG, 2018).

European family business barometer for 2019 (KPMG, 2019) showed that the war for talent is one of the leading area of concern for Europe’s family businesses (63 percent). High-growth companies are especially concerned: 73 percent of firms whose staff numbers have risen by 20 percent or more cite the war for talent as a top worry.
Even firms whose workforces have declined say finding talent remains an important issue (54 percent). The war for talent appeared to be most acute in Belgium (84 percent), Croatia (77 percent) and Ireland (79 percent), while it’s far less of a concern in Italy (51 percent) and Switzerland (39 percent).

Even firms whose workforces have declined say finding talent remains an important issue. On the contrary, some of the reasons why companies might be losing war talent are: informal pay governance process because is less formal in family owned business than in public companies, absence of compensation strategy and lack of external market knowledge (Seitz, no date).

Family businesses are confronting challenges in a way that they need to balance requirements of the business and also expectations of the family. With right strategy and skills, it is possible to establish an environment where everyone would be able to prove themselves and build a good foundation for business and family as well (Lynch, 2021).

COVID-19 crisis. When talking about difference between family and non-family business and their response to COVID-19 crisis, it is important to mention that family businesses are experiencing crisis differently than non-family businesses because their experience is based on long term horizons. Most of the family businesses were negatively impacted by the pandemic. Researches show, most of the owners of the family owned businesses did not worry about short-term revenue loss and cash flow. The answer to question why do family businesses react to crisis better lies in the fact that in multigenerational family businesses they define success in different ways and as said they think long-term. This long-term way of thinking makes them more ready to dive into new business ranges (Liberti, 2020).

According to Wenzel, Stanske and Lieberman (2020), strategies family businesses can use to overcome crisis in this case pandemic and depending on the family and ownership resilience are following:

- Exit/Retrenchment strategy – this refers to the deliberate discontinuation of business activities
- Perseverance strategy – maintaining status quo of its business activities
- Divestment strategy – this applies to eliminate a portion of the business
- Innovation strategy – adopting new business models and innovations as a way of going out of crisis (Jayakumar, De Massis, 2020).
4. Characteristics and key challenges of family business in the Croatian context

4.1. Characteristics of family businesses in Croatia

Within the existing legal framework regulating company law, there is no specific definition of a family business. There are examples of very large companies which are run as family companies both in terms of the ownership structure as well as management of business processes. On the other hand, there are single proprietors and crafts which are not run as family businesses but are just a legal form of economic activity. In the past, a craft was almost always a family business which was handed on from owner to siblings. Today, a craft is just a legal form which is different from other legal forms such as a limited liability company or a shareholding company in various aspects such as ownership rights, liability, regime of paying taxes, etc. None of these general laws which define economic units contain the concept of a family business (Crnković Pozaić, 2008).

There is no empirical evidence of the family business which is based on a single definition and it is impossible to ascertain their structural components such as a delineation by size, number of employees, share of value added, and other considerations (Crnković Pozaić, 2008).

As data for 2019 in table 1 shows, 99.7% of all companies in Croatia are SME’s, they employ 74.3% of the employed, create 60.3% of total income and contribute to 53% of exports (CEPOR, 2020). However, the share of family businesses in the total SME number is rather difficult to estimate.

According to the Business Transfer Barometer Croatia survey (CEPOR, 2015), 97% of business owners of SMEs in Croatia, 55 or more years of age have children, but only 38% of owners have a family member who is involved in owning or managing the business, which, according to the EU definition, categorizes them as a family business. This is a significantly lower share compared to 65% of the share that family businesses have in Western European countries. It is worth noting that these countries have a long tradition of entrepreneurship and private ownership while Croatia is only in the phase of the first wave of the business transfer process.

Table 1. Significance of SMEs for Croatian economy (source: CEPOR, 2020)

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<tr>
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<th>2018</th>
<th>2019</th>
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<tr>
<td>Number of small and medium enterprises</td>
<td>130.757</td>
<td>135.890</td>
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<tr>
<td>SMEs share in total number of enterprises</td>
<td>99.70%</td>
<td>99.70%</td>
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<tr>
<td>SMEs share in total number of employees</td>
<td>72.20%</td>
<td>74.30%</td>
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As Kružić (2016) states family businesses in the Republic of Croatia have not been researched in a way that would provide an opportunity to quantify their impact on the national economy. The transition of the social and economic system has enabled a significant increase in the number of family businesses, both those newly established and those that have become the property of individual families through privatization processes.

In public discussions, family business represents a business that is family-owned, and provides jobs and income for family members. It is estimated that 50% of employees in Croatia work in family businesses, that most micro and small companies in Croatia are family-owned, and that they are owned by the first generation of entrepreneurs who manage the company at the same time. In Croatia, there are examples of large companies operating as family businesses - both in terms of ownership structure, and in terms of managing business processes and involving the owner’s family in making strategic decisions in the company. Some of the most successful companies in Croatia in the post-transition period were started as family businesses (e.g. Agrokor) or have been successfully repossessed by the family after their nationalization in the period of socialism (e.g. Gavrilović) (Alpeza i Peura, 2012).

