

FIDUCIARY ASSET MANAGEMENT

As a means of founders' transgenerational succession strategy

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ABSTRACT

The 1990s generation of the fall of communism has reached retirement age by now, so the time has come for a generational transition. Studies on the succession of family enterprises mainly focus on internal factors such as professionalisation, involvement of external managers, successors' socialisation, or the issue of asset values. However, the institutional environment shaping succession options including inheritance law, formal intermediaries, succession-related tax rules also have a major impact on the long-term survival of family businesses and the transfer of wealth from one generation to the next. The objective of this paper is to shed light on the peculiar features of family enterprises and their internal factors defining succession alternatives in this country. It intends to describe the formal set of institutions and the relationship between those institutions, transgenerational wealth transfer, and succession strategies. In the case of mixed exit strategies, it analyses the options, advantages, and risks of the application of fiduciary asset management as one of the “wedges of asset management” between the principals of family enterprises and the managers.

JEL codes: D64, K36

Keywords: fiduciary asset management, family enterprise, succession alternatives, strategy of succession, asset transfer

1 INTRODUCTION

The set of family enterprises is an infinite multitude that consists of extremely diverse components. Its components change in time while it is also characterised by major geographical differences. The relationship between the family and the enterprise is different if there is an ownership community of the founder including siblings and cousins (*Gersick–Davis–McCollom–Hampton–Lansberg, 1997*). The

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actual family and its legal concept identified in different legal systems may also be different (*Zellweger, 2017*). Differentiating family enterprises from non-family enterprises using further factors (*Astrachan-Klein-Smyrniotis, 2002*) in addition to the trio of family, ownership, and management (*Tagiuri-Davis, 1996*) is even more complex. There are differences in different geographical regions and countries because of diverse social systems, the size of enterprises and the different legal systems (inheritance laws). Whichever approach is used for analysis, their being transgenerational bridging families and generations is a key characteristic for the separation of family and non-family enterprises.

Transgenerational asset transfer, however, is not restricted to the handover of material assets - the family enterprise and the business portfolio. Transferring non-material assets, socioemotional wealth (SEW) also become emphatic in addition to asset transfer. Family enterprises accumulate certain immaterial assets in time (social capital, know-how, set of skills, emotional ties) and their transfer is at least as important and significant as the transfer of material assets (*Carr-Chrisman-Chua-Steier, 2016; Chirico-Gómez-Mejia-Hellerstedt-Withers-Nordqvist, 2020*).

The social-emotional set of values is different with different family enterprises. Another difference is subject to the part of the life cycle an enterprise is in. The emotional bonding and the succession strategy of a founder-principal to their enterprise is different from that of a second or third-generation family member-principal(s) where multiple ownership and a heterogeneous family ownership structure has already been formed. Succession strategies and the long-term survival of family enterprises are also defined by the external institutional environment they operate in. What formal intermediaries provided by law are available? Different jurisdictions have different succession systems that generate different patterns of transformation in family enterprises. Rules of inheritance have a direct impact on both the lifespan and the value of family enterprises (*Carney-Gedajlovic-Strike, 2014*).

Their position in their life cycle and the formally available institutions together define potential succession alternatives for family enterprises and provide the framework of succession strategies.

The aim of this paper is to describe succession options and potential inheritance strategies after a review of the internal factors and external institutional environment of transgenerational asset transfer. The peculiar features of SMEs and family enterprises in Hungary are analysed. I offer a detailed analysis of the scheme of fiduciary asset management as one of the mixed exit alternatives temporarily transferring principals' disposal authority, the options, and cases of its application subject to the situations of succession. The advantages and risks of fiduciary asset management will be analysed from the aspects of the principal, the beneficiary and the assets managed (the family enterprise).

2 THE ISSUES OF TRANSGENERATIONAL ASSET TRANSFER

Studies on succession mostly examine the rate of long-term survival of family enterprises and of the SME sector in a wider sense in connection with internal company factors. The issues studied in connection with the transgenerational transfer of assets and family enterprises include the transition from a family enterprise into a professional company (*Rutherford–Kuratko–Holt*, 2011; *Gersick–Lansberg–Desjardins–Dunn*, 1999; *Stewart–Hitt*, 2012), succession planning by the enterprises (*Murray*, 2003; *Eddleston–Kellermenns–Floyd–Crittenden–Crittenden*, 2013), the integration of external leader-managers into management and the socialisation of successors (*Klein–Bell*, 2007; *Chittoor–Das*, 2007; *Steier*, 2001) or the problem of the asset value of enterprises (*Bennedsen–Nielsen–Perez–Gonzalez–Wolfenzon*, 2007; *Zellweger–Kellermanns–Chrisman–Chua*, 2012).

The studies on the succession and professionalisation of family enterprises usually neglect the external factors of asset transfer (*Carney–Gedajlovic–Strike*, 2014). External factors are related to three dimensions, which can be deduced from the inheritance law of a given economy, since the form of transgenerational asset transfer is defined by (i) testamentary freedom, (ii) the presence, advancement, and judicial format of “intermediaries” or “substitutes”, and (iii) the system of property- and inheritance taxation.

Testamentary freedom is the degree of individuals’ freedom to dispose of their acquired assets, which relates to the future. Testamentary freedom is higher in legal systems where common law is decisive (typically in English speaking countries) than in countries of continental law (*Ellul–Pagano–Panunzi*, 2010). Limitations to testamentary freedom appear in legal provisions on inheritance. In addition to formal requirements, legal provisions define minimum material rules, such as forced share, beneficial ownership, etc. However, too many limitations of testamentary freedom may have a counter-productive effect because overregulation may have a negative impact on the economic development of family enterprises or may result in lower investment rates ((*Carney–Gedajlovic–Strike*, 2014).

