Examining the Relation Between Ethical Focus and Financial Performance in Family Firms: An Exploratory Study

Ernest H. O’Boyle, Jr.¹, Matthew W. Rutherford², and Jeffrey M. Pollack³

Abstract
Empirically, the confluence of family involvement, ethics, and performance is a sparse research area. The authors explore a rich theoretical framework relating family involvement, ethical focus, and firm performance and empirically test a mediated model using a sample of 526 family businesses. The results illustrated that a firm’s ethical focus mediated the relation between family involvement and financial performance. Specifically, data supported the relation between family involvement and a firm’s ethical focus. And increased ethical focus predicted increased financial performance. The authors discuss the implications of these findings and offer potential areas for future research in family business studies.

Keywords
ethical focus, firm performance, family firms, American Family Business Survey, AFBS, family involvement

From an evolutionary perspective, family involvement in firms has brought substantial advantages (e.g., Nicholson, 2008a, 2008b). For early humans, working as a family in clan-based structures enabled successors to benefit from the materials (e.g., food, shelter, wealth) previous generations accumulated. Thus, future generations had a greater propensity to survive and pass on the family genes. Consequently, it is no surprise that (a) estimates indicate family firms account for roughly three fourths of all businesses globally and (b) the amount of academic research examining the role of family involvement in businesses has grown dramatically, and within the past decade it has been established that family firms are important to both researchers (e.g., Westhead & Cowling, 1998) as well as policy makers (Kirchoff & Kirchoff, 1987; Sharma, 2004).

However, what is surprising is the lack of consensus as to why family involvement in firms may be valuable. It is our theory-based contention that ethical focus is a key construct in this involvement–performance relation. Specifically, there is a substantial amount of literature maintaining that firms with high levels of family involvement will also have more of an ethical focus (Aronoff & Ward, 1995; Dyer & Whetten, 2006; Miller & Le Breton-Miller, 2003). In addition, we propose that family firms that are able to translate involvement into ethical focus will be more likely to turn this into competitive advantage and thereby increase firm performance. This proposition is based on a number of works that have suggested that ethics is an important outcome of family involvement and may lead to competitive advantage in family firms (Adams, Taschian, & Shore, 1996; Aronoff & Ward, 1995; Chrisman, Chua, & Sharma, 2005).

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These views, however, are generally based on anecdotal evidence and are not without detractors (e.g., Donckels & Frohlich, 1991; Kets de Vries, 1977). Therefore, the present research empirically examines a model in which ethical focus mediates the relation between family involvement and firm performance (see Figure 1). In testing this model we draw from, and seek to inform, the literature bases of family business studies, business ethics, and the resource-based view of the firm. Overall, our results from the present exploratory research shed light on the conflicting opinions regarding the nature of the relations among family firms, ethics, and performance.

We proceed as follows. First, we examine the literature related to family involvement and ethics. Next, we explore the literature related to ethics and firm performance. Finally, we discuss the relation between family involvement and firm performance before presenting the context of our study and outlining our methods. We then present the findings of the current research and discuss the implications and future directions these data highlight for the field of family business.

Family Involvement and Ethics

At present, family involvement is a broad construct with no precise definition (Chrisman et al., 2005). The construct has been defined many ways by many different scholars. Some define it simply as a degree of family ownership (e.g., R. C. Anderson & Reeb, 2003), whereas others use the percentage of family members employed (e.g., Mishra & McConaughy, 1999). These single-dimension measures, though, have been recently called into question (e.g., Holt, Rutherford, & Kuratko, 2010; Klein, Astrachan, & Smyrnios, 2005), and there has been a push to characterize family involvement as a multidimensional construct. Accordingly, we adopt a definition similar that of Chua, Chrisman, and Sharma (1999) here—family involvement represents a substantial family presence in ownership, governance, management, succession, and/or employment.

