Ethical Focus and Financial Performance in Family Firms

Family involvement is often critical for the survival of a firm. For early humans, working as a family in clan based structures enabled passing on the family genes and perpetuate the organization across the generations. Hence, from an evolutionary perspective, it is not surprising why family firms account for three fourths of all businesses globally. However, there is lack of consensus among the scholars on why family involvement in family firms may be valuable.

Recently, O'Boyle, Rutherford, and Pollack (2010) have argued that the most important outcome of family involvement in the firm is the ethics, which may lead to competitive advantage in family firms and thereby increase firm performance. They based their reasoning on the notion of reputational impact. In firms with high degree of family involvement, members are more likely to identify with the business and view it as an extension of the family and themselves. As a result, they are unlikely to engage in behaviour that would undermine the reputation of the firm. In fact, these members are likely to behave as stewards and enhance the organization's reputation. Such organizations with high family involvement would be characterized by more open forms of management that facilitate trust-building and collaboration among the members. With such pro-organizational dispositions, it is reasonable to assume that the members will behave ethically. The authors term such organization-wide ethical disposition as the *ethical focus*.

Prior views on the relationship between family involvement, ethical focus and firm performance have been anecdotal. The authors of the study proposed that ethical focus mediates the relationship between family involvement and firm performance, and empirically tested this mediated model using a sample of 526 family businesses. They measured family involvement in terms of the extent of ownership and control, desire of the family members to keep the business in the family, congruence of values and professionalism. To tap the ethical focus, they assessed the degree to which organizational members discuss ethical standards with each other and key stakeholders. Firm performance was measured by calculating income (earnings before interest expense and taxes) as a percentage of sales.

The results illustrated that ethical focus mediated the relationship between family involvement and firm performance. That means, family involvement result in ethical focus, which positively impact the financial performance of the firm. Overall, this study highlight the role ethics can play in influencing the firm performance.

Source: Ernest H. O'Boyle, Matthew W. Rutherford, and Jeffrey M. Pollack (2010), "Examining the Relation Between Ethical Focus and Financial Performance in Family Firms: An Exploratory Study," *Family Business Review*. 23(4): 310-326