“*Intermediaries*” or “*substitutes*” are “*fiduciaries*” external to the family (or the principal), whom the principals (founders) of family enterprises authorise to manage the affairs of the beneficiaries (heirs or persons made heirs) so that they should also supervise the managers leading the enterprise. The founders (principals) set up a dual agency relationship (*Zellweger–Kammerlander*, 2015; *Child–Rodrigues*, 2003), in which the “substitutes” (second agency level) monitor the managers (first agency level) in a vertical order of dual separation of ownership and control. After being set up, those legal “substitutes” develop a life of their own and acquire an autonomous company-organisational form. The number of “substitution forms” as means of the founders’ transgenerational succession strategy

is continuously growing because of economic development and the evolution of rules relating to asset management, property, and securities.

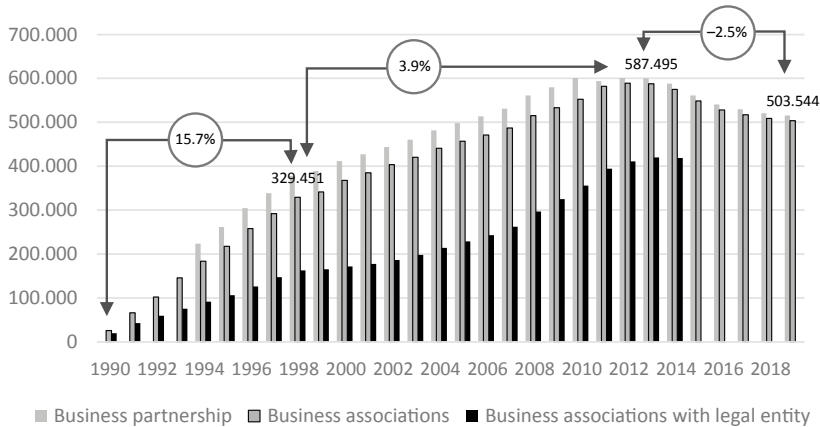
Property and inheritance taxes may be incentives or limitations that either hinder or facilitate the transfer or reassignment of capital (assets) from one generation to the next. The lack of property or inheritance taxes preserves the assets intended to be “reassigned” between generations. On the other hand, inheritance taxes highly fragment and reduce the value of assets available for the next (heir) generation, so the vitality and longevity of family enterprises will suffer. Any limitations regarding the inheritance or share of assets (property taxes) withdraw the relevant assets from the market, as the movements of the assets are defined by legal provisions rather than by market forces.

Transgenerational asset transfer in the form of long-term asset management will preserve capital cohesion (unity), but, paradoxically, the balance of asset management will shift towards safeguarding rather than asset accumulation or value growth (Carney–Gedajlovic–Strike, 2014).

3 THE PECULIAR DEVELOPMENT FEATURES OF SMES AND FAMILY ENTERPRISES IN HUNGARY

Following the fall of communism, thousands of private enterprises mushroomed from “top to bottom” as state ownership was dissolved in spontaneous privatisation, or “bottom to up” in the form enterprises built on individuals’ ideas and business ambitions. The growth lasted until the 2010s, then it turned into a permanent decline. No mass generation shift had occurred by that time, the founders were still the leaders of their enterprises while the population in their thirties or forties at that time (the generation promoting the fall of communism in the 1990s) has reached retirement age by now.

Figure 1
Evolution of the number of partnerships, companies and companies with legal entity and the average growth rate of companies in the period 1990–2019



Source: <http://KSH> Number of partnerships² (own design)

One can see from the scarce statistics available that there is a high number of enterprises in which an “exit pressure” is mounting because of their principals’ ages. Based on their principals’ ages, “over half of the enterprises, about twelve thousand, with sales revenues of over HUF 100 million will soon face the challenge of generation shift in some form. Calculations have shown there are about 850 privately owned medium-size companies with sales of over EUR 1 million (HUF 350–360 million) in which the average age of the principals is sixty-two³. The number of enterprises owned by 60+ individuals is 53 thousand⁴.

The exit of the founding generation, setting up succession strategies and the actual implementation of transgenerational asset transfer is made difficult by (i) the lack of experience and preparedness of the principals, (ii) the lack of preparedness

² Downloaded on 22.11.2020.

³ Ministry of Innovation and Technology (2019). The strategy of strengthening Hungarian micro, small and medium-size enterprises (2019–2030). Ministry of Innovation and Technology, Budapest.

⁴ National Bank of Hungary (2019): Financial stability report, May 2019. Budapest: National Bank of Hungary.

of the companies, (iii) the fast changes of the economic environment, and (iv) the lack of an established institutional system.