With regard to a definition for ethics, generally “ethics refers to the rules or principles that define right and wrong” (Sims, 1994, p. 5). More specifically, the term ethics usually refers to thoughts of how individuals should live their lives and, thereby, what actions or decisions are right, fair, caring, good, or responsible. In this research, we utilize the term ethical focus to denote an organization-wide ethical disposition. We tap this disposition with items that assess the degree to which organizational members discuss ethical standards with each other and key stakeholders. Frequent dialogue about ethics, especially with key stakeholders, is indicative of organizational members who have internalized the content of that dialogue and intend to act on that dialogue (Sorenson, Goodpaster, Hedberg, & Yu, 2009). Moreover, frequent dialogue on such issues also leads individuals to share beliefs collectively based on that dialogue (Tsai & Ghoshal, 1998). In a study of 405 family firms, Sorenson et al. (2009) found that increased dialogue positively and significantly affected ethical norms. It is our contention that higher levels of family involvement will be associated with higher levels of ethical focus. The reasoning for involvement being associated with ethical focus is largely based the notion of reputational impact. Firms that have a high degree of family involvement are likely to have members who closely identify with the business (Donnelley, 1964; Schein, 1983; Whetten & Mackey, 2005). As individuals in these “high-involvement” firms are likely to the view
the business as an extension of the family and themselves, they are unlikely to engage in behavior that would damage the firm’s reputation in any way. And they are more likely to engage in behavior that would reflect favorably on the firm. “They and their potential partners know that when they give their word, the family livelihood and reputation for multiple generations are at stake” (Miller & Le Breton-Miller, 2003, p. 131).

Dyer (1986) suggested that family firms ranking lower in involvement are apt to engage in behaviors that generally work to serve the family over outsiders. This less than ethical disposition, however, generally decreases as level of involvement increases, thereby fostering a culture that reflects a more inclusive and trust-oriented organization (Dyer, 1986; Wiklund, 2006). In this way, members of higher involvement family firms display the behaviors of stewards as opposed to agents (Ward, 1997). In support of this, a number of researchers have found that a stewardship view may be the most appropriate view for understanding the behavior of individuals in high-involvement family firms (Corbetta & Salvato, 2004; Eddleston & Kellermans, 2007; Kellermans & Eddleston, 2004).

The fact that members of firms high in family involvement act as stewards has important implications for the relation between involvement and ethical focus. Stewardship theory, which arose in the sociology and psychology literatures as an alternative form of management to one based on agency theory (Davis, Schoorman, & Donaldson, 1997), challenges the basic supposition that all human behavior results from self-interest, opportunism, and utility maximization (e.g., Jensen & Meckling, 1976). Instead, stewardship advocates hold that utility can be maximized in other, more intrinsic forms (Davis et al., 1997; Donaldson & Davis, 1991; Zahra, Hayton, Neubaum, Dibrell, & Craig, 2008). As a result, stewardship theory suggests more open forms of management that help to build trust and collaboration between the owner–manager and the firm’s employees to establish a culture of pro-organizational, rather than proself, values (Davis et al., 1997). If most members of an organization are disposed toward the organization in this way, it is reasonable to assume that these members will act in a way that is consistent with a high degree of ethical focus.

As a recent review of the literature on ethics and family firms revealed, the empirical literature on the topic is light but extant (Ciocirlan, 2008). The discussion above outlines the theory-based logic behind the proposed positive relationship between family involvement and ethical focus. Below, we provide a synthesis of the literature, highlighting relevant empirical works and drawing on several influential qualitative or anecdotal pieces.

Dyer and Whetten (2006) analyzed 261 firms in the S&P 500 (59 family and 202 nonfamily) on dimensions of ethical focus. Testing for differences in firm behavior, they found that both groups behave similarly, “but family firms are more adept at avoiding social concerns than their nonfamily counterparts” (p. 795). They concluded that studies reporting that family firms are less ethical (e.g., Morck & Yeung, 2003) may have been incorrect and/or at least incomplete. Furthermore, Dyer and Whetten argued that firms with greater degrees of family involvement were at least as ethical as nonfamily firms—quite possibly more so.

In a commentary on this work, Wiklund (2006) stated that, in his view, the extant literature supported the notion that family firms were more ethical. Moreover, he asserted that a more restrictive and complete definition of family business would result in greater differences between the two groups, with family firms emerging as more ethical. Regarding Wiklund’s point, though, definitional problems abound in the family business literature. Thus, recent developments within the literature described “how family a family firm is” by using a components of involvement approach (Chrisman et al., 2005). This approach is an expression of degrees of interaction among the family, firm, and management. Captured in multiple ways (e.g., the number of family employees divided by the number of total employees), much of the work on the topic is descriptive and/or anecdotal. Though there have been a number of attempts to appropriately model this idea of involvement (e.g., Klein et al., 2005), one weakness of many models is the difficulty measuring the parameters (e.g., part-time employees, board members, power, experience, culture). Therefore, following Wiklund’s advice, and reflecting recent research on instrument development in the area (Holt et al., 2010; Klein et al., 2005; Uhlner & Meijaard, 2004), our measure of involvement examines the issue with a multidimensional scale.

