Family Firms and Business Ethics:
How Characteristics Link to Ethical Issues[i]

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INTRODUCTION

Family firms serve as today's dominant organizational form worldwide. And yet, limited research exists about their unique characteristics and how these attributes generate particular strengths and weaknesses that relate to business ethics. For example, owners of family businesses, often focusing on the value of continuity, may intuitively adopt a longer-term perspective that elevates a commitment to corporate citizenship (Fassin, Rossem, & Buelens, 2011; Hoffman, Hoelscher, & Sorenson, 2006). But in some cases, these very same attributes can generate ethical concerns that potentially threaten, rather than strengthen, the firm's ethical health. To better understand family firms and business ethics, this paper indentifies core characteristics often present in family firms. An analysis of how these elements offer both strengths and weaknesses is then associated with the presence of ethical issues that may emerge. Having outlined several specific concerns, the work concludes with implications and suggestions for management practice.

OVERVIEW

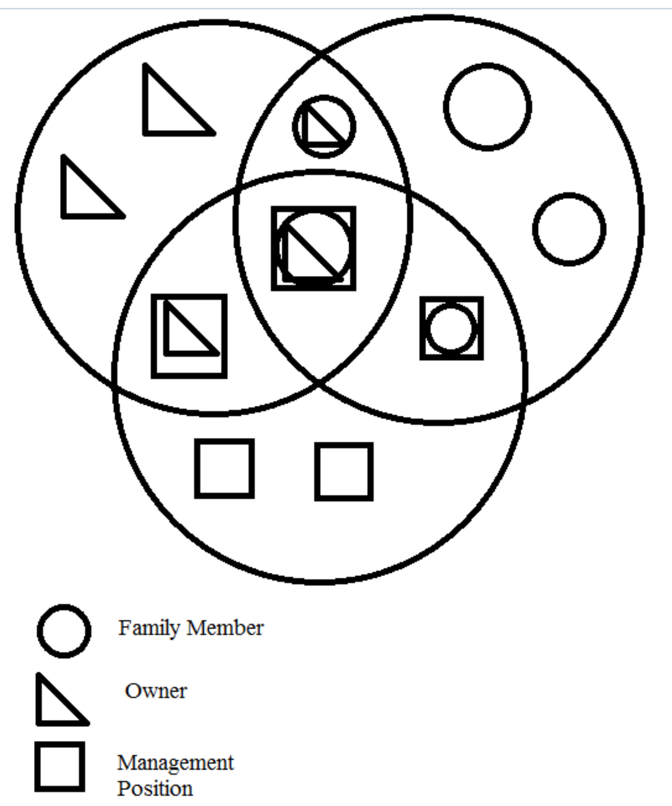
With limited scholarship on ethics in family firms, this research paper was designed to unpack the link between family firm characteristics and ethical behavior. A family firm refers to an operation where the majority of shareholder voting rights are held within members of a family, who are typically the predominant owners of the business. This includes the founder or founders of the firm. These leaders often want to pass the company on to the next generation within the family. In the United States, family firms are the backbone of the economy, accounting for 64 percent of the gross domestic product and generating 62 percent of the nation's employment (Astrachan & Shanker, 2003). Family firms also form 35 percent of Fortune 500 companies within United States (Astrachan & Shanker, 2003). Given their profound economic power, it is vital to understand how family firms operate, with an eye toward business ethics. Central in establishing a healthy organization is creating and sustaining its effective functioning, which depends upon its ethicality.

While a great deal of research has been conducted to understand business ethics in varying industries, very little attention has been directed toward ensuring ethics within family firms. Missing from the literature is how these firms' nuanced identities may generate unique ethical challenges that may impede their effective operations. Family firms present unique strengths and weaknesses due to their nuanced characteristics, which contribute to particular ethical issues that can shape and influence employee behavior. With increasing expectations on family firms regarding protocols driving internal governance and compliance-based requirements, it is essential that management has a better understanding of how a firm's identity may generate and/or be linked with specific ethical challenges.

We know that an organization's structure and culture offer unique insight toward understanding a firm's approach to business ethics (Denison, Lief, & Ward, 2004). The structure of an organization tells us about how the firm is governed and what rules operate and direct performance (Zahra, Hayton, & Salvato, 2004). The culture of a firm reflects how employees approach their daily work and relate to one another (Treviño & Nelson, 2011). Characteristics related to structure might be reflected in the presence of a more organic form, one that provides little codified ethical guidance. Or the organization may be hierarchically structured, with specific and clear mandates, and outlined reporting channels. The culture influences how employees go about accomplishing their goals. Perhaps the firm's culture is, metaphorically speaking, like the "Wild West" in America. That is, it doesn't matter how you go about achieving your goals, so long as you achieve them. Or, it may be one that incorporates empathy and respect for others, emphasizing care for people and the planet, along with securing profits for the shareholders. Here, organizational citizenship, corporate social responsibility, and adherence to B-Corp standards are held in high regard (cf. http://www.bcorporation.net).