- (i) Hungarian SMEs and family enterprises are an extremely heterogeneous group. One can find among them false self-employment hiding employment but securing a family's existence, some that were acquired and structurally inherited via spontaneous privatisation, but also some that are suppliers to multi-national corporations or ones making use of opportunities of market growth that have established modern company operations. The risk, however, is not presented in the diversity of enterprises but in the lack of the founder-principals' exit strategy and their complete or partial *unpreparedness* for the generation shift. No experience of several years is available around them, nor have they access to models or transformation patterns to be copied from other enterprises.
- (ii) The growth and development of companies goes hand in hand with the expansion of employee numbers, while internal operational processes become more complex. This necessitates that the enterprise must become professional relevant to its degree of development (Stewart–Hitt, 2012). There are different dimensions of corporate professionalism or “self-propelled” operating mechanism independent of the principal including an effective company management system, formal financial and controlling systems (Giovannoni–Maraghini–Riccaboni, 2011) and formal HR systems. The organisational structure and operation of Hungarian SMEs and family enterprises typically *has not been prepared* for an existence independent of the founder. It is the principal-manager alone who possesses the leadership and operating “know-how” and skills and no successor manager has been selected either internally from the company or externally. Decision processes are concentrated in one hand, professionalisation has not started yet or it is rudimentary.
- (iii) The *economic environment* is in a process of major changes. The fourth industrial revolution, digitalisation breaks down the traditional value chains built on each other and generates a circular “platform” economy (Kenney–Zysman, 2016). Big data, fast access to the market and information and technological developments simplify and shorten market penetration channels and times. Pressure by financiers and investors to consider environmental, social and governance (ESG) factors has a major impact on company cash-flows and results in an operational-financing environment significantly changed (Friede–Busch–Bassen, 2015).
- (iv) Further obstacles include *different interpretations, the lack of uniform definitions and a self-propelled set of institutions* supporting succession. To identify family enterprises in this country, researchers use the most accepted international definitions for a start (Chua–Chrisman–Sharma, 1999; Astra-

chan–Klein–Smyrniotis, 2002; Chrisman–Chua–Pearson–Barnett, 2012) and consider the trio of family, company, and ownership but from a different aspect and to a different degree (Wiesz–Drótos, 2018; Kása–Radácsi–Csákné, 2017). It is difficult to provide a uniform definition because we are still on the threshold of a mass generation shift (successors of the generation of the fall of communism); the second generation has just started to ‘settle in’ and take part in the management of private companies. There is little domestic experience about the part played by institutions supporting the succession of family enterprises (fiduciary asset management, asset management funds, private capital and investment funds, holdings) in a generational change. Fiduciary asset management⁵ and asset management funds⁶ are relatively new legal institutions, the number of available cases is low.

4 SUCCESSION STRATEGIES AND ALTERNATIVES

Apart from family ownership and family control, family enterprises also must have a *vision*, intentions, behaviour, and decision relating to the future of the enterprise so that it could survive for generations (Chua–Chrisman–Sharma, 1999). The ability and willingness of the “transferee” (the next) generation to adapt, the presence and quality of the handover strategy, the “exit strategy” of the “transferor” (previous) generation are critical success factors in succession⁷. The *exit strategy* covers the principal’s (the first-generation founders typically in Hungary) ideas and will regarding company ownership and management in future. Ownership and management can be transferred to a family member (internal to the family) or to a person external to the group of relatives, but it can also occur jointly (mixed transfer). The theoretically possible combinations of the above two factors (ownership and management) will define the alternatives and options of “succession exit” available to the principal.


5 Law V of 2013 promulgating the Civil Code, Book Six (contract law, other agreement related regulations), Part Three (Agreements) Title XVI (Agency agreements), Chapter XLIII (Trust management contracts)

6 Law XIII of 2019 about asset management foundations

7 Natural succession is due to unplanned, external circumstances, the passage of time (in the event of death). “Exit succession” is when the owner of the business voluntarily succeeds the business of his own free will and intention.

Figure 2
Succession alternatives subject to the nature of ownership and management

| | | | | |
|-------------------|------------------------------------|---|--|--|
| Management | Family internal (exclusive) | Family internal succession Family ownership and family management | Mixed ownership and family management | Family management left after succession |
| | Mixed | Family ownership and „mixed“ management | „Mixed“ ownership and „mixed“ management | „Mixed“ management after family external succession |
| | Family external | Family ownership and non-family (external) management | „Mixed“ ownership and non-family (external) management | Family external succession MBO / IPO External investor Liquidation |
| | | Family internal | Mixed | Family external |
| | | Ownership | | |


Intensity of familiness

Source: Zellweger (2017) and own design

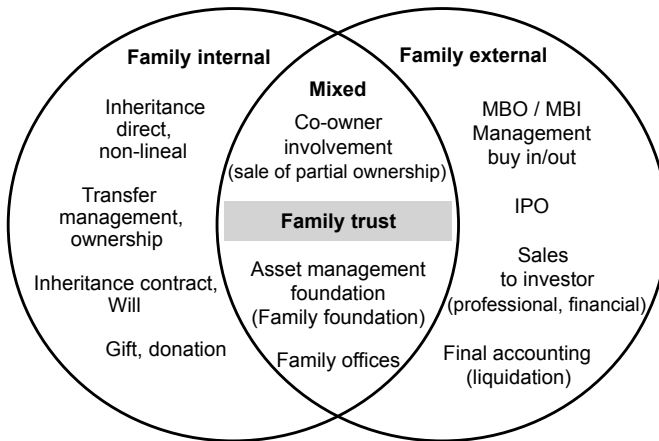
Realistic and plausible *exit alternatives* are defined jointly by the internal operational features and the external environmental factors of specific family enterprises.

