

Articles

FAMILY and FAMILY BUSINESS INTERSECTIONS, FAILURE MODES, and RECOMMENDATIONS

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This paper explores the intersections between family dynamics and family businesses. This intersection is inevitable but not always fully understood by owners, family members, and consultants who provide services to family businesses. Both constructs, the family unit, and the family business meet the definition of a complex, adaptive, socio-technical (CAST) system, so we will explore systems theory as it applies to these two dynamic constructs. Years of consulting with family businesses lead to a review of specific failure modes, issues, and recommendations for avoiding or managing the same.

Introduction

Systems thinking offers a robust set of lenses to view family units and the businesses that families own and run. Donella Meadows provides a simple, elegant definition of a system used throughout this article (Meadows, 2008, p. 2).

"A set of elements or parts that is coherently organized and inter-connected in a pattern or structure that produces a characteristic set of behaviors, often classified as its "function" or "purpose."

The reader will see that this definition captures the essence of the family unit – parents, children, aunts, and uncles interacting in a unit to own and run the business – and the business unit – employees, often family members, interacting to manage the business.

Both systems, the family unit, and the business unit, also fit the description of a complex adaptive, socio-technical system, a CAST system. Deriving from systems science, systems dynamics, and systems theory, the concept of a CAST tries to capture the complexity, ambiguity, and dynamics inherent in these ubiquitous constructs. This is a meaningful connection, as CASTs are notoriously hard to understand, manage, and lead. As Mobus and Kalton have indicated, this is because the CASTs are characterized by networks of relationships that emerge and develop complex dynamics that are not always obvious as to source and reason. This is especially true in the family business, where family dynamics may differ between different families and between an individual family and the business. Secondly, CASTs are constantly adapting through the interactions of "intelligent" agents. People within the CAST are adapting, but the level of intelligence can vary dramatically. Each agent, read family member or unit, can, and will develop its perspective on the system. The collective view may differ, leading to elements of the CAST being at cross purposes, a common state in families and businesses. This in-

telligence variability means that the CAST elements evolve and develop at different rates and scales, leading to potential friction and turbulence. A second-order effect of this phenomenon is that transfers of information among and within the CAST and the encoding of knowledge occur at different rates and times, further complexifying the dynamics (Mobus & Kalton, 2022). Finally, these differing dynamics drive different levels of energy and passion within the CAST, leading to variable emotional states. The two complex adaptive socio-technical systems, family and business, are often inexorably intertwined. Let's look at both of these CASTs in more detail.

The Family, The Business, and the Combination

A family unit is a complex, multi-dimensional, non-optimized, emotionally charged societal construct. It would be nice to find that the family unit had excellent communication and empathic skills and was always transparent and rational. However, even a cursory glance at the literature and the news debunks this thought. It is a CAST system with all the attendant dynamics described above.

In parallel, the business is a complex, multi-dimensional, emotionally charged, often non-optimized legal construct. Again, it would be helpful to find that every business is transparent, rational, predictable, repeatable, and professionally managed regardless of ownership. However, the sheer volume of management help and advice available debunks this myth.

So, what does the combination look like? Can we assume it is easier to comprehend and manage? Is it less complex? Less emotional? More optimal? More transparent? Those of us who have consulted in this space for years would answer – "none of the above" (Welsh, 2022).

These two CAST systems often interact, some would say collide, by default rather than design. The author contends that families need to treat each system separately. Each

needs to be understood and managed as a separate system, and the interaction and intersection of each must be anticipated and designed. If this separation is not followed and an understanding of the resulting system dynamics is not appreciated, intergenerational harm can occur to the family unit or units involved (Frank et al., 2023). The systems theory framework described herein reaffirms that dynamic, adaptive capabilities are vital to family business success in knowledge and digital-based economies (Zapata-Cantu et al., 2023), uncertain times (Dabić et al., 2023), and effective governance (Signori & Fassin, 2023).

Many families, however, assume the family system is sufficient to manage the business (Donaldson, 2017). Occasionally this works, but in the author's experience, that outcome is infrequent. The larger, more complex, and intergenerational the family business becomes, the less likely the family system will be a good proxy for professional management (Danes et al., 2023). As you will see in the following discussions, mixing these two systems without proper consideration can lead to troubling family issues.

Family Business Dynamics

The author has seen six family business dynamics manifest themselves in working with family businesses over decades. These are not all unique to family businesses, but family dynamics make the universal ones much more difficult to manage.

First, the life cycle of the family and founder plays an essential role in family business dynamics. Differences in experience, vision, investment approach, generational differences, and sensitivities can, and will, often lead to different views on the business.