Family members serve in a variety of roles, adopting a myriad of functional duties (e.g., consulting, managing, strategic operations, marketing, distribution, etc.). Tagiuri and Davis (1996) offer a depiction of this information (see Figure 1). Some family members may be owners and managers, while others may be excluded from the company operations but still have shareholder ownership rights and power. Outsiders (non-family members) may be part-owners and/or managers as well. There is often a distribution of duties, with family members assuming different roles. But when one or more relations have simultaneous roles in key decision-making functions, they become centralized within the family. This structure can cause one family member to have too much power and leave him/her unchecked. Moreover, the organization may be vulnerable increased ethical risk when individuals (family or non-family members) assume multiple roles. While the structure and culture of an organization are central to driving ethics in business decisions, the basis for its core strength stem from the firm's core values. Values are the reservoir for what really matters to leaders, managers and employees on a day-to-day basis.

Figure 1: Overlap of Family, Ownership, and Management Groups (Tagiuri & Davis, 1996)



VALUES

Values tell us about what is most important, relevant and of "value" to the firm and the members who represent and enact the organization's mission. A family firm's central values often emanate from the family of origin. As such, values are central nodes of insight within the firm, directing us to what the organization really cares about, what is central to the firm's identity, and how values are reflected in the way business is conducted.

Family values refer to both traditional and cultural principles (i.e., values passed on from generation to generation within the family). These values relate to the family structure, roles, beliefs, attitudes and ideals of the unit. Values within families and the firms they represent relate to social, political, religious, work and moral concerns. Social values include doing no harm, being respectful in your interactions, being generous with what you have, and being honest. Political values may be related to capitalism, patriotism, lawfulness and working hard for success. Religious values often center around showing compassion, being modest and following the Golden Rule. Work values may consist of cooperative teamwork and doing your best (Seasons, 2005). Finally, moral values can be represented by honesty, determination, patience and self-regulation (Bengtson, 2001). Some values, like self-regulation, also serve as moral competencies, skills that support ethical strength in everyday task actions (Sekerka, 2016).

In business, these values influence how operations are conducted, represented in the formation of relationships with employees, customers and suppliers. Outsiders come to expect certain characteristics to be present when they do business with a company. Thus, when conducting their business, customers and suppliers develop perceptions that this particular firm cares about society, is largely stakeholder-driven, and is interested in the triple bottom line (profits with respect for people and the planet). Conversely, outsiders may come to expect that the firm does not care about society, is largely shareholder-driven, and is only interested in the bottom line (profits).

Those doing business with a family firm (or any firm, for that matter) may learn over time that their dealings will be fair and honest, rooted in integrity. Or, they may come to learn that only certain people will benefit from a particular deal, practices/policies are absent or morph to benefit the family, and/or that deals are made only if they are advantageous to the family. While business is never this simplistic or binary, a general observation is that family values have an inordinate and powerful influence in how employees are treated, how business is conducted, and how the firm is perceived by outsiders (stakeholders).

A characteristic is a quality or feature inherent to a part of firm, emerging from the firm's structure, values and culture. By outlining these characteristics, we can see how they may be viewed as strengths and weaknesses, offering a competitive edge or hindering or inhibiting the functionality and profitability of the firm's operations (Habberson & Williams, 1999). For additional information about specific terms referenced throughout this work, prefer to the "Terminology" page (see Appendix).

STRENGTHS

Family firms' relationships with customers, suppliers and other external stakeholders often present a competitive advantage. Family firms tend to treat others with respect and may be seen to have more trustworthiness than other firms. They don't have to please shareholders and their business plans are usually tuned for long-term profits instead of short-term quarterly profits. Ultimately this allows family firms to be less reactive to economic changes, to have less capital cost, and to care more about their stakeholders.

Family firms have lower transaction costs, more trustworthy reputations, efficient informal decision-making channels, less organizational structure, and lower monitoring and control costs (Habberson & Williams, 1999). Given that members usually hold the majority of the shareholder voting rights, this can decrease costs due to efficient informal communication and increased flexibility when making decisions.