Internal features include the capabilities of the descendants ((Lee-Lim-Lim, 2003), the heterogeneity of family members and family relationships (Chandler, 2015; Zellweger-Kammerlander, 2015), the size of the enterprise and the complexity of its assets (Chandler, 2015; Westhead-Wright, 1998), factors related to the position of the enterprise in its life-cycle (Le Bretton-Miller-Miller, 2013; Gersick-Lansberg-Desjardins-Dunn, 1999), or to its development and professionalism (Stewart-Hitt, 2012; Dekker-Lybaert-Steijvers-Depaire-Mercken, 2013; Dekker-Lybaert-Steijvers-Depaire, 2015), which all define the degree of independence of the enterprise of its founder, the “measure” (distance) of the split. *External factors* include the institutional environment defining exit alternatives for succession, (i) *inheritance rules*, (ii) the available *set of institutions* and (iii) succession related *taxation issues*. They will define the nature of asset transfer, transfer within or

without the family or mixed (temporary), i.e., how and in what form the family enterprise will be handed over (the family assets distributed).

Figure 3

Succession alternatives subject to formal sets of institutions



Source: Zellweger (2017) and own design

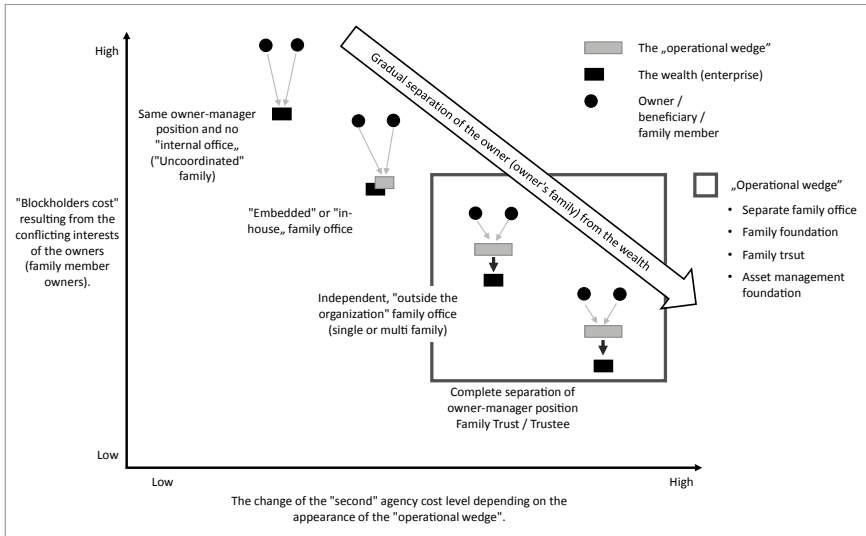
- a) *Succession within the family* means the *direct transfer* of ownership and management positions to family members, to the next generation. In the case of intestate succession, the family enterprise as property is transferred to the heirs independent of the principal's will, according to the share-distribution provided in law (equally shared). The Civil Code (Law V of 2013) includes a list of persons entitled to inherit. Inheritance is based on consanguinity (except for adopted children) in a strict order stipulated by law. In case of a disposition of property upon death, the testator is free to dispose of their assets except for one significant restriction (reserved share). It can take the form of a will, a contract of inheritance or a gift upon death (donation mortis causa).
- b) In the event of *succession external to the family*, the ownership and management functions *are removed from the family circle*, i.e., neither descendants nor relatives take over them, they are transferred to persons external to the family, so the enterprise loses its family nature. Alternative forms of implementation include the sale of the company (immediate, optional, or forward sale), management buy-in or buy-out, public offer or private sale to professional or financial investors. A special case is the termination of a family enterprise without legal successor, liquidation or winding-up.

- c) “*Mixed type*” exit alternatives are schemes when the management of the *transfer of the assets is temporary*. In the first phase of its life cycle a family enterprise is a monolithic culture, it is characterised by converging interests and the principal-manager’s preferences only. When the enterprise is transferred to the descendant generations, the group of principals may become multiple (inheritance, involvement, sale). Although shared interests to increase asset values remain, different preferences will appear regarding risk assumption, dividend policy, the time horizon of growth, investment strategies or social preferences, so the monolith culture will be broken up. Conflicts may appear within the group of principals. The number of a principals’ group and their contradictory interests may generate major costs as decision making becomes complex, operation loses effectivity, non-rational preferences or different risk assumption ideas appear (“block holders” costs) (Zellweger–Kammerlander, 2015).

As ownership and management positions are distanced, institutional forms are bound to appear, which are wedged between the principals and the managers controlling the enterprise, to ensure effective operation of the assets. Such institutions function as “*asset management wedges*” because they will settle conflicts among the principals, find a common platform for their interests and are able to ensure growth, operation, and income production. Such institutional forms may include a separate family office, a family fund, fiduciary asset management or an asset management fund.

Employing an external manager by the enterprise generates agency costs (bonus, other benefits) to be paid so that the manager’s interests should not be different from those of the principal (Jensen–Meckling, 1976). If the assets and the family are separated, the trustee, the institution of a fiduciary asset management wedge, will be the intermediary between the asset holders (the family) and its operating manager (operator of the assets). According to Zellweger, there will appear a “dual agent” (Zellweger, 2017), as the asset manager is commissioned to manage the assets and will be in an agent’s position vis a vis the principal (the family). On the other hand, the agent will start to behave as a principal towards the operating managers (agents) of the enterprise.