Note from the field: The author worked with a founder approaching retirement age and a son being groomed to take the business over. Although each party was committed to the business and the transition, their phases of life were at odds. The founder was risk-averse and comfortable with his established systems and relationships. However, the son saw flaws with the current approach and opportunities for growth and expansion. This friction played out throughout the company and seriously threatened the prospects for the business in the short and long term. More importantly, they eroded the relationship between father and son.

Second, birth order issues can often vex family businesses. The author has witnessed many cases of older children who demand a seat at the family business table without the requisite skills and capabilities to add value. Similarly, families impress upon more senior family members the need to step up and work in the family business even though there is no interest. Neither birth order nor genetics is a proxy for the talent, passion, and desire to work in the family business, yet that is often the assumption.

Note from the field: The author worked with a very successful business in which the older son was only involved because he could get paid well, and his parents thought he deserved to be in a prominent position since he was the eldest. However, the younger son was the sibling passionate about the business and added value daily. Eventually, he became discouraged and left the business. The com-

pany suffered without his presence and ended up sold to someone outside the family. His parents and older brother blamed the younger son for not being loyal to the family, and the acrimony led to strained family relations.

Third, gender issues can often haunt family businesses, especially within particular cultures.

Note from the field: The author worked with a very successful construction business in which the daughter was the most effective manager and instrumental in the business's success. And yet, when it came time to transition the company, the owner decided that the construction business was "too rough for girls" and transitioned the business to his son. The latter was much less accomplished and dedicated. The spurned daughter quit the business and went to work for a competitor creating terrible friction within the family unit.

Fourth, personality theory and personality differences can often plague family businesses. The author has seen many instances where the owner founder looks for themselves in their son or daughter and almost demands that they be someone they are not to ascend to the top position and replace them.

Fifth, destructive behaviors and addictions, while not unique to family businesses are often enabled due to familial care and concern that have no place in the business system.

Note from the field: I worked with a firm that had a family member with severe behavior and addiction problems. When asked why they continued to employ this individual, the family responded that their company was the only place where this individual could find work. While the familial concern was to provide the best for this sibling and should be admired from a family perspective, the signal to the rest of the company was disastrous and eroded confidence in the family and their care for the business.

Sixth, family conflict coping and resolution mechanisms may not be effective in the business and vice versa. The most prevalent manifestation of this is avoidance of critical issues. While not unique to family businesses, legitimate business issues are often avoided due to the presence of a family member or a familial relationship.

Note from the field: The author worked with a fifth-generation family business that refused to address an underperforming business because it was the original foundational business and was still run by a descendant of the founder. Instead of facing the fact that it was a poorly run, marginal business, the other family members kept their contempt for the business and the manager to themselves. Both the companies and the families suffered as a result of this avoidance.

Issues and failure modes

Consulting with family businesses has revealed common repetitive issues and failure modes. Again, these are not unique to family businesses. Still, they are exaggerated by the family dynamics and potentially damaging to critical family relationships outside of the business, making them very important.

Lack of common goals – Particularly prevalent in multi-family and multi-generational businesses, a lack of common goals can be very detrimental to the business and family relationships.

Note from the field: I worked with a family business where the mother and father had brought in their two children to run various parts of the company and eventually take over. Unfortunately, the two siblings had very different visions of where to take the business and how to operate it. The mother and father were constantly mediating between the two camps. As the family units aged, the disagreements continued and even forestalled a potential sale to a strategic buyer.

Lack of clear structure, roles, and responsibilities – This is certainly not unique to family businesses. Still, families are particularly bad about being clear and definite about family members in the business and the authority, responsibility, and decision-making. This may be acceptable to the family members, but it is, at best, confusing and demoralizing to non-family member employees. Further, non-family employees will assume junior family members will ascend into leadership roles and act accordingly when that may not be the intent or outcome.

Lack of written agreements – Again, this is not unique to family businesses, but many family businesses struggle with a lack of written agreements. Informal talks around the dinner table or on vacation are used as a proxy for consensus and agreement. Dead relations are invoked as having said or implied some course of action that may or may not have been intended.

Note from the field: The author worked with a family business where, upon the passing of the founder, a son who had not been involved in the business reemerged to declare that the father had promised him the company. The distressed widow had no way to refute this claim, and the ensuing family crises enveloped the business and added immeasurably to the family's grief.

Solving family issues with the business – Family businesses offer an alluring vehicle for solving family issues. Perceived favoritism is countered by a similar proffering in another part of the business. A sibling or cousin who needs a job but is not particularly employable is brought on the family payroll. Many such actions are justified under the guise of "this is our business, so we can do what we want with it." While this is true, the ramifications and consequences to the business and other family members can be devastating in the long run.