Family-oriented workplaces inspire employee loyalty. Employees that are with the firm for a long time typically build trust with the family members and are noted to have higher wages. Family firms encourage employees to be creative and make efforts to bring out the best in their workers. They typically have more flexible work practices for employees, lower hiring costs, lower human resources costs, and their employees tend to be more efficient (Huang, Li, Meschke, & Guthrie, 2015). Family firms have lower costs in labor-intensive businesses versus their counterparts (Tagiuri & Davis, 1996).

Table 1. Family Firm Dimensions: Strengths and Weaknesses

Dimensions	Strengths	Weaknesses
Infrastructure	Informal; flexible; entrepreneurial; innovative	Unclear; confusing; boundary problems; indecisive; resistant to change; lack of management development; no organization charts
Roles	Often play multiple roles; flexible; dual relationships; quick decision-making	Role confusion; jobs don't get done; nepotism; dual roles interfere with learning and objectivity; family birthright can lead to unqualified family members in jobs
Leadership	Creative; ambitious; informal authority; entrepreneurial	Autocratic; resistant to structure and systems; avoids letting go

Family's Involvement	Employees committed; loyal; shared values and belief system; family spirit; family name; family dream; strong sense of mission/vision	Can't keep family issues out of business; inability to balance family's and business's need for liquidity; lack of objectivity; inward looking; emotionally charged decision-making; can't separate work and family; rivalries
Time	Long-term perspective; committed; patient capital; loyalty; deeper ties; trust built up over time	Hard to change; tradition bound; history of family affects business decisions; trust affected by early disappointments
Succession	Training can begin early; mentoring a life-long process; can choose when to leave	Family issues get in way; unwillingness to let go; inability to choose a successor
Ownership/Governance	Closely held; family owned; high degree of control; earnings are motivators	May sacrifice growth for control; do not have to answer to stockholders; often no outside board of directors; high premium on privacy
Culture	Innovative; informal; flexible; creative; adaptable; common language; efficient communications	Founder's role stifles innovation; inefficient; highly emotional; resistant to change; reactive; high risk for conflicts
Complexity	Can foster creativity; rich interplay of roles and goals	Must be managed to avoid confusion; can be a drain of resources and energy

The managers within family firms often see their employees as part of the family. If they have a good employee, these firms tend to invest care into the employee and improve the employee over time. This may involve, for example, sending the employee to seminars or contributing to his or her education. When we consider the fact that family firms have a long-term agenda, we can see why they want stable employees in management positions. Management and any higher-up positions are usually occupied by the employees that have been with the firm for a long time (Huang, Li, Meschke, & Guthrie, 2015). Taking this information together in consideration with the extant literature on family firms, Table 1 (above) outlines several of these dimensions and highlights the potential strengths or added value that emanates from these nuances. Similarly, the weaknesses are also noted, to which we now address in further detail.

WEAKNESSES

A major problem within family firms is operating by a set of unwritten rules. Family firms' codes of ethics and/or codes of conduct are often driven and set by the founders' beliefs and practices. While organizational members (family or otherwise) are likely aware of the purpose and mission of their firm, politics may obscure clarity. Agreement and congruence among family managers cannot be presumed. Assumptions like this can drive the belief that everyone understands. Because family firms are less likely to have an explicit code of ethics, they rely upon an implicit form of communication to drive ethical conduct. One study of family businesses found that only 87 firms out of 162 (53.7%) had a written code. The code, when present, was written by the founder in only 36 (40.4%) of these firms. A concern emerges that if there is a code of ethics, is it a "lived" or is it just for show? We know that reliance upon tacit knowledge to infuse ethical decisions and actions in organizational settings does not work.

Another concern is that personal and family values may trump what's good for the firm itself (Plant, Pratt, & McCann, 2009). This problem may lead family members active in the business to care less about or disregard external corporate laws, and focus more on their own self-interest. Trust among family members can also fuel this problem. A case in point is when voting rights are directed by the family, and a viable system of checks and balances is absent. Founder and family shareholders, as active members of the firm's operations, need to understand and follow the rules like any other organizational member. This also suggests that family members need to follow suit with annual performance evaluations and cross-checks must be in place. These reviews and checks must be administered by unbiased (or external) management teams to ensure transparency and ethical functionality (Plant et al., 2009).

