
Family Business in the Czech Republic

Pavla Breckova¹

Abstract:

The modern history of private entrepreneurship as well as family businesses in the Czech Republic began a quarter of a century ago, which, compared to traditional democracies, is a relatively short period of time. During this period, companies underwent turbulent changes, and although the perception of entrepreneurship has not changed much since the 1990s, and entrepreneurship is still not held in much esteem by society, the image of family firms and their actual sophistication is much more positive. The purpose of the research was to map out the current situation of small and medium-sized family businesses in the Czech Republic, the perception of barriers for the business and the perception of positives associated with the typical features of a family business. This paper also offers a structured basic identification of the pros and cons of family business in the environment of young democracy perceived especially by the family businesses themselves. It is based on the quantitative survey conducted among 505 respondents – family businesses in the segment of small and medium sized enterprises (SMEs). This research has filled the gap in knowledge about the topical priorities of SME family business; it is these top priorities, which provide the most valid signals about the current condition of this part of the national economy.

Key Words: family business, SME

JEL Code: M10, M13, M19

¹ Pavla Breckova, University of Finance and Administration (VSFS, www.vsfs.cz), Estonska 500, 110 00 Prague, Czech Republic. Telephone: +420 210 088 804, e-mail: pavla.breckova@vsfs.cz. She is long term academically focused on segment of small and medium sized enterprises and institutionally involved in Association of small and medium sized enterprises and crafts of the Czech Republic (Vicechair of Board of Directors). She has been actively involved in dozens of research papers on the business environment, with a particular focus on SMEs.

1. Introduction

Private business generally in the Czech Republic has a complicated history. If we count it just within the sovereign state times, it started 1918 with the common state with Slovaks, i.e. Czechoslovakia. The period of 1918-1938, before Adolf Hitler came, it is called “First Republic”. Within this period, in the time of economic rise the family businesses flourished and used to have a very good reputation. Social perception of family business generally was positive. The tradition of private business was interrupted by the 2nd World War and the interruption lasted for long half a century. It had a devastating impact on the business culture and, perhaps consequently, on social perception of doing own business.

The “Velvet revolution” in 1989 meant changes in the political structure and consequently in the equity structure which resulted in major changes in market principles that had been interrupted for many years. The 90s were rather wild in terms of business environment: enormous demand for almost anything and lack of good legislation created often-unhealthy business manners, relationships, corruption.

Although this period passed a relatively long time ago and standards have been set up, and in spite of cultivation of the business environment, people still perceive business enterprise as something that is not always very transparent and even borders on fraud. Despite numerous examples of best business practice, being a businessperson is not ranked as one of the top high prestige jobs. This is shown by a survey carried out by Breckova and Havlicek (2015) concerning motivation and barriers when starting one’s own business, in particular with regard to the younger generation: “A certain role may also be played in this area by the overall general social perception of business activity and to a certain extent even criminalisation of business activity, in relation to statements from government officials mainly from the left-wing of the current group of political leaders in the Czech Republic”.

Family businesses also underwent a certain type of development in the postrevolutionary period. It was much more natural and more accessible to start a business as a small family firm, involving other family members; this was due to several reasons, amongst others, financial reasons. On the other hand, entrepreneurship was at its very beginning in the CR, just like the associated legislation and business environment. Everybody was, more or less, learning on the job since the prevailing majority of the population had, until then, been employees of the socialist system. Their inexperience and some, fairly understandable, signs of unprofessionalism were mostly apparent in family businesses where the jobs at the top were, quite logically, filled with people from within the family, and the selection criteria were not only about professional qualifications. On the one side, this approach brought many positives; however, family businesses lacked professionals, good sales representatives and communicators. This was clearly demonstrated in

more exact fields such as machinery and other types of production and the restricted ability to export. Quite logically, this was reflected in how society perceived family businesses, i.e., as less professional with non-standard internal company procedures. On the other hand, as claimed by Benacek (2006), “authentic small-scale family businesses were often squeezed out of the space for rapid development by surviving former state-owned enterprises that were converted into corporations owned formally by thousands of minor stock-owners but run in fact by a thin class of insiders with dominant stakes”. The same author claims that privatised companies, even if owned by families, completely lacked the traditional features of a traditional family business, such as independence from the State, evolution through the toil of generations and a strong set of ethical values, which rendered them a distinct identity.