Solving business issues with the family – The inverse of the above. Many businesses grasp for family members to solve a business problem. The company needs someone to handle HR, and a niece who took a course in HR at community college is available, so there is a ready solution, or the business can't justify a loan to the banks. Hence, they get an uncle to guarantee the loan. These actions seem reasonable for the family unit, but are they in the best interest of the business?

Note from the field: A highly successful business owner and his wife had only one child, but he was passionate about a field other than the one in which the family busi-

ness was involved. He moved to an area where his desired career was thriving. As his parents aged, they relentlessly pressured him to return to the family business since they had no successor. Eventually, he reluctantly moved his wife and family back home and took over the family business. Except, the father would not step aside. The father and son constantly battled about the direction of the business. The son and his wife were miserable, away from friends, and the son was frustrated at being powerless. Eventually, he left the business and moved back to his preferred area with much acrimony, and the business slowly faded away.

Equal treatment for unequal contribution – Often, family members in a family business are treated equally in terms of pay, benefits, and authority based on the theory that they are all equally important family members, and the parents do not want to favor one over the other. However, that is precisely what happens. If one family member is more valuable to the firm and puts in more time, they may be unhappy with equal treatment. Similarly, I have seen where a certain family member has been very successful in and with the business, and other family members expect to be compensated equally precisely because they are siblings, not because they add commensurate value.

Holding family members to lower standards than staff, e.g., lack of accountability – Many family businesses make allowances for underperforming family members just because they are family members. While a family-owned business can certainly do this, the implications across the larger business can be very challenging, leading to an erosion of confidence in the business.

Assuming family relationship translates into skills, passion, and competency relevant to the business – As stated above, familial and genetic connections do not automatically imply the family member has the interest, passion, and experience to be effective in the business.

Fortunately, families can take some very powerful actions to avoid or manage the above. All of these failure modes are more manageable using the tools and techniques described below.

Recommendations and tools

Overlap by design

The most important action is a change in mindsets about the business. Since these two CASTs are so interwoven, families must mentally tease the two systems apart, address each individually, and then carefully craft the overlap.

Regarding the family system, the family needs to discuss and reconcile the why and how of the family business. Managing family businesses and legacies can sometimes involve a divergence of views between family members regarding how this may be achieved and the role individual family members and others are to play. Certain events may result in further challenges, for instance, the retirement or death of a founding member in the family business or a family member's divorce. Developing a Family Business Constitution is a very useful tool for teasing the two systems apart, clarifying the dynamics of each as separate entities, get-

ting to the why and how, and finally memorializing these thoughts by writing them down.

Family Business Constitution

A Family Business Constitution, also known as a Family Business Charter or Family Business Code, is a document that outlines the principles, values, and guidelines that govern a family-owned business. It serves as a written agreement among family members involved in the business, establishing a framework for how the business will be managed, the roles and responsibilities of family members, and the mechanisms for conflict resolution. It often evolves over time to accommodate changes in the family structure, business environment, and other relevant factors. The exercise of producing a family constitution is often valuable in itself as it will engage the whole family and provide a platform to explore all aspects of the family's dynamics and circumstances.

Key components of a Family Business Constitution may include:

- **Mission and Values** - Clearly stating the mission and core values of the family business, and articulating why the family is even in the business begins the process of teasing the two systems apart, aligning them with the family's overall vision (Michael-Tsabari et al., 2014).
- **Governance** – It is essential to delineate the governance mechanisms and how one can become involved in the governance of the business (Aronoff & Ward, 2011). *Note from the field:* See the section (following) on outside perspective for ideas that can be helpful here.
- **Ownership** – Identifying the types of ownership, obligations of ownership, and transferability are critical understandings that can avoid contentious disputes at inopportune times. *Note from the field:* Many family members want ownership in the business but are unwilling to accept the liabilities and responsibilities that go along with that ownership.
- **Strategy** – Outlining how the plan for the business will be developed and by whom can assure clear direction. *Note from the field:* Families are often at odds with what they want to do with or want from the business. This makes effective strategic planning very hard. Clearly, there is a direct tie to the section on governance here.
- **Employment** – This section outlines how the business can employ family members and what criteria they must meet to be eligible. This section also usually delineates salary and pay expectations. *Note from the field:* Many clients the author has worked with require family members to have degrees, experience, or skills in areas of importance to the business and even a minimum of years outside of the family business before even being eligible for employment. Additionally, many family business constitutions stipulate that family members will only be paid at the market rate, and all other compensation must come from other distributions.
- **Roles and Responsibilities** – This section is used to clearly define the roles and responsibilities of family members involved in the business, and whether they hold management positions or serve on the board.
- **Management and Leadership Succession** – This section outlines the criteria and process for selecting leaders and successors within the family, including qualifications, training, and timelines (LeCouvie & Pendergast, 2014). *Note from the field:* Absent clear guidance on this topic will lead to the default belief on the part of other employees that any and all family members in the business will be ascending to the highest levels, potentially changing organizational behavior dynamics dramatically.
- **Communication Protocols** - Outlining effective communication strategies to ensure transparency and open dialogue among family members involved in the business is key to success. *Note from the field:* As previously stated, many families conflate the business and the family, and this section can help clarify what is a family issue and what is a business issue, and how and where those might be addressed.
- **Financial, reinvestment, and dividend policies** – Families often disagree on the use of finances, budgets, retained earnings and reinvestment in the business, often at the detriment of the very asset they are arguing over. Policies in this area assure the successful sustainment of the business asset.
- **Dispute resolution and buy/sell agreements** – This section lays out the predetermined mechanisms available to all parties in the event of an intractable disagreement or a desire to exit the business on the part of one or more family members.
- **External Advisors:** This section acknowledges the potential role of external advisors, such as consultants, accountants, and legal professionals, in guiding the family business.