Another weakness of family firms is that outsiders (non-family members) may find it difficult to secure upper-tier management positions within company. This comes back to the trust issue tied to family history. Furthermore, if an employee they invested in leaves the company, family members are often replaced by other members of the family. Trust and/or commitment to the family unit drive these decisions. This can cause family firms to lose good employees who may be more efficient and effective than family members, if they given the opportunity. There are instances when family members who are bestowed with top-tier positions who may not be qualified for the job. Family firms often lack succession planning. In some cases the founder of the firm has worked hard and doesn't trust other members to be competent, or simply doesn't want to admit that he/she needs to step down one day. Consequently family leaders end up doing most of the work, instead of sharing the workload with their successors. This may contribute to family firms inheriting weak successors when the founder eventually needs to step aside or can no longer serve.

Extended family can also pose a threat to family firms. This problem usually starts with the third generation of the family, when spouses and cousins start to join the ranks. Some family members might not want to work in this organization, or work in a way that reflects what their predecessor or the legacy directive had in mind. These related but less directly connected family members may feel entitled to engage or even wield their power because of family ties. Members who are working hard might feel unappreciated if the same benefits are given to non-working members. This problem carries over to spouses as well. For instance, if spouses start working within the family firm, they might feel that they are entitled to additional benefits, which may or may not be warranted.

VARYING ATTRIBUTES

Varying attributes are some dimensions that could work either in family firms' favor or to their disadvantage. These dimensions are infrastructure, roles, leadership, family's involvement, time, succession, ownership, culture and complexity (see Table 1). These are heavily tied into the family values. If the family values are solid, these would work in their favor more than hurting the family firm.

Due to the family structure, family members' simultaneous roles falls under the alternating attributes category. Relatives can often back one another in decisions. This centralizes power, making the decision-making process more efficient. When ownership groups are compatible, family managers can act decisively, giving the firm a competitive advantage. On the other side of this coin, family members can abuse having multiple roles and take advantage of the most influential role to gain more power for themselves. For example, an owner-father can use his father role to maintain his position and dominate his son-subordinate.

The long history among family members results in a high degree of emotional involvement. Potential for love or hate among family members can cause them to be a source of support or hindrance to each other. Once emotion presents itself, members can either express or suppress the feeling. Love can increase motivation, loyalty and trust among family members. Hate, on the other hand, can complicate work relationships, undermining confidence and trust, and can cause family members to withhold emotional support and avoid one another. In turn, this causes discord and confusion in the organization and slows down the decision-making process (Tagiuri & Davis, 1996).

Family members' informal private language mixed with emotional involvement will produce a high level of empathic awareness. Thus, each member will know what makes another happy or angry. Increased awareness can improve cooperation and teamwork among family members. If one of them is uncomfortable during a business deal another one can pick up on it and support the relative. If this reaches an extreme level, however, empathic awareness could cause family members to feel over scrutinized. They may think that every move that they are making is being observed closely for a mistake.

The family name has a reflection on the firm. This is a shared identity between the family and the firm. Family values are deeply embedded within the firm. An outsider who comes to the firm expects to see the traits of the family. The firm can take pride in its family name. Members of the family can be proud and gain respect from outsiders. However family members' actions could also damage the firm's image. If they act disrespectful towards an outsider, it could lead to a roadblock for future business deals.

ETHICAL ISSUES

Characteristics of family firms may lead firms to be more resistant or volatile to ethical dilemmas. When a family's core values and culture are strong, ethical dilemmas don't usually present themselves. If values are weak, however, firms may be more likely to face ethical problems. Family firms with strong core values tend to be stakeholder-driven. These firms recognize that members of the community and the firm are one big family. Stakeholder-driven companies tend to be more careful about their impact on society versus their counterparts (shareholder-driven organizations). They are supportive to the community, provide jobs for local residents and make efforts to reduce their environmental impact. The firm sees itself as having a moral obligation to the community. A successful business takes from the community in the form of profits, which are distributed among its employees, directors and shareholders in wages and dividends.

If we look at alternating attributes, the firm can show its values to outsiders, and family values will be tied into the firm and its products. For example, if a family's values are being honest, treating everyone equally and being respectful, these attributes will attract like-minded customers to the brand. Customers who are conscious about the environment and social impact will prefer this family's brand over other brands. While competition amongst brands is an ever-present source of concern in sustaining a firm's survivability, real danger presents itself when a family firm has weak core values. This will likely cause ethical problems for the firm, which can take it down faster than anything from industry competitors. Ethical problems could range from basic office drama to social issues, to fraud, corruption, and corporate scandals. These ethical issues can cause employees and members of the community to become uncomfortable with the organization and result in the firms pushing family members out just to maintain the integrity of the company, and in the hopes to preserve its reputation.