Figure 4
Forms and position of an “asset manager wedge”
subject to agency/block holders’ costs



Source: Zellweger–Kammerlander (2015) and own design

The assets and the family may be separated as the succession strategy of a family enterprise is established. The institutional form applied, the type of asset management wedge, depends on the degree, at which the principal (settlor), the principal of the family enterprise intends to separate the assets and the person of the successor. On the other hand, their options are limited by the availability of *substitute institutional forms, the types of asset management wedge*. Alternatives are defined by economic-social development, civil law codes, the rules of inheritance and securities or customary law. In Hungary, fiduciary asset management (Law V of 2013. Book Six, Part Two, Title XVI, Chapter XLIII and asset management funds (Law XIII of 2019 on asset management foundations) have been regulated, but other forms of substitution such as a family office can also be applied.

In addition to economic-financial considerations, the selection of a succession strategy is influenced by the wish to maintain the social-emotional wealth accumulated in the enterprise (Chirico–Gómez-Mejía–Hellerstedt–Withers–Nordqvist, 2020), the successor’s capability, the principal’s confidence or worries of how much the successor will be able to accept the real material nature of family assets such as property, money, assets as well as its immaterial nature including family values, faith, traditions, or social sensibility (Carr–Chrisman–Chua–Steier, 2016).

5 FIDUCIARY ASSET MANAGEMENT

There are several legal options for separating ownership and asset management: (i) establishment of a company with legal entity, which is separated from the members and (ii) binding contractual legal relationships where one legal entity receives the legal position needed to make principals' decisions so that the profit so produced will increase the assets of another legal entity (*Menyhárd, Békés B. et al., 2020, Chapter I*). A company, a fund or an asset management fund are independent legal entities, fiduciary asset management is a contractual relationship. The form best meeting the objective of asset management is subject to the principal's intentions and goals, the economic-social environment, the legal and taxation environment, and transactional costs.

Fiduciary asset management is a fairly new economic-legal form available for economic players, it took effect under the Civil Code on 15 March 2014 (Act V of 2013 promulgating the Civil Code, Book Six (Contract law, other agreement related regulations), Part Three (Agreements) Title XVI (Agency agreements), Chapter XLIII (Fiduciary asset management contracts)).⁸

“In the course of fiduciary asset management, a legal entity transfers disposal rights over the assets it owns to another legal entity, which must utilise the assets transferred to the benefit of the principal or a third party by exercising the decision rights so received” (*Menyhárd, Békés B. et al., 2020, Chapter I*). Fiduciary asset management is a three-player legal relationship, the players are the principal, the asset manager, and the beneficiary. It means an asset manager other than the principal receives ownership (disposal) rights on condition it must make its decisions related to the management and use of the assets so that the return made on the assets will increase the beneficiary's assets. It is a legal transaction where “one legal entity (the principal) transfers ownership of certain things, rights and claims representing its assets to another legal entity (the asset manager) that must utilise the assets entrusted to it to the benefit of a third party (the beneficiary) by exercising the decision-making rights so received” (*Vékás et al., 2018, Chapter XLIII*).

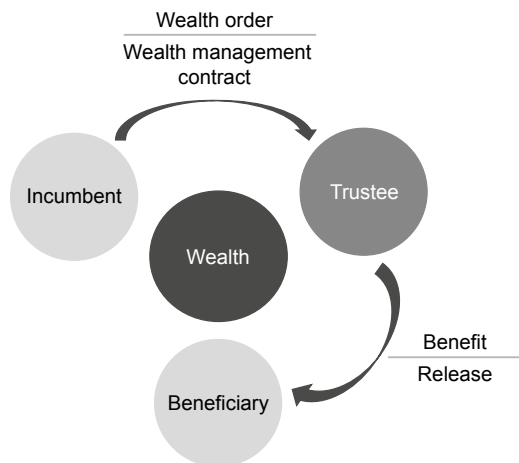
Fiduciary asset management can be established by means of any legal transaction including a contract, a will or a unilateral legal declaration and consists of two consecutive moves of asset transfer in opposite directions, a transfer of assets and a release of assets. Transfer of assets takes place when the relevant contract

8 Its application is helped by additional regulations, Law XV of 2014 about trustees and the rules of their activities (Bkktv) and Government decree 87/2014 (III.20.) on certain rules of financial guarantees of fiduciary asset management companies.

is concluded, and when the contract expires, the asset manager will release the assets to the beneficiary identified in the contract. Although an asset manager obtains unlimited ownership of the assets managed under rights in rem, but it is limited by contract law through the conditions of asset management and the beneficiaries' interests specified in the contract (Sándor et al., 2018). The principal will "lose" the assets by transferring them; its ownership (control of the assets) ceases as well as all its rights from ownership, i.e. the right of disposal, possession, use and taking the profit.

As regards its economic content, fiduciary asset management is *asset circulation*: the assets are transferred, managed, and released. Like swap transactions, it can be described as a combination of *two transactions of opposite directions*, one is the asset transfer and other is the release of assets to a designated person when the contract expires (reversion). In the period between the transfer and the release an asset manager has *management commitments* over the assets transferred because of the transfer of disposal rights. Since assets change continuously and dynamically, the management commitments require asset value to be preserved and increased and to provide the beneficiaries with the contractual benefits.

Figure 5
Structure of fiduciary asset management



Source: Own design

The principal component of fiduciary asset management are *the assets managed* transferred to the asset manager by the principal. A settlor will not transfer all

their property in the legal sense but certain assets or their totality as assigned⁹ and an asset manager will manage them as a distinct entity separated from its own property. An asset manager will only manage “active” assets (assets, instruments), things, goods and claims on its own behalf but to the benefit of the beneficiary in return for a fee paid by the principal (settlor). A fiduciary asset management contract is an inverse onerous legal transaction because the party obtaining property rights, the asset manager, will be entitled for remuneration rather than the transferring principal (settlor).