The final empirical article expressing support for a positive relationship between ethical focus and involvement is Deniz and Suarez (2005). They examined 112 Spanish firms and found that family firms vary with regard to their ethical focus along dimensions related to
family involvement. Their analysis derived three clusters, with the most ethically inclined families demonstrating the highest levels of family ownership and generational involvement.

There are also many anecdotal and qualitative works that have described a positive relation (Aronoff, 2004; Guzzo & Abbot, 1990; Post, 1993; Sharma, Chrisman, & Chua, 1997). Generally these studies strongly submit that, on average, family firms take a more caring, nurturing, and values-driven approach to their stakeholders (Stavrou, Kassinis, & Filotheou, 2007).

In addition, there is one notable study that found a neutral relationship. Adams et al. (1996) contrasted 214 family firms to 230 nonfamily firms and found little variation on a host of ethics variables. They did find that nonfamily firms were more likely to have a formal code of ethics, whereas family firms were more likely to use informal methods to encourage ethical behaviors (e.g., mentoring, role modeling).

To our knowledge, Morck and Yeung (2003) is the lone published empirical work that found a distinctly negative relation between family involvement and ethics. Their analysis took place at the country level and found that countries with a denser population of family firms were less developed than countries with a more sparse family firm population. Looking at 27 developed countries, they submitted that this was because families in these firms actively—and possibly corruptly—worked to preserve the well-being of the family to the detriment of society at large.

Anecdotal works have also expressed the view that the relation between family involvement and ethics is negative. Two notable studies include Josephson (1934) and Banfield (1958). Josephson popularized usage of the term robber baron to describe the illegal and unethical behavior of the dominant families in the United States. His view was that these families (e.g., Astors, Carnegies) worked very hard to build their families’ wealth while knowingly reducing the well-being of others in America. Banfield provided a richer description of Morck and Yeung’s (2003) empirical analysis by studying a particular a region in Italy. His assessment, though, was similar to theirs in that he attributed poor economic conditions to the prevalence of dominant families.

It is not the intention of this article to debate the merits of agency or stewardship theory perspectives within the family firm, though we do agree with a number of authors (e.g., Dyer, 1986; Kets de Vries, 1977; Schein, 1983) who maintain that members of family firms are more likely to view the business as an extension of themselves. As a result, they are more likely to avoid situations that may bring negative perceptions to their organizations, as this could negatively affect their family name, personal wealth, and sense of well-being.

Drawing on the literature reviewed above, and following recent work in the field (Holt et al., 2010; Klein et al., 2005; Uhlaner & Meijaard, 2004), below we present hypotheses regarding family involvement and ethics. Overall, the literature suggests at least no relation, and likely a positive relation, between family involvement and ethics. Given the conflicting findings within the literature, we put forth these hypotheses as exploratory. As our measure of family involvement is multidimensional, we present hypotheses for each construct that composes our operationalization of involvement. The first construct for which we provide a hypothesis relates to ownership, along with the employment of family members. We term this first construct ownership and control. Second, is the idea that generational involvement is important, as is the desire of family members to keep the business in the family (e.g., Chrisman et al., 2005). We term this second construct participative continuance. Finally, the importance of shared values (related to the family) among organizational members has been found to be a cornerstone of family involvement (e.g., Nicholson, 2008a, 2008b). Therefore, we term this third construct value congruence.

**Hypothesis 1a**: A firm’s ownership and control will predict ethical focus such that firms with higher levels of ownership and control will exhibit higher ethical focus.

**Hypothesis 1b**: A firm’s participative continuance will predict ethical focus such that firms with higher levels of participative continuance will exhibit higher ethical focus.

**Hypothesis 1c**: A firm’s value congruence will predict ethical focus such that firms with higher levels of value congruence will exhibit higher ethical focus.

**Ethical Focus and Firm Performance**

Within the field of family business studies, the relation between ethics and a firm’s financial performance is an underresearched area. A small but growing set of studies
have examined ethics in family firms (e.g., Adams et al., 1996; Gallo, 2004), though for a well-established theoretical framework related to firm performance, we must look outside the domain of family business studies. The relation between a firm’s ethical focus and performance, in general, is fairly well developed outside of the family business literature.