Many characteristics of the family are deeply embedded within the firm. This will often lead firms to resist change. Traditional bonds, family history and trust issues influenced by early disappointments will fuel this problem. Family firms that cannot adapt to changes in the business world will be hindered. This problem will slow down the firm and cause it to lose its competitive advantages over their competition. Owners often will not accept new innovations, and the perceived usefulness of new ideas will be lowered. This will lead to a high risk for conflicts between the owners and employees who would push for a change. The confusion that is created by this will cause the firm to drain its resources and energy.

Unstructured governance can lead to a power surge to the owners. A power surge occurs when voting rights and managing power is concentrated in one person or group. This can cause owners to turn the firm effectively into a dictatorship. When power increases, owners tend to ignore others' opinions. Owners start to feel that they are above everything and they begin to ignore external corporate laws. A power surge might corrupt the owners, leading them to not let go of certain topics and situations. Due to the power surge, owners think that they will be the head of the company and family for a long time. This can interfere with the next generation's learning when an owner tries to have absolute control. In some cases owners are under the impression that if they are not in charge, everything will be less effective. They then start doing most of the work instead of sharing the workload with their successors to educate and improve them. This leads to weak leadership once owners eventually have to step down from their positions.

Shared identity generates another problem for the future generation, which can cut down the longevity of family firms. Grandchildren might not be interested in working within the family firm. Due to the shared identity, however, they are entitled to certain shares from the firm. This can cause distance between the members who want to be part of the firm and the entitled members. The firm's integrity will be compromised when shares gets distributed and entitled members may use their rights to vote just to get in the way of the business.

Another problem that is caused by shared identity is placing unqualified family members in certain positions within the firm. Other family members that share the name with the firm by default may feel entitled to a better position within the firm. Owners may not want to upset relatives and they allow unqualified family members to have higher-up positions. This problem continues on when extended family members join the family firm. Third generation family members (grandchildren) and their spouses are entitled to shares within the company due to their shared identity with the firm. The danger in this is when some of the family members aren't committed to the firm. Members who are committed would naturally want more due to their hard work and contribution to the firm.

A negative emotional environment will set the family firm back. If the family history is marked by conflict or discord, when there is more than one family member in power they can use this emotional history to hinder each other's credibility within the family firm. When owners use hateful emotional involvement with their "family language," results can be devastating and it will disrupt the workplace environment. As a result of this, the family firm can split and employees will start picking sides. The family firm's structure is based upon trust, but extreme, unbalanced versions of trust can hurt the firm. When owners trust an employee within the company too much they can spark favoritism among the employees and cliques start forming within the employee pool. This issue creates inequality between employee pools. When the issue is mixed with family history and bad blood, family members might start picking on another owners' favorite employee and go as far as firing them from the company.

Corporate social responsibility can present itself as an ethical dilemma to family firms. When family values are profit-driven, they can ignore their ethical labor practices. Unionization within the employee pool could be seen as a traitorous move against the family. Employees who are associated with unions might end up losing their jobs so that the family firm can break the unionization.

RECOMMENDATIONS

Change is hard to realize in family firms due to family values being deeply embedded within the firm. If family firms want to increase their longevity and avoid ethical challenges, owners need to have an open mind to change. Once owners realize that these ethical challenges will endanger their companies, the change will be easier on both the firms and their employees.

Our first recommendation to family firms is having written mission and vision statements as well as rules and guidelines. Most family firms operate on unwritten rules and regulations. Written mission and vision statements will remind owners and employees why they have created the firm and what the expected vision of the firm is. Unwritten statements and rules are also susceptible to being forgotten when new generations start to move into the firm. If there is confusion or argument between the owners and employees about the firm, they would have these written statement and rules to fall back on.

To ensure the longevity of the company, successor planning is important. Most family companies ignore successor planning because owners do not think about giving up their seats. Owners need to pick a successor. We recommend having an additional set of rules for the family members who are going to work within the company. These rules could range from the education level that a successor has to reach to their required work experience. For example, owners can set up a rule that forces the next generation to graduate college with at least a Bachelor's degree in business and work outside of the family firm for three years. This will ensure that the next generation will have knowledge and work experience before they start working in the family firm. It is also recommended that owners act as mentors to their subordinates by giving them various tasks to assess how they handle them. Subordinates might start with small tasks, like finding a buyer for their product, and later move into larger tasks, like conducting a merge or handling a big business deal. It is important that the owner/mentor is just observing and giving back constructive criticism. Subordinates should also ideally be observed by a non-family employee or third party to avoid conflicting interests from owners sharing family identity.