As Crnković and Pozaić, (2008) state the statistical data being very vague on family businesses makes experiential data more informative. The interviews carried out with experts point to the following characteristics of small family companies in Croatia:

- They are typically owned by the head of household who is more often male than female;
- It is most often either a family farm or a craft but in fewer cases it is also a limited liability company;
- Size of the company is small, usually up to 10 workers;
- Usually the spouse is also active in the firm as an unpaid family worker and the siblings participate occasionally if they are still going to school/college or more regularly if they have finished their regular school;
- The siblings are often employed with a work contract in order to attain health and pension insurance;
- Family businesses in agriculture are specific in that they are strongly differentiated according to their relationship to the market: some are commercial and some are subsistence;
• Services in tourism are also often family businesses but are often seasonal in character so that family members have additional occupations;
• It is frequent to work as an employee and also have a business where the spouse is usually the dominant figure although seldom the actual owner;
• Although mostly small in size, family businesses can be large and there are several very large firms in Croatia which fit the family business pattern.

Empirical research on family business is rather scarce in domestic literature. Renko et al. (2007) conducted research on the population of prospective borrowers of promotive loans offered by the Croatian Bank for Reconstruction and Development from their Program of financing the encouragement of small business foundation.

Some of the findings were following:
• the highest number of family businesses are in the agricultural domain and are based on family tradition;
• there is a significant number of family businesses in tourism and catering services which are based on a multitude of seasonal jobs in the form of tourist apartments and rooms for renting with meal service or without meal service;
• there are not as many family businesses in services, especially material service projects;
• there is extremely small number of production based family businesses.

4.2. **Key challenges of family businesses in Croatia**

Some of the main obstacles and challenges for family businesses in Croatia are lack of definition, lack of statistical monitoring, lack of support in the transfer of ownership and management, no specialized consulting services, few appropriate educational programs and marginalization of generational transfer issue (CEPOR, 2013).

For family business owners in Croatia succession presents probably the most challenging part of managing family firm.

Insight into the issue of entrepreneurial exit in Croatia is provided by two surveys: GEM - Global Entrepreneurship Monitor, which has been conducted in Croatia since 2002 and Business Transfer Barometer Croatia Research from 2015 conducted by CEPOR - Center for Policy Development of Small and Medium Companies and Entrepreneurship. The objectives of this study were to determine: the number of companies in Croatia that, given the age of the majority owner (55 and older) and their attitude towards business transfer represent a risk group, the way they plan to conduct business transfer, and the need for support in that process.
A significant proportion of business owners who participated in the Business Transfer Barometer survey, who think about the future of the company after their withdrawal from management, believe that the company will continue to operate (65%), only 6% believe that the company will be sold (signifying continuation of the business), while 7% believe that the company will be closed. In the European Union (Varamäki, Tall and Viljamaa 2013) the share of companies sold after the withdrawal of owners from business is almost 40%. This indicates a significantly lower share of business owners in Croatia who see the sale of the company as possible strategy to exit the entrepreneurial venture compared to companies in the European Union. The results of the same survey also show that a relatively small proportion of business owners are considering other exit options such as selling a business, transferring management role to one of the key employees, or hiring an external manager. According to research conducted in the EU, only 15-35% of businesses transfer business to family members and continue to operate as a family business (CSES, 2013).

The results of the survey indicate: 16,590 companies whose owners should start planning the business transfer process with about 179,000 employees in these companies, and more than 5,300 companies that represent a risk group, which puts in question about 57,000 jobs (CEPOR, 2015).

Key recommendations important for creation the assumptions for the development and sustainability of family businesses in Croatia are businesses (Alpeza i Peura, 2012).

- adoption of the definition of family introduction of statistical monitoring of family businesses (State Bureau of Statistics, FINA);
- create a support program for family businesses in generational transfer that would include education and assistance of professionals advisors;
- create training programs (train-the-trainers) and specialization advisors on family business transfer issues, using the European best practices
- organization and support by the line ministry for national events with the aim of exchanging best practices (conferences or round tables on family businesses);
- launch national center/ family business institute on the principle of public-private partnership with clear research, lobbying and educational role in the development of family business field.

5. Conclusion

It can be concluded that family firms are the dominant form of organization across the globe, contributing to 70% to 90% of all firms worldwide.
Considering advantages and limitations of family businesses, the family businesses can be the source of stability for family members sharing the same family values as well they could be the source of family conflicts which hinder realization of family business goals.

The absence of the universal definition of family business in theory and in practice, makes statistical tracking of these companies more difficult which results in different data on their number, structure and impact on the economy being gathered.

In Croatia, there are examples of large family companies as well as small ones. However, family businesses in Croatia were not researched in a way that would quantify their impact on the national economy. The domestic literature is rather scarce in empirical research on family businesses.

Family businesses face general business challenges which impact all companies, however, these challenges may be more severe for family rather than non-family businesses due to their specific characteristics. Additionally, there are challenges that occur for family businesses only.

One of the key challenges specifically related to family business is succession. Because of the high rate of failure in implementation of the business transfer process in small and medium-sized enterprises managing business transfer process is of the determinants of long-term sustainability of small and medium-sized enterprises.

The importance of business transfer problems is additionally emphasized in Croatia due to the large number transfers that are expected to occur in companies established in the 1990s. The success of business transfer process in Croatia will be dependent on the engagement of government bodies, entrepreneurial support institutions, universities, research centers, banks, advisors and finally business owners.

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