A large and growing literature exists that is termed corporate social and financial performance. A long tradition of studying how ethics and corporate social and environmental responsibility affect firms exists (e.g., Abbott & Monsen, 1979; Aupperle, Carroll, & Hatfield, 1985). Cumulating this literature that has expanded over the years, a recent meta-analysis found that corporate ethics (e.g., social responsibility, environmental responsibility) is positively linked to financial performance (Orlitzky, Schmidt, & Rynes, 2003).

A company’s actions may positively influence its bottom line in numerous ways. Importantly, a company with a high degree of ethical focus may have more positive interactions with employees. For example, Wright, Cropanzano, and Meyer (2004) conducted two studies that identified several facets of job design and treatment of employees in which a strong relation was found between negative moods and job performance. Recently, companies such as Taco Bell, Farmers Insurance, and General Dynamics have been rumored to have misclassified hours to avoid paying overtime, exaggerated job advertisements, and misrepresented job descriptions (Conlin, 2002; Sandberg, 2003; Shaw, 2008). These unethical actions may negatively affect important organizational metrics such as job performance, absenteeism, turnover, counterproductive work behaviors, job satisfaction, and, consequently, firm performance (Blau & Boal, 1987; Carsten & Spector, 1987; Judge, Thoresen, Bono, & Patton, 2001).

Not only will a firm with a high ethical focus have satisfied and productive employees, but one additional way in which a firm’s ethical focus may affect the financial bottom line is through interactions with customers (Ashkanasy & Daus, 2002; Koys, 2001). Specifically, research shows that positive moods in employees relates to a positive impact on relationships with customers (Ashkanasy & Daus, 2002). Positive moods in employees foster a setting where “people ‘catch’ or are ‘infected’ by emotion from others” (Ashkanasy & Daus, 2002, p. 79). This “infection” of mood involves both customers and coworkers. Overall, considering these findings regarding the role that increased ethical focus can play in organizations, we offer the following hypothesis.

**Hypothesis 2:** A firm’s ethical focus will predict performance such that firms with higher ethical focus will report greater financial performance.

**Family Involvement and Performance**

A generally accepted belief has asserted that family involvement is positively related to a firm’s financial performance (Burkart, Pannunzi, & Shleifer, 2003; Casson, 1999; Stein, 1988). Though rival views exist (Barclay & Holderness, 1989; Shleifer & Vishny, 1997), in the extant literature on family businesses, the broad notion holds: On some metric of firm performance, increased involvement relates to increased performance.

Rutherford, Kuratko, and Holt (2008) examined the published literature that empirically tested the relation between involvement and performance and found 23 studies. Of these studies, 9 demonstrated support for a positive relation between family involvement and firm performance. Only 1 study (Lauterbach & Vaninsky, 1999) found a negative relation between involvement and firm performance; 9 studies demonstrated neutrality. That is, “very family firms” perform neither better nor worse than “low family firms.” Finally, 4 studies indicated partial support for a positive relationship. Galve and Salas (1996), for example, found no difference in profitability between a sample of family and nonfamily firms but did find that family firms are more efficient than nonfamily firms. These somewhat mixed results encourage us to take a different tack with regard to the relationship.

We propose that ethical focus will mediate the relation between family involvement and firm performance. This proposition is based on the literatures of family business studies and evolutionary psychology and is consistent with the reasoning of Pearson, Carr, and Shaw (2008, p. 953), who proposed that family involvement within a firm causes family-specific capabilities (i.e., resource-based view; Barney, 1991) and that those capabilities, then, lead to increased performance. Pearson et al. extended a resource-based view model of the family firm (Barney, 1991) to propose a social capital perspective. They argued that the specific nature of the family component in firms
facilitates competitive advantages. Thus, we present the following hypothesis:

Hypothesis 3: A firm’s ethical focus will mediate the relation between all facets of family involvement (i.e., ownership and control, participative continuance, value congruence) and financial performance.