The key benefit of a family business constitution is to recast the family business as a core asset that is professionally managed, rigorously and independently planned for, and that happens to be managed by family members (Manelli et al., 2023).

Note from the field: A refrain I often hear when promoting a family business constitution is, “We don’t need to professionally manage this family business because we are not a big business!” The fact is you probably need to manage it more carefully due to the potential to damage long-term, intimate, and emotional family relationships.

Family business council

The family business council is most often used in larger, multi-generational family structures but is also helpful for smaller family units. The council is a subset of the family unit(s) designated to guide multi-generational family businesses and pull family issues out of the business. The council is usually established and guided by the Family Business

Constitution. Key elements include family issue resolution, succession planning and training, and comprehensive estate planning that looks at all families' estate issues holistically so that individual plans do not compromise the underlying, jointly owned business.

Note from the field: Many families conflate estate planning and business planning, often burdening the business with unreasonable demands unrelated to the core business. These two planning processes are very different and must be kept separate. However, they often interrelate in large family businesses, and the council offers a forum for dispute resolution.

Outside Perspective

It is hard for family members who work in the business to be truly objective about the business. Additionally, family members who do not work in the business may not be aware of or sensitive to the challenges and dynamics of the business. Having independent outside advisors can be greatly beneficial, offering non-emotional advice and counsel (Aronoff & Ward, 2011).

Note from the field: Often, these outside advisors are limited to attorneys, CPAs, and other consultants who regularly work with the business. While these individuals are undoubtedly important resources, they are not genuinely independent due to the nature of the relationship.

Truly independent, outside advisors are usually members of a board. Boards typically take one of two configurations, a board of directors or a board of advisors. The board of directors typically has a legal fiduciary responsibility to all shareholders or members, and management must act on the board's decisions. Boards of advisors, however, merely offer guidance, and the management team or owner can ignore the advice. These freedoms, for advisors - no fiduciary responsibility, and owners - no obligation to act on board directs, often make boards of advisors more open and transparent and less stilted.

Note from the field: I often hear of boards for closely held companies, "What do we need outsiders for? They will only

tell us what we already know. They don't know our business." The fact is family businesses can be very insular, and outside genuinely independent advisors can help with many of the emotional issues as well as the business issues.

Conclusions

According to the Family Firm Institute and the US Small Business Administration, family businesses represent a significant percentage of the national GDP, yet they are often misunderstood. Family members and the business community often underestimate the complexity and challenges faced by both the family and the business—much business consulting targets larger, more recognizable businesses, leaving family businesses without the support they need. The family, or families, must realize these complexities, understand the separate nature of the two CASTs, and carefully plan for each and the resulting overlap. Fortunately, there are tools and resources to help.

Opportunities for future research and practice

Academics and practitioners alike have a number of great resources to engage with in the pursuit of learning and additional research. Journals like the "Family Business Review" and "Journal of Family Business Strategy" often publish research and articles on topics related to family businesses. Organizations like the Family Business Alliance, Family Business Network (FBN), and The Family Firm Institute (FFI) provide resources, research, and events related to family businesses. Additionally, many traditional consulting firms have dedicated family business divisions or individuals. Finally, the author has experienced great opportunities for both research and application in experiential, project-based courses where teams of students work with family businesses to help them wrestle with some of these issues and apply some of the suggested tools.

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