As mentioned earlier, power surges can generate robust ethical challenges. Owners need to distribute power amongst non-family employees to avoid this problem. Allowing and distributing work amongst non-family employees will also help the company to continue on when owners need to retire one day. This will also solve the problem of unqualified family members getting into higher-up positions. Employees that come to power should be able to give their unbiased opinion on business topics to family members within the company. It is important that owners choose the employees whom they respect and trust the most in order for this recommendation to work.

Third-party help or external auditors could also prevent ethical challenges from emerging. External help can give their unbiased opinions on management, business deals and firm structure. It is hard for owners to be unbiased towards employees and family members. Owners might see employees as part of the family or share identities with the family members. This could cause owners to alter their decision-making in favor of one or more employees, although it could hurt the company. External help will not only help the owners, but will prevent some of the office drama from happening between the owners.

A final recommendation for family firms would be to put a corporate share system in place. This system would consist of having three class shares, "A" "B" and "C". "C" shares could be owned by both family members and the public. "B" shares could only be traded among the family members to preserve the family firm integrity, but "B" shareholders would not have voting rights. "A" shares could only be traded within the family, and "A" shareholders would also have voting rights. "A" shares would mostly be held by the current owners, and if other family members proved their commitment/worth to the company. “A” shareholders could then vote these family members into the “A” class share. This would allow family firms to have qualified family members within the decision-making arm of the company. If family members worked hard and were voted into “A” shares, they would also receive increased dividend yield. This would reduce the tension between hardworking family members within the company and family members who want to work outside of the company but still inherit the legacy from their parents.

CONCLUSION

This analysis has been a nascent start toward understanding business ethics in family firms. By identifying and analyzing the characteristics of family firms, and then unpacking the strengths and weaknesses emanating from these varying attributes, we can begin to address how to more effectively support this type of organization’s ethicality. With a particular focus on the ethical challenges that are likely to emerge, scholars and practitioners can work together to help identify and resolve these issues before they emerge. While some concerns relate directly to family dynamics and are unlikely alterable, recognizing the potential for negative impact on the ethical health of the firm in advance of an ethical conflagration is essential. If left unattended or addressed only implicitly via tacit measures, the stability and functionality of the firm—and even its mere existence—may be in eminent danger. As such, the recommendations are to encourage family firm leaders to make ethics explicit within the firm and to ensure that employees at every level, regardless of family relationships, adhere to processes, procedures and norms that support moral action in their everyday task actions. Moreover, by inculcating ethical discourse in the organization’s day-to-day operations and incorporating ethics into performance metrics, family firms can leverage their strengths, while prohibiting their weaknesses from contributing to ethical vulnerabilities.

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APPENDIX

Terminology

Attributes: a quality or feature regarded as a characteristic or inherent part of someone or something.
Business ethics: (also corporate ethics) a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and entire organizations.
Company culture: the personality of a company. It defines the environment in which employees work. Company culture includes a variety of elements, including work environment, company mission, value, ethics, expectations, and goals
Competitive advantage: a condition or circumstance that puts a company in a favorable or superior business position.
Corporate Social Responsibility: the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large.
Emotional environment: an invisible measure of "feelings"—sometimes it can have a "feel-good" factor where employees feel positive, and at others it can have a "not-so-good" feel about it when employees are down or unhappy.
Ethical behavior: behavior that is characterized by honesty, fairness and equity in interpersonal, professional and academic relationships and in research and scholarly activities. Ethical behavior respects the dignity, diversity and rights of individuals and groups of people.
Family firm: a commercial organization in which decision-making is influenced by multiple generations of a family—related by blood or marriage—who are closely identified with the firm through leadership or ownership.
Moral obligation: has a number of meanings in moral philosophy, in religion, and in layman's terms. Generally speaking, when someone says of an act that it is a "moral obligation," they refer to a belief that the act is one prescribed by their set of values.
Organization: an organized body of people with a particular purpose, especially a business, society, association, etc.
Power surge: movement of power to concentrate on one person or group.
Stakeholder: a person with an interest or concern in something, especially a business.
Shared identity: a set of common defining characteristics and qualities shared by a group, such as a family or organization.
Shareholder: an owner of shares in a company.
Values: broad preferences concerning appropriate courses of action or outcomes. As such, values reflect a person's sense of right and wrong or what "ought" to be.

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