Method

Data

The data used in this study are from the 2007 Arthur Anderson/Mass Mutual American Family Business Survey (AFBS). The survey addressed a variety of issues related to the nature, structure, beliefs, and performance of family businesses and family business owners. The survey included a broad cross-section of family businesses representing most industries throughout the United States. The total sample size of family-owned business exceeded 600, but we excluded cases with extensive missing data on hypothesis-relevant variables (e.g., performance, ethical focus). In the present research we focus on small, family-owned businesses that had fewer than 500 employees (Small Business Administration, 2008). Our final sample size was 526.

Measures

Family involvement. As noted, family involvement is a broad construct with no precise definition (Chrisman et al., 2005). However, there has been a push to define family involvement as a multidimensional construct (Holt et al., 2010; Klein et al., 2005). Accordingly, we adopt a similar definition to Chua et al. (1999) here—family involvement represents a substantial family presence in ownership, governance, management, succession, and/or employment, with the understanding that measuring two or more of these constructs has more value than simply measuring one. As a result, our items are intended to tap factors associated with ownership, governance, management, succession, and/or employment. Moreover, it was our intention to include items that address the interplay among individuals who own, govern, manage, and/or work in these firms. Therefore, we sought out items in the 2007 AFBS exclusively related to the role of families in their business and identified 19 items that met our criteria (see Appendix A). Sample items included “How aligned are your family values with your business values?” and “To what extent does your family have control of your business?” It should be noted that our definition of family involvement differs substantially from the criterion used to identify firms in the AFBS. Although our definition is a broad, multidimensional one, the AFBS uses a fairly simply identification method: businesses where at least two of the business’ officers or directors had the same last name.

These 19 items were all modeled after other measures of family involvement (e.g., Klein et al., 2005; Lumpkin, Martin, & Vaughn, 2008; Uhlaner & Meijaard, 2004). However, as it has become increasingly clear that family involvement is a multidimensional construct (Holt et al., 2010; Klein et al., 2005), it would have been inappropriate to collapse these items into a single family involvement scale. Thus, consistent with emerging research, we believe that the multiple constructs may provide both individual and collective validity in the prediction of both ethical focus and firm performance. For this reason, we examined these items using factor analyses treating all aspects of familiness as separate but correlated constructs. In line with recommendations (e.g., Conway & Huffcutt, 2003), a principal components exploratory factor analysis (EFA) with oblique minimum rotation resulted in a scree plot and Eigenvalues favoring a four-factor solution. We predicted a three-factor solution (i.e., ownership and control, participative continuance, value congruence). However, all items loaded on one of four factors, with cumulative variance for the factors totaling 58%, and no cross-loadings exceeded values of .20. The first factor (i.e., participative continuance) consisted of items relating to generational involvement and family employment, similar to items that make up Klein et al.’s (2005) dimensions of power and experience. The second factor consisted of items related to value congruence between the family and the business, similar to items that make up culture in the related instruments (e.g., Holt et al., 2010). These items address the degree to which respondents identify with the business and themselves. The third factor related to the professionalism of a firm. Specifically, this construct tapped whether a firm was a “business-first” firm or a “family-first” firm (e.g., Ward, 1997). These items are indicative of the degree to which a firm is “professionalized.” For example, one item examined whether “this is a business which happens to employ
people from the same family” as opposed to “this is a family, which happens to be in business together.” The fourth and final factor related to percentage of family ownership (i.e., ownership and control).

Next, we conducted a confirmatory factor analysis (CFA) on the model to further test the theoretical structure of the four-factor family involvement construct. Table 1 provides the results of this model compared to a variety of alternatives. After reviewing each model, we identified significant misfit occurring within the participative continuance dimension because of the constraint of two highly correlated error terms. Once set free, the model fit improved tremendously across all models. Respecification of the model is a key part of structural equation modeling (Kline, 2005), but continuous respecification or respecification of model parameters that alter the theory is strongly discouraged without replication (Cortina, 2002). In our case, the theoretical meaning of the participative continuance construct and the model as a whole is unchanged by the inclusion of these two paths. All models reported in Table 1 contain these two additional parameter estimates. Chi-square difference tests confirmed the four-factor model as the best fitting model. Overall, the fit was acceptable with regard to relevant goodness of fit indices, $\chi^2(144) = 410.51$, comparative fit index (CFI) = .96, root mean square error of approximation (RMSEA) = .06, standardized root mean square residual (SRMR) = .06 (Hu & Bentler, 1999; Williams, Ford, & Nguyen, 2002).