Fiduciary asset management regards property as a distinct whole, because “any asset, sum insured, damages or other valuables that replace a managed asset from the trust property, and any benefits generated by these shall be part of the trust property, even if they do not appear in the records” (Civil Code, Section 6:312 paragraph (3)).

5.1 Fiduciary asset management as a means of managing succession situations and succession strategy

As the ownership structures of family enterprise become heterogeneous as a result of transgenerational asset transfer (succession and multiple inheritance) (Kellermanns–Eddleston–Barnett–Pearson, 2008), or the lack of the successors’ ability, capability, readiness or will, a risk arises for the going concern or efficient operation of the enterprises (Chirico–Gómez-Mejía–Hellerstedt–Withers–Nordqvist, 2020). The more the management and family and principals overlap, i.e., the stronger an enterprise is embedded into a family, the stronger is the impact of problems and challenges rooted in natural persons’ life situations and incurred in connection with company operations. Each case, i.e., the heterogeneity of the principals’ group, the successor’s suitability and capability or the natural person’s life situations entails a risk regarding uninterrupted company operations, and the implementation of its growth and sustainability business. In any situation fiduciary asset management can be a long-term or temporary effective and suitable instrument of company operation so that a conscious and intentional suc-

9 The Civil Code identifies the concept of an asset in the interpretative provisions (Civil Code, Section 8:1 (1), paragraph 5: “asset means a thing, a right, or a claim”), but it fails to give a definition of property as “the totality of property rights and obligations connected to a person of legal entity” (TAMÁS LÁBADY [2017]: *A magánjog általános tana* [General principles of private law]. Budapest: Szent István Társulat, 213.) As regards fiduciary asset management, the Civil Code explicitly defines the content of “assets managed”, as they are “the things transferred to his principalship as well as the rights and obligations transferred to him by the principal (hereinafter: “trust property”) (Civil Code, Section 6:310 paragraph (1))

cession strategy with proper foresight be implemented. Different situations may arise, such:

- (i) *Intention to continue operations.* Fiduciary asset management is a suitable means to ensure uninterrupted company operations because the owner as principal transfers the whole enterprise as property including all ownership and disposal rights to a professional asset manager and authorises them to manage and control it. The asset manager will proactively manage, organise, and control the enterprise in accordance with the provisions of the relevant contract including contractual limitations. Such a situation may arise if an owner, despite their intention to exit, cannot sell the enterprise to a third part or there is no suitable descendant to continue it.
- (ii) *Lack of capabilities.* A situation may arise when there are descendants or family members for continuation, but their capabilities do not make them suitable for takeover. Fiduciary asset management offers the principal an opportunity to establish an operating and legal scheme by transferring the enterprise to a professional asset manager. The descendants will share capital income or receive certain predefined allowances.
- (iii) *Lack of preparation.* In this case there are descendants or family members, but the owner-principal is of the opinion they do not possess the proper experience or qualifications yet. Applying fiduciary asset management, an enterprise can be transferred temporarily (for maximum 50 years) to an asset manager that will operate it until the designated successor(s) have prepared for assuming direct control. A principal may explicitly identify the conditions to be met by the successor(s) before they can take over the company.
- (iv) *Incapacity.* In this situation there are no descendants of capacity yet or at all because they are underage, their discretionary power is limited, or they are long-term incapacitated. By using fiduciary asset management, a settlor can ensure the enterprise will be managed with proper care and readiness until a minor becomes of capacity or ready. If a descendant is long-term incapacitated, fiduciary asset management will guarantee to the principal the assets transferred (the family enterprise) will be managed according to their guidelines, and the designated beneficiary will be provided for until the end of their life through the allowances identified.
- (v) *Preparation for future.* Fiduciary asset management is a suitable means to continue an enterprise if the principal while still alive transfers it to an asset manager provided, they identify the guidelines and rules of asset management relating to the enterprise or group of companies transferred at the time they are transferred. In that way, a principal can “control the future” while still at an active age and can make sure how the enterprise will be contin-

ued. The settlor can identify the principles of preserving and increasing asset value (asset management principles) as well their ideas including investment policy, dividend payments, expectations of return and profit to be applied by the asset manager to operate the company. The break-up may occur step-by-step too. A settlor may hold a temporary position in asset management (they may be a temporary asset manager or may take a position in the asset management company).

- (vi) *Avoid fragmentation.* By applying fiduciary asset management, an owner-principal may prevent that the company should be cut into pieces during inheritance and conflicting interests arise among the principals. If a principal has more than one descendant (multiple inheritance), there is a danger that after the principal's death the heirs will have different preferences regarding their share. Conflicts may arise regarding the operation, growth of the company, about dividend payments, investments or selling shares, which may jeopardise the chances of maintaining the company, preserving its value or provide growth. By fiduciary asset management a settlor can make the property "independent" by transferring it to an asset manager so that the nature of allowances due to the beneficiaries and their timing are specified in the relevant contract. Heirs will not receive shares but (as beneficiaries) an "annuity-type return" on the assets.

Fiduciary asset management is a suitable means to manage succession, as it can ensure continuity, the uninterrupted operation of the company. It can provide capabilities or skills lacking temporarily or long-term that are not there, or the successors have not obtained them yet. It can bring about changes such as professionalisation, changes in organisational operational or control strategies that will promote the long-term survival of the enterprise, retain an increase its values. Fiduciary asset management is also suitable to implement a principal's succession strategy because it can provide smooth connections between the company and the family in future in the long run.