Nevertheless, genuine family businesses were known for their enormous drive and commitment, and thanks to this, many family businesses started developing, alongside the entire market, and became very good companies with standard procedures, professional PR communication and quality products. The current perception of family businesses by society has moved to where they are seen as more trustworthy, in particular in the service sector (accommodation, hospitality), and they have become clear favourites on the market.

Considering the aforementioned, the survey respondents (family businesses) presented in this paper view the nature of a family business as an advantage when running a company, however, this might not necessarily be a business advantage when viewed by society. The survey on which this paper is based was carried out amongst 505 family businesses in the Czech Republic, all of them from the small and medium-sized enterprise (SME²) segment, with a set criterion of the number of employees (i.e., up to 250).

2. Literature review

The segment of small and medium-sized enterprises is crucial for any economy; however, political parties have different attitudes towards this segment during their

² For defining micro, small and mid-sized enterprises, we use the standard European Commission Regulation (EC) No. 651/2014 dated June 17th, 2014. The basic criteria for evaluating the size of an enterprise include the number of employees, the annual turnover and the balance sum of the yearly balance sheet (size of assets/property). A tiny (micro), small or mid-sized enterprise is generally understood as an enterprise that employs fewer than 250 people and whose annual turnover/revenues do not exceed EUR 50 million and whose assets/property do not exceed the value of EUR 43 million. In the category of small and mid-sized enterprises (SME) small enterprises are defined as enterprises that employ fewer than 50 people and whose annual turnover/revenues or assets/property do not exceed EUR 10 million. In the category of small and mid-sized enterprises (SME) tiny (micro) enterprises are defined as enterprises that employ fewer than 10 people and whose annual turnover/revenues or assets/property do not exceed EUR 2 million.

election periods. It is true that, in particular in post-communist countries in Central and Easter Europe, there is generally no unified strategic approach to this segment, which would be respected and fulfilled over a long period. An important feature of SMEs in national economies is stability. “They only rarely leave the home country in terms of moving manufacturing sites, and only rarely transfer the capital out of country” (Breckova and Havlicek, 2013a and 2013b). These authors continue, “one of the main assets of the SMEs nevertheless, is their flexibility and an ability to survive under various conditions and it applies also to the international operations, which are no longer a domain of large or multinational companies.” Benacek and Michalikova (2012) also document a varied approach to the SMEs segment: “Although economically widened after the EU enlarged from 15 to 27 member countries during 2004-2006, Europe remained nevertheless highly heterogeneous both to the degree of economic development, internal policies and entrepreneurship”.

Family businesses have become a dominant feature of the Czech economy. There are dozens of definitions of family businesses, however, it is not a primary purpose of this paper to state or extract these definitions. For the purposes of this paper, a family business is a business where most of the capital and executive management lies in the hands of two or more family members. We can identify with a broader description of a family business provided by Eisenhardt (1989) who defines a business as a family business if a member of one or more families (rather than a state, corporation, or management trust) is its controlling owner, implying a managerial commitment toward the business’ overall performance. The main strength of a family business rests in the combination of unambiguous ownership by a person with a managerial stake, which allows for direct accountability and enforcement of property rights, without recourse to moral hazard and asset stripping. It also results in high wage flexibility and persistent personal commitment to the wellbeing of the firm. A family firm is generally relieved from the risks of relying on agents that are able to dominate over principals (owners). Such a mismanaged ‘agency dilemma’, backed by asymmetric information, leads to conflicts of interest, uncertainties, moral hazard, rent-seeking, adverse selection, bureaucracy, corruption and suboptimal performance (Eisenhardt, 1989). Other advantages of family businesses are their greater ability to withstand economic shocks (partially due to downward wage flexibility), high investment, reliance on its own savings and net job creation (Benacek and Michalikova, 2012).