All loadings between the indicators and the latent variables were statistically significant ($p < .05$). At the construct level, an interesting finding was the negative correlation between the professionalism and the ownership and control constructs. Also, the value congruence factor is negatively related to the factor addressing professionalism, indicating that organizational members are more likely to identify with the firm when the firm is run more like a family.

**Ethical focus.** Five items in the 2007 AFBS evaluated the extent to which ethics were discussed (see Appendix B). The items asked owners about the frequency with which ethics were discussed at each level of the business—from the top management team to everyday customer interactions. We did not endeavor in the present research to examine specific ideologies such as moral developmental stages (e.g., Kohlberg, 1984; Snarey, 1985) or individual moral philosophies (e.g., Forsyth, 1980). Rather, we used frequency of ethical dialogue and discussion as a proxy for the degree of ethical focus in family firms. An EFA of the items converged on a single factor with one Eigenvalue greater than 1.0 accounting for 76% of the variance. No skewness or kurtosis values exceeded 1.0, and Cronbach’s alpha for these items was acceptable ($\alpha = .92$). All items significantly loaded on the ethics latent variable in the CFA ($p < .01$), but fit results were mixed, $\chi^2(5) = 209.2$, CFI = .92, RMSEA = .28, SRMR = .056, with CFI and SRMR indicating reasonable fit but RMSEA failing to achieve an

<table>
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<th>Model</th>
<th>$\chi^2$</th>
<th>df</th>
<th>CFI</th>
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<td>Single factor</td>
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<td>150</td>
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<td>Participative continuance/value congruence and ownership and control</td>
<td>1803.5</td>
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<tr>
<td>Participative continuance and value congruence/ownership and control</td>
<td>1581.4</td>
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<td>Participative continuance, value congruence/ownership and control</td>
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<td>Participative continuance/ownership and control, value congruence,</td>
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<td>Participative continuance, value congruence, professionalism/ownership and control</td>
<td>586.9</td>
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<td>Proposed four-factor model</td>
<td>410.5</td>
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CFI = comparative fit index; RMSEA = root mean square error of approximation; SRMR = standardized root mean square residual. Slash indicates that the factors were combined.
acceptable level. Nevertheless, we believe these results (e.g., reliability, EFA, CFA) taken as a whole indicate an acceptable construct specification.

**Performance.** The 2007 AFBS provides multiple measures of performance. However, most were subjective (e.g., “How well do you feel you are doing compared to your competitors?”) or projective (e.g., “What percentage increase in sales do you anticipate in the coming year?”). We opted for a more objective and quantifiable measure. Thus, we included income (earnings before interest expense and taxes) as a percentage of sales as our outcome variable. This measure is regarded as a more accurate measure of firm performance (Dalton, Daily, Ellstrand, & Johnson, 1998). Unlike other measures, such as gross sales, that are often so skewed they require log transformation, the distribution of this variable was normal, with neither skewness nor kurtosis values in excess of 1.0.

**Firm characteristics.** Several variables not directly relevant to the hypotheses were controlled for in the analyses. For instance, the age of the firm in years, the size of the firm (measured as the total number of full-time employees and log transformed), and industry were covaried out of the hypothesis tests. All three of these variables have previously been shown to relate to firm performance but are outside the scope of our hypotheses.

### Results

Table 2 contains the means, standard deviations, and correlations among the variables we examined. All hypotheses were tested with structural equation modeling using LISREL 8.80 (Jöreskog & Sörbom, 1993). The path model is presented in Figure 2. Following the recommended two-step approach of J. C. Anderson and Gerbing (1988), we first examined the CFA for the full model. For all analyses, we entered the control variables and set their factor loadings to 1.0 and error variances to zero and estimated direct paths to firm performance. This covaries out the effects of industry, firm age, and size on each of the model tests. The CFA showed adequate fit, $\chi^2(393) = 1180.6$, CFI = .92, RMSEA = .062, RMSEA 90% confidence interval = .058, .066, SRMR = .06, and all paths loaded significantly onto their respective factors.