5.2 Pros and cons of application

By transferring the property, the family enterprise, into fiduciary asset management, i.e., transferring ownership position "for a definite time", a principal can prevent that heterogeneous ownership positions arise through inheritance. In addition, a principal can acquire capabilities for themselves, and the assets transferred for management (the enterprise) they did not have earlier, or they did not have the necessary resources for, or they were deficient.

A principal can exercise *future control* over the assets transferred for management. A founder-principal can define in his lifetime the future fate of the enterprise by transferring it into fiduciary asset management. They can identify the principles and values in the asset management contract that must be used by the asset manager in future. They can identify the principles of asset management including the principle of safeguarding the assets, the principle of profit expectations, the principle of risk avoidance, etc., as well as guidelines relating to investments, such as safeguarding, long-term investment approach, profit maximisation, diversified portfolio management, etc. They can also ensure by fiduciary asset management that the enterprise is operated by a suitable person (asset manager) instead of an unsuitable or unprepared heir.

Asset management can ensure *going concern operation*, because it guarantees continuity of management even if there is a change or unexpected turn in the life of the principal. By using fiduciary asset management, a founder-principal can ensure the continued operation of the enterprise in the event of their death, illness, or incapacity. As ownership rights and operations are transferred, the decisions linked to ownership such as powers at general meetings, the increase or decrease of equity capital, the sale of the company, dividend payment, merger, etc. can be made in future independent of the principal's person ensuring in that way the functionality of the company.

It provides *secrecy*, as a non-public asset management contract allows the principal to become "invisible". A settlor can transfer the property into the asset manager's ownership for a definite time through fiduciary asset management, who will manage it as their own and will appear as principal to "the outside world". The fiduciary asset manager will be entered in the share register and will appear to third parties as a direct contracting party.

The scheme also provides a principal with *taxation advantages* and profit. It can optimise taxes because by transferring the enterprise into fiduciary asset management the revenues from ownership including dividend income or revenues from the decrease of share capital and other capital transactions will be due to the asset manager, so a settlor will not have to pay taxes on such movements. A settlor can transfer the assets selected and their "yields and incomes" to the asset manager through fiduciary asset management, so the principal's tax payments will be reduced.

It also allows *keeping the property*, because the heirs' direct rights over the property cease. By applying fiduciary asset management, the principal can ensure that the company will not be distributed, situations of multiple inheritance or conflicting inheritance cannot hinder company operations. The principal's decision mechanisms and decisions about company operations remain coherent, conflicting views and positions do not appear at general meetings, because it is guaran-

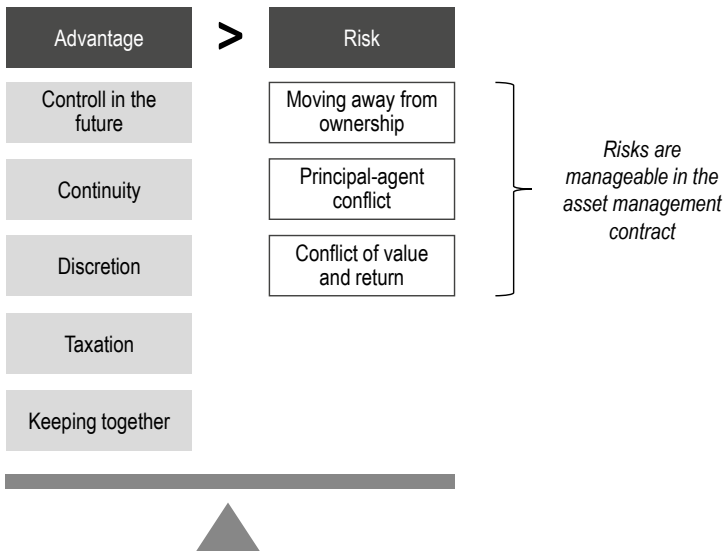
teed by the person of the asset manager and their exclusive responsibility for asset management. The heirs will only receive beneficiary allowances.

Transferring into fiduciary asset management opens the way for the professionalisation of the company. A principal can acquire skills from the asset manager or order professional, industrial and technical expertise (“knowledge transfer”) the enterprise lacked earlier or that he could not accumulate by himself. So, a settler can assign professional knowledge and competences to the enterprise transferred that are necessary for its management and continuous operation, the development of its business relations and market growth.

Transfer into asset management allows *professional business optimisation*. Fiduciary asset management allows the application of better organised management and operations of the enterprise as management, operating and decision processes are institutionalised. All that will improve company efficiency and lead to optimised structures of operating expenses. A principal “disconnects” from the enterprise as it is transferred to fiduciary asset management. The asset manager can reorganise the company, rationalise different corporate functions. They can reorganise financial and IT processes introducing controlled ones. Structured decision-making mechanisms will appear. Management and decision-making levels, procedures and protocols will be established. An internal company structure will reduce operating risk and optimise costs. Building an effective management information system (controlling, business intelligence) will improve the speed and effectiveness of decisions.

When an enterprise is transferred into asset management, the right of operating it (disposal right) is transferred from the principal to the asset manager. In that way the control over operations will be out of the principal’s scope. This can be disadvantageous, but the related risks can be limited by the fiduciary asset management contract and supplementary rules.