Another author (Koráb, 2008) admits that family businesses have been considered an obsolete way of running a company in Europe. "Experts claimed that family firms are only interested in their traditions and in their existence, and they never enter the modern era. However, lately the taunting has eased. Due to the feeling of responsibility for spending private resources, family-run businesses are far more flexible and more focused on their objectives than externally appointed managers are. Owners have obligations not only towards the business but also towards their

successors within the family" (Koráb, 2008). This paper focuses on the current state and current problems of family businesses in the Czech Republic, based on the results of the survey conducted in the SME segment in the first half of 2015.

3. Material and Methods

Family business in the Czech Republic and its typical features were researched in the survey conducted in April 2015 and the author of this paper was actively involved in it (for details see the AMSP's 32nd survey with the title "*Situation of Family Business in CZ*", 2015)³. The survey on which this paper is based was carried out amongst 505 family businesses in the Czech Republic, all of them from the small and medium-sized enterprise (SME⁴) segment, with a set criterion of the number of employees (i.e., up to 250).

The main objectives of the survey were to map out the current situation of family businesses, the perceived barriers to their business and positives associated with the typical features of family businesses. Another primary area of the latest survey of family SMEs was to map out their current operating priorities since these provide the most valid signals about the current situation of this part of the national economy.

In order to obtain the empirical material quantitative research were chosen and has been applied. The main research method was the research survey using the in-depth telephone interviews based on a questionnaire for data collection. Computer Assisted Telephone Interviewing (CATI) was applied as the main survey method and the contacts were randomly selected among the family small and medium sized enterprises from the publicly available databases. The survey conductors requested data from respondents during telephone interviews based on the structured questionnaire in the electronic script for 12 minutes and stored the data directly on the PC. The number of respondents who answered the entire questionnaire was 505 and they had between 6 to 249 employees as shown as follows divided by the prevailing criterion (number of employees): 6-20 employees (81%), 21-99

³ AMSP CR survey with the title "Family Business in CZ", 2015, available at <http://www.amspace.cz/32pruzkum-amspace-cr-rodinne-firmy>

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employees (18%), 100-249 employees (1%). No other conditions concerning size were applied; however, a majority of the companies (82%) showed a turnover of up to 110 million CZK (equivalent to circa 4 million EUR).

The structure of the respondents' sample was as follows: about 45% were manufacturing companies, 15% trading, 30% service sector. Highly competent people, mostly family members of the family businesses approached, answered the survey questions.

4. Results and Discussion

The main findings of the survey of family businesses are as follows:

1. Most of the respondents consider the nature of a family business to be an advantage when running a company.
2. Half of the company representatives state that their children are also working for their company. A third of them got involved in running the company at the age of 18-21.
3. 68% of respondents view it as very important if family members gain experience in foreign companies.
4. 9 out of 10 company representatives agree that a company should be handed over when the owner is still alive. Bequeathing a company in a will is not a good option according to the majority of respondents.
5. 58% of respondents would be willing to sell their company outside the family if conditions were favourable.

More than two-thirds (69%) consider the nature of a family business to be an advantage, and only 6% of respondents view it as a negative. The most common advantage of a family business, as stated by 82% respondents (i.e., representatives of family firms in the SME segment), is flexibility, which is viewed as a major benefit. Three-quarters of family businesses also appreciate business ethics and view their ethics to be of a higher standard than the general business standard. The three biggest advantages of a family business, as viewed by a similar ratio of respondents (70%), are company stability, atmosphere at the company and attitude towards employees, which are again perceived as better than the general standard in the entrepreneurship sector.

When evaluating the functionality of the management system in a family business, a positive perception still prevails (63% of respondents), however, 15% view it as a relatively major disadvantage. This is because the competencies of the family members are not clearly defined and there are formal and informal influences, which can be different in their private and business lives. It might be quite surprising to find out that 62% of family businesses in the SME segment put an emphasis on long-term planning. There is a logical explanation for this, however, it does not

correspond to, for example, and general numbers in the SME segment where the emphasis is mostly put on short-term and medium-term planning. Nevertheless, in the same survey a tenth of family businesses consider long-term planning their weak point.