Following model testing procedures outlined in James, Mulaik, and Brett (1982), we next tested the full mediation model. Our proposed model states that ethical focus fully mediates the relation between the family involvement constructs and performance. The fit of the fully mediated model was good, $\chi^2(403) = 1216.7$, CFI = .92, RMSEA = .062, RMSEA 90% confidence interval = .058, .066, SRMR = .06. All paths from the family involvement constructs to ethical focus were significant. The participative continuance path ($t = 2.56, p < .05$) and the value congruence path ($t = 5.88, p < .05$) to ethical focus were both positive. The two paths from professionalism ($t = -2.03, p < .05$) and ownership and control ($t = -2.22, p < .05$) were negative and significant. The path from ethical focus to firm performance was positive and significant ($t = 2.17, p < .05$). The $R^2$ values for the endogenous variables, ethical focus and firm performance, were .14 and .03, respectively. Individual standardized coefficients are presented in Figure 2.

We next tested a partially mediated model examining the four paths between the family involvement constructs and performance. The fit of this model was also good, $\chi^2(399) = 1201.93$, CFI = .92, RMSEA = .062, RMSEA 90% confidence interval = .058, .066, SRMR = .06, and resulted in a statistically significant chi-square difference from the full mediation model ($\chi^2_{\text{diff}} = 15.7, p < .05$). Individual standardized coefficients for the partially mediated model are presented in Figure 2. The only significant path from the family involvement predictors to profitability was participative continuance ($\beta = .16, p < .05$).

In determining whether a model is partially or fully mediated, it is necessary to look beyond the chi-square difference test as a binary decision-making tool. This is because the chi-square difference test suffers from the same flaw as the chi-square omnibus test in that negligible misspecification can result in statistically significant findings when sample sizes are large (Steiger, 1990). This, coupled with only one of the four direct paths from family involvement to performance achieving significance and the fact the 1% improvement in fit from the fully mediated model to the partially mediated model came at the cost of considerable parsimony, led us to tentatively support the fully mediated model. However, we present both models in Figure 2 and provide the fit statistics of both models above.

Although the overall fit of the model was acceptable, to test the adequacy of the theory it is helpful to isolate the fit attributable just to the structural paths between constructs (McDonald & Ho, 2002). This provides an
Table 2. Means, Standard Deviations, and Correlations

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<td>1. Professional services</td>
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<td>2. Trade and sales industry</td>
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<td>-0.39***</td>
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<tr>
<td>3. Technology industry</td>
<td>0.07</td>
<td>0.25</td>
<td>-0.17**</td>
<td>-0.17**</td>
<td>—</td>
<td></td>
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<tr>
<td>4. Manufacturing industry</td>
<td>0.10</td>
<td>0.30</td>
<td>-0.21***</td>
<td>-0.22**</td>
<td>-0.09*</td>
<td>—</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>5. Other industry</td>
<td>0.27</td>
<td>0.44</td>
<td>-0.37***</td>
<td>-0.38***</td>
<td>-0.16***</td>
<td>-0.20***</td>
<td>—</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>6. Firm size</td>
<td>2.68</td>
<td>1.27</td>
<td>0.00</td>
<td>-0.18***</td>
<td>0.04</td>
<td>0.13***</td>
<td>0.07</td>
<td>—</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>7. Firm age</td>
<td>26.41</td>
<td>18.39</td>
<td>-0.09</td>
<td>0.03</td>
<td>-0.02</td>
<td>0.12***</td>
<td>-0.01</td>
<td>0.14***</td>
<td>—</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Participative continuancea</td>
<td>0.00</td>
<td>5.06</td>
<td>-0.03</td>
<td>-0.06</td>
<td>0.00</td>
<td>0.12***</td>
<td>0.01</td>
<td>0.24***</td>
<td>0.30***</td>
<td>(0.79)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Ownership and controlb</td>
<td>0.00</td>
<td>1.77</td>
<td>-0.07</td>
<td>-0.02</td>
<td>-0.09*</td>
<td>0.08</td>
<td>0.09*</td>
<td>-0.14***</td>
<td>0.07</td>
<td>0.06</td>
<td>(0.69)</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>10. Value congruence</td>
<td>3.20</td>
<td>5.42</td>
<td>0.08</td>
<td>-0.07</td>
<td>0.06</td>
<td>-0.03</td>
<td>-0.02</td>
<td>0.07</td>
<td>0.12***</td>
<td>0.29***</td>
<td>0.07</td>
<td>(0.88)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Professionalism</td>
<td>14.58</td>
<td>6.42</td>
<td>-0.02</td>
<td>0.08</td>
<td>0.00</td>
<td>0.00</td>
<td>-0.06</td>
<td>0.01</td>
<td>0.14***</td>
<td>0.33***</td>
<td>-0.10*</td>
<td>0.03</td>
<td>(0.81)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Ethics</td>
<td>17.58</td>
<td>5.42</td>
<td>0.07</td>
<td>0.01</td>
<td>0.07</td>
<td>-0.10</td>
<td>-0.05</td>
<td>0.17***</td>
<td>0.03</td>
<td>0.16***</td>
<td>-0.05</td>
<td>0.33***</td>
<td>-0.01</td>
<td>(0.92)</td>
<td></td>
</tr>
<tr>
<td>13. Profit</td>
<td>43.46</td>
<td>28.23</td>
<td>0.01</td>
<td>-0.04</td>
<td>0.01</td>
<td>-0.04</td>
<td>0.05</td>
<td>0.05</td>
<td>0.10*</td>
<td>0.20***</td>
<td>0.01</td>
<td>0.13***</td>
<td>0.10*</td>
<td>0.11*</td>
<td>—</td>
</tr>
</tbody>
</table>