Figure 6
Advantages and risks of fiduciary asset management



Source: Own design

Disconnect from property. A principal will cease to be the owner of the assets transferred; they will simply have a contractual relationship with the asset manager. A principal can offset their “waiver” of ownership by defining the principles and guidelines relating to the assets and the enterprise in the asset management contract. In a fiduciary asset management contract a principal may specify asset management principles they deem important, such as the principle of the retention of property, the principle of profit expectation, the principle of risk avoidance, the principle of liquidity as well as investment guidelines related to the assets such as adherence to a long-term investment approach, the proper level and measure of risk management, the application of business planning and the principle of ensuring proper professionalism and competence. In that way an asset manager will be committed to observe the provisions of the asset management contract and its principles.

Conflicts between the manager and the principal. Transferring an enterprise to an asset manager by its principal is not only the “loss” of ownership rights but also giving up operating control and management rights. A conflict of management and principal can also arise within the asset management group if the asset manager employs managers other than itself. A principal may prepare for that in the asset management contract and further agreements based on it, and can define

principles and directions, principles of asset management such as the principle of the retention of property, the principle of profit expectation, the principle of risk avoidance, the principle of liquidity as well as investment guidelines such as purpose limitation, a long-term investment approach, a properly diversified portfolio or profit maximisation that are binding so they will settle or mitigate manager-principal conflicts and their effects.

Conflict between asset value and return. During fiduciary asset management, a conflict may arise between the retention of asset value (safeguarding property) and the increase of its value, profit maximisation on the assets and the allowances due to the beneficiaries from the property. Too large allowance may withdraw funds from the company that are necessary for operation and growth, which reduces the income capacity of the enterprise and asset value. A proper balance can be maintained through suitable regulations in the asset management contract. In an asset management contract, a principal can clearly define their objectives related to the assets transferred (the enterprise), such as the retention of the property managed as a whole, adaptation of the enterprise to market and economic processes, the profitability of the enterprise, the retention of its profit generating capacity in proportion to capital, etc., and the principles of beneficiary allowances (when and under what conditions the beneficiaries receive their allowances).

6 SUMMARY

Succession is a critical issue for family enterprises (and SMEs). Not only because it is an event strongly affecting the future that occurs at a given point in time in an enterprise's growth and life cycle linked to a change in ownership but also because its success is subject to multiple corporate internal and external factors and assumes the joint presence of several types of competences linked to a natural person. No two succession situations are identical, but succession affects all company stakeholders including employees, customers, creditors, and business partners.

The economic-social situation, the necessity of exit is given; a shift of ownership and the separation or transfer of principal and manager functions must be implemented in the period of the generation change. An alternative of implementation is when the principal does not want to have the enterprise out of their sphere of interest, so they look for a form that will ensure retaining the enterprise within the family circle for a long time. In that event an intermediary (a "substitute" or "asset management wedge") may enter that will temporarily manage the property, the enterprise in the interest of the principal or persons identified by the principal. That type of asset management is temporary both in time and "space".

It is temporary in time, when the new generation is not yet prepared for taking over (it has not obtained the necessary knowledge) or if the new generation is not able to take over yet or not at all as it is not suitable, it lacks the necessary capabilities for takeover. It is also temporary in “space” as the principals of the assets having disposal rights change during the legal relationship while the property also changes. An asset manager must return the assets to a designated person at the designated date. However, the appearance of a third party, the intermediary, raises the problem of agency theory since that person will also consider their own interests when making decisions (principal-agent problem).

The legal system of a country will define the formal legal institutions available for filling the position of intermediary (“substitutes” or “asset management wedge”). The relevant rules have an impact on the long-term survival and viability of family enterprises, they define the “principal’s” degree of freedom of disposing over their assets. If a legal environment is overly restrictive about disposal rights, the property becomes “dead money” (Carney–Gedajlovic–Strike, 2014), because it is fragmented in the process of successions or because disposal rights get lost.

Basically three factors identify the actual organisational-formal schemes or legal forms principals (founders) can apply for the asset management wedge as they design their succession strategies: 1. The measure of testamentary freedom, i.e., how free a person is to dispose of their property after death, 2. the presence of intermediary institutions, i.e., if there actually is a legal form that ensures free disposal of the assets and does not limit the flow of assets between the generations, and 3. property and inheritance taxes, i.e., the taxation system of a given country when a person dies.

To sum up, there exists an economic basis or business situation. It is objective since an enterprise must be continued and maintained, (or at least that is a rational goal) for the next generations. The legal superstructure will define the ways and means of succession, how a transgenerational asset transfer can be conducted.

Both the economic base and the legal superstructure have their characteristic features. They are the input variables for the economic base. Such input variables include the degree of development of an enterprise, how much the principal’s and management’s roles have been separated, the professionalisation of management and the organisation, the degree and acceptance of digitisation, the corporate-organisational culture, etc. The output variables are the characteristic features of the legal superstructure, i.e., the timescale of transfer, the scopes of authority, the degree of freedom and the nature of powers to be applied for a transfer. Fiduciary asset management is one of the forms of the asset management wedge. The characteristics of a family business and asset management constitute its economic content. Its legal superstructure is a fiduciary asset management contract that identifies the framework of its operation and the parties’ relationship.

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Legal provisions

Law V of 2013 on the Civil Code

Law XV of 2014 about fiduciary asset managers and the rules of their activities (Bvktv) and Government decree 87/2014 (III.20.) on certain rules of financial guarantees of fiduciary asset management companies

87/2014 (III.20.) Government decree on certain rules of financial guarantees of fiduciary asset management companies