As their biggest disadvantage, family businesses consider their access to financing; this was stated in the survey by nearly a quarter of their respondents. This is something, which will surprise us only partly since the SME segment is generally underfunded, in other words, the approach to operating and investment financing has been perceived as negative over a long period. However, this goes against the general trend, when banks declare sufficient resources and willingness to provide credit, in particular to family businesses. Typical features of a family business (its character) that were the basis for the aforementioned survey⁵ can be defined in the manner shown in Figure 1.

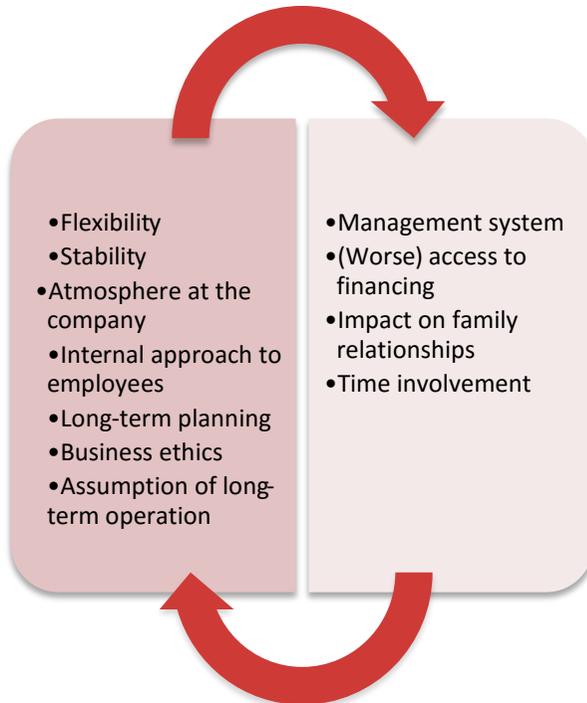


Figure 1. Typical Features of Family Business

Source: Author's elaboration, 2015

⁵ AMSP CR survey with the title "Family Business in CZ", 2015, available at <http://www.amspace.cz/32pruzkum-amspace-cr-rodinne-firmy>

The stated features in Figure 1 can be both positive and negative, as depicted: the left-hand side states mostly positive features associated with a family business, the

right-hand side includes features which are mostly perceived as a risk or being negative. However, some specific features can very quickly move from one category to another. These typical features are processed within the context of the Czech business environment, however, it is possible to generalise them, at least within the V4 Region (Visegrad Group 4) and in some other post-communist countries.

The survey also covers current problems experienced by family businesses in the Czech Republic, the biggest problem, according to respondents, being recruitment (outside the family). This was stated by 36% family businesses. It is shown that, with the rate of unemployment going down and higher requirements for company effectiveness, the labour market is less able to cover business needs. This corresponds with the long-term criticism of the government that keeps providing incentives to, mostly, foreign investors, subjecting their success to creating thousands of new jobs at times when there is a sharp decline in unemployment. The author of this paper earlier published that small and medium-sized enterprises may suffer from these incentives because they are typically unable to achieve convenient tax and financial support conditions. Moreover, SMEs neighbouring with these supported investments experience lower competitiveness, minimally locally or regionally, e.g., in drafting of qualified professions (Breckova, 2015; Havlíček, Thalassinos & Berezkinova, 2013).

Half of the respondents - representatives of family businesses - employ their own children; most often, they get involved in working for the family business at the age of 18-22. However, the issue of succession seems to be an arising problem in the Czech Republic. The post-revolution generation of people who founded their own companies are nearing retirement age, and the new generation should now start running the companies. However, there is no historical experience, or approved models, and no best practice in the local conditions are easily available. It is possible to look abroad, especially in the countries with non-interrupted tradition of free enterprise and the tradition of family businesses; however, it is never applicable in a larger scale. The history is different, so are the habits and social perception, business practices and also embedded legislation and linked trust in certain tools (for example, trusts, family funds, etc.). Most family businesses (68%) agree that it is vital that the successor of the owner gains experience in other companies. Most of the respondents deem it sensible to start talking to their children about getting involved in the family business before they turn twenty.