N = 526. Alpha coefficients are in parentheses.
a. Items for the participative continuance and ownership dimensions were standardized
b. *p < .05. **p < .01.
additional test of the adequacy of the fully mediated model. This is because most of the estimates in structural equation modeling link constructs to indicators, and thus the preponderance of fit or misfit attributable to these paths in the measurement model can mask considerable misspecification in the theoretical model. In other words, bad theory can be masked by good measurement. Thus, if a full mediation model were not an adequate reflection of the data, then this would become apparent in the isolated structural model. To test the adequacy of our theoretical model, we used procedures outlined in McDonald and Ho (2002) and O’Boyle and Williams (in press) to calculate the RMSEA and its 90% confidence interval of just the theoretical paths between the latent constructs. In a 10-year review of structural equation modeling in five of the top management journals, more than 60% of the path models failed to achieve a RMSEA of less than .08 and only one in four path models had upper RMSEA confidence intervals less than .10 (Williams et al., 2009). For our theoretical model, both the RMSEA-P (.070) and its 90% confidence interval (.043, .093) indicated a well-fitting theoretical model.

Discussion

Results from a sample of 526 small family-owned firms examined in the 2007 AFBS illustrated that the level of family involvement predicted ethical focus and that ethical focus predicted a firm’s financial performance. We submit that this empirical support for a mediated model relating involvement, ethical focus, and firm performance provides a substantial extension within the literature regarding family business studies.

Specifically, our analysis of items included in the 2007 AFBS relating to family involvement revealed four...
main constructs (i.e., value congruence, ownership and control, professionalism, participative continuance). The value congruence, participative continuance, and ownership and control factors are constructs related to family involvement that have been cited many times in the extant literature (e.g., Rutherford et al., 2008; Smith, 2008; Zahra et al., 2008). The other construct was less intuitive. That is, the construct representing professionalism was not expected. It taps shared norms, and we suspected that these items would load with our culture items. Interestingly, these items loaded together, reflecting something akin to the professional nature of the firm. Although this is not without precedence (e.g., Lussier & Sonfield, 2004), recent studies have been less likely to associate degree of professionalism with family involvement.

In support of Hypotheses 1b and 1c, the value congruence factor and the participative continuance factor were both positively and significantly related to ethical focus. This supports authors who have found that high involvement leads to a more ethical firm (e.g., Deniz & Suarez, 2005; Dyer & Whetten, 2006). In contrast, though, the other two factors (ownership and control as well as professionalism) were negatively and significantly associated with ethical focus. Therefore, Hypothesis 1a was not supported. In simply looking at the ownership and control dimension, our findings support those (e.g., Morck & Yeung, 2003) who hold that concentrated ownership among family members leads to less ethical behavior in the firm. Similarly, firms that engage in management practices that tend to favor the family over the business (i.e., professionalism) also see a lower degree of ethical focus. This latter finding is less surprising given that scholars have advocated a more professional and inclusive approach to managing the family firm (Chittoor & Das, 2007; Dyer, 1986, 1989).

Results from our tests of Hypotheses 1a, 1b, and 1c indicate that there appear to be some facets of involvement that result in an elevated level of ethical behavior in the firm but other facets that result in less of an ethical focus. Thus, within the literature, conflicting opