ETHICS

5 Signs That Your Family Business Might Have an Ethics Problem

by Nick Di Loreto and Rob Lachenauer

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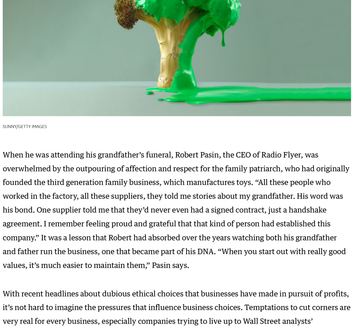

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When he was attending his grandfather's funeral, Robert Pasin, the CEO of Radio Flyer, was overwhelmed by the outpouring of affection and respect for the family patriarch, who had originally founded the third generation family business, which manufactures toys. "All these people who worked in the factory, all these suppliers, they told me stories about my grandfather. His word was his bond. One supplier told me that they'd never even had a signed contract, just a handshake agreement. I remember feeling proud and grateful that that kind of person had established this company." It was a lesson that Robert had absorbed over the years watching both his grandfather and father run the business, one that became part of his DNA. "When you start out with really good values, it's much easier to maintain them," Pasin says.

With recent headlines about dubious ethical choices that businesses have made in pursuit of profits, it's not hard to imagine the pressures that influence business choices. Temptations to cut corners are very real for every business, especially companies trying to live up to Wall Street analysts' expectations.

In theory, family businesses are well-positioned to resist those temptations. Because most family businesses are privately-held, their owners are often shielded from the pressure of quarterly reports. Instead, they can make business decisions that might look irrational to the outside world – forgoing opportunities, investing in a strategy that might not make economic sense on paper – but that are consistent with their values and long-term goals. "There are fewer pulls on you in a family business to do things that are shortcuts," Pasin says. "There's just not the pressure for crazy growth." That means that family businesses built on a history of integrity, like Radio Flyer, *should* be more immune to those temptations. For them, it's not just business, it's personal.

The results bear out in the real world, too. In 2017, the Edelman "Trust Barometer" survey of 15,000 respondents across the globe found that family businesses were far more trusted than those that were not family-owned. With all those advantages going for your family business, how do you make sure that you don't unintentionally let your values drift and damage the business your family has spent generations building?

As he discusses in his book *How Will You Measure Your Life?*, Harvard Business School professor Clayton Christensen argues that the road to ruin happens one incremental step at a time. Each individual choice that moves further from the moral high ground makes it easier to take the next one. This is the theory of marginal thinking: making what seem to be completely rational choices about the immediate decision in hand, without ever considering the full costs of that decision over time. For example, in 2005 General Motors made the decision not to redesign a faulty ignition switch that was linked to car crashes because it would have added $1 cost per car. The decision to keep the defective switches would eventually cost far, far more, leading to $4.1 billion in repair costs, victim compensation, and other costs, not to mention the toll of congressional hearings and the ensuing public relations debacle.

The same marginal thinking happens in our personal integrity as well. Just this once, I can make an ethically questionable choice or ignore the rules. Just this once. Except for most of us, Christensen argues, "just this once" repeats itself over and over again.

In our experience working closely with multi-generational family businesses, it's clear that the risk of marginal thinking can play a significant role in leading a family business away from the values it once stood for. Many family businesses find themselves in situations they never intended to pursue as a result of many logical, small, incremental decisions. Staying true to those values requires work and vigilance from each generation.

Here are the five warning signs that your family business is in jeopardy of heading down the wrong path:

You lose the full family narrative. Family values are passed down from generation to generation through stories. But not just the triumphant ones. It's important to share both the successes and failures in family business history, what Emory University professor Marshall Duke calls "the oscillating narrative" – an acknowledgement not only of the good times, but also the difficult times. Understanding why the family came to face difficult challenges and what sacrifices were made or not made to overcome them can provide guideposts to help future generations avoid temptations to compromise on their values for short-term gains.

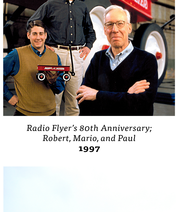
You think "professionalizing" the business means taking the heart out of it. Steve Shifman, CEO of Michelman, a developer of environmentally-friendly materials for industry, struggled to balance maintaining qualities that made his third-generation family business special and the need to remain competitive when he first took over the business in 2003. "I was hell-bent on professionalizing the whole business," Shifman recalls. "But then I slowly realized that I had created a false binary between 'family business' and 'professional business.' Part of what made us able to recruit and retain our amazing talent was also what made us special as a family business. We are driven by purpose and values, not just by markets. This isn't just a wealth-generation machine to us, it's something more. I realized there was something magical about that."

You only allow "credentialed" people in the room for key decisions. Often as family businesses grow, they build boards with outside professionals. Those who don't "measure up" (often family members) are ignored or excluded. Usually those external professionals assume that total shareholder return is the ultimate goal – and advocate choices consistent with that goal. But those choices may also be inconsistent with family values. Protecting those values requires a family member with an outsider's perspective in a position to ask important "why" questions. In fact, some of the best family business board members we've seen have no "traditional" experience but always ask the hardest questions. In one striking instance, a family member who had been relatively uninvolved in the business during the past decade challenged the board to justify why they had agreed that the company's industrial tooling business could make parts for semi-automatic rifles. The marginal economic rationale was clear, but the underlying family values didn't support the investment. Without a fresh perspective to pause the conversation and make sure that such a step was consistent with the family's values, the company might have gone head-long into the weapons business.

You start defining yourself and your family through money. People who know the Pasin family know they stand by their word. The inherent trust, built up over generations, doesn't exist because of their wealth. It is defined by the many handshake agreements honored throughout their history. Sometimes, however, family business owners start defining themselves through their money and fame, lending their name to buildings, parks, and other public areas. There can be lots of good civic reasons to support local causes, but if the underlying motivation is about showing off your money, the family has started down a slippery slope. When the need for outsider adulation dominates decisions, those outsiders start defining your values, rather than your own family. And once you've given others a right to define your own family values, you may feel the pressure to cut corners to make ever-grander gestures that maintain your public image.

Profit becomes your primary motive. Academics and thought-leaders have been telling us for years that the purpose of a corporation is to maximize shareholder value. That may be true for public companies, but family businesses are free to be different. They have an advantage in that the owners can choose what to prioritize – be it profit, family harmony, social responsibility, or some other dimension. When family businesses choose to over-emphasize profit to the detriment of their customers or the communities within which they live, they can find themselves heading down the wrong path. But those that can clearly articulate their motives beyond profit can help reinforce values and strengthen family harmony. At one family with whom we worked, the owners chose to run one of its businesses at a loss because it provided careers for family members and a much-needed public service to the community.

Because family companies face so little scrutiny from the outside world, it might be all too easy to take "just this once" baby steps down a path that can eventually destroy the values they hold dear. Radio Flyer's Pasin recalls one such moment with his father, years ago, when he questioned his father's decision not to use cheaper materials for one of the company's trademark red wagons. "I remember my Dad making the decision whether to use a cheaper steel and a cheaper tire on one of our wagons years ago," Pasin recalls. "And I said to my Dad 'Does it really matter? Will consumers know?' And my Dad said 'I'm not sure. But when in doubt, I like to overbuild stuff because I can sleep at night. There will be a lot of things you will lose sleep over running this business, but this won't be one of them.' I think about that every day. It's one of the most important lessons my Dad ever taught me."



Radio Flyer's 80th Anniversary; Robert, Mario, and Paul
1997

Robert with his grandfather Antonio, "Nonno"
1971

Robert welcoming FUNomenal Flyers to Radio Flyer HQ!
2018

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