The fifth key finding concerned the attitude of family business representatives to selling their business outside the family. 58% would consider a sale of a family business, providing the offer was tempting, and 2% of respondents are planning to

sell their business in the near future. This is an interesting finding, which shows that owners do not have an emotional link to their companies, and they are rational enough to admit that if they receive an interesting offer they would consider selling

their family business. It can also be assumed that they have learned from the 2008-2011 crisis. However, it is still significantly more acceptable for owners of family businesses to hire a manager outside the family than to sell their family business (73%).

The survey⁶ also examined priorities of family businesses concerning their development. In 2015 the company representatives estimated the development of sales revenue for the coming years optimistically; their priority was to ensure the efficiency of their business, as shown by Figure 2.

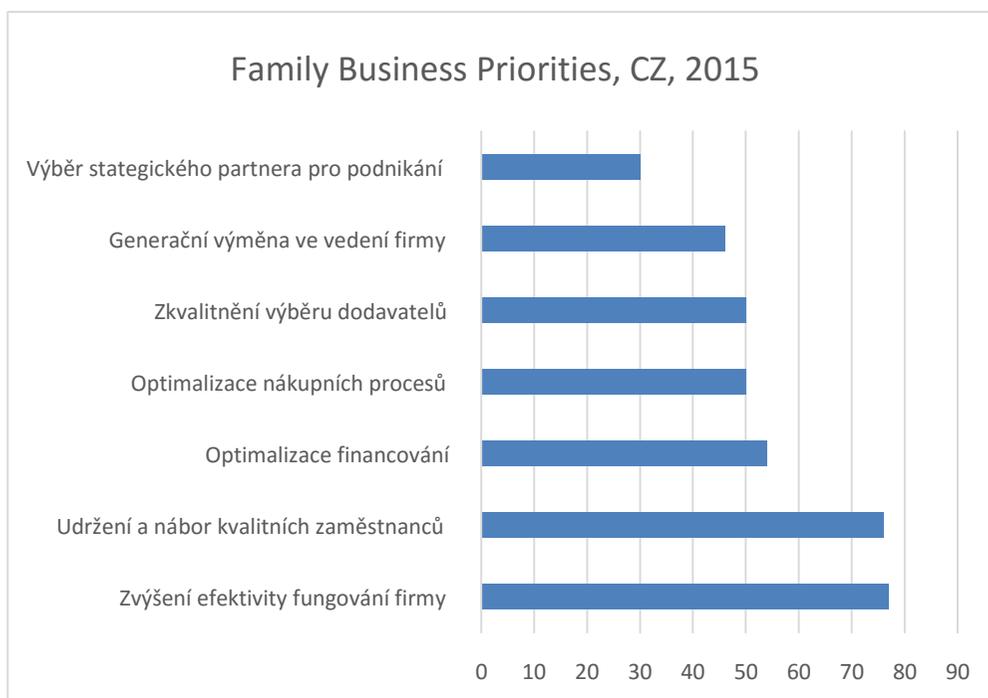


Figure 2. Family Business Priorities, CZ, 2015

Source: Author's elaboration, 2015

⁶ AMSP CR survey with the title "Family Business in CZ", 2015, available at <http://www.amspace.cz/32pruzkum-amspace-cr-rodinne-firmy>

Selecting a strategic partner for business
Generational change in company management
Improving the selection of suppliers
Optimising procurement processes
Optimising financing
Maintaining and hiring good quality employees
Increasing efficiency of company operations

77% of respondents wish to directly focus on increasing efficiency of the company. Maintaining and recruiting good quality employees is viewed as crucial (76%). More than half of family businesses consider it their current priority to optimise financing (54%), and to optimise procurement processes (50 %), which is related to a better selection of suppliers. As mentioned above, the issue of succession is topical, and the generational change in company management is considered a priority by 46% of family businesses.

Amongst others, the survey confirms the latest trend that family businesses believe in their abilities, products and personnel. It is positive news for the prosperity of the country that companies do not focus on their turnover, but profitability and the benefit associated with good quality employees.

Conclusion

The modern history of private business as well as family business in the Czech Republic started a quarter of century ago, as stated in the abstract of this paper. Private enterprise has developed and undergone many changes since the 1990s. The same goes for family businesses in the SME sector, which this paper focuses on. The paper is based on findings established in a quantitative survey of family businesses in the SME sector. Primarily, the survey focused on mapping out the current state of family businesses with an emphasis on the advantages and disadvantages of family business, as stated above, and on the perception of family businesses by their actual owners. The survey also examined the current priorities of family businesses, which do not differ much from the problems that are addressed by the entire SME segment, with the exception of succession and involving children in running a family business, which are typical features of a family business. This issue is becoming even more topical now since a new generation should be taking over the company management. Those who founded family businesses in the 1990s are nearing their retirement age, but they want to remain involved in running the family business. They are dealing with the issue of succession and efficient handover of their companies. This is in fact the first wave of handing over a family business to the next generation in the Czech Republic, and many businessman, quite logically, are not sure how to proceed with regards to succession. Historical experience is missing,

as are approved models, and no best practice in the local conditions are easily available. It is possible to look abroad, especially in the countries with noninterrupted tradition of free enterprise and the tradition of family businesses; however, it is never applicable in a larger scale. The history is different, so are the habits and social perception, business practices and also embedded legislation and connected trust in certain tools (for example, trusts, family funds, etc.).

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More than two-thirds (69%) perceive the nature of a family business as an advantage when running a business, and only 6% of respondents consider it to be something negative. The most common advantage of a family business, as stated by 82% respondents (i.e., representatives of family firms in the SME segment), is flexibility, which is viewed as a major benefit. Three-quarters of family businesses also appreciate their business ethics and view them to be of a higher standard than the general business standards. The three biggest advantages of a family business, as viewed by a similar ratio of respondents (70%), are company stability, atmosphere at the company and attitude towards employees, which are again perceived as better than the general standard in the entrepreneurship sector. When evaluating the functionality of the management system in a family business, a positive perception still prevails (63% of respondents), however, 15% view it as a relatively major disadvantage. This is because the competencies of the family members are not clearly defined and there are formal and informal influences, which can differ in their private and business lives.

On the other hand, as their biggest disadvantage family businesses consider their access to financing, this being stated in the survey by nearly a quarter of respondents. This is something that will surprise us only partly since the SME segment is generally underfunded, in other words, the approach to operating and investment financing has been perceived as negative over a long period. However, this goes against the general trend, when banks declare sufficient resources and willingness to provide credit, in particular to family businesses.

⁷ AMSP CR survey with the title "Family Business in CZ", 2015, available at <http://www.ampsp.cz/32pruzkum-ampsp-cr-rodinne-firmy>

The survey also examined the priorities of family businesses concerning their development. In 2015 company representatives estimated the development of sales revenue for the coming years optimistically; their priority was to ensure the efficiency of their business. For the future prosperity of the country, it is positive news that they do not focus on their turnover, but profitability and the benefit associated with good quality employees. 77% of respondents wish to directly focus on improving the efficiency of company operations. The key is to maintain and recruit good quality employees. More than half of family businesses consider it their current priority to optimise financing (54%), to optimise procurement processes (50%), and thus to improve the selection of suppliers.

As mentioned above, the issue of succession is topical and a generational change in company management is considered a priority by 46% of family businesses. Half of the respondents - representatives of family businesses - employ their own children; most often, they get involved in working for the family business at the age of 18-22. Most of the respondents deem it sensible to start talking to their children about getting involved in the family business before they turn twenty.

The rational thinking of family businesses is also becoming evident. One of the key findings of the carried out survey was the willingness to sell their family business, providing the terms were beneficial, outside the family (58%). Nevertheless, the option of hiring a company manager outside the family still prevails over sale (73%); still, this is an interesting finding showing that owners do not have an emotional link to the company any more, and they are able to make a rational decision that if an offer were interesting they would be willing to sell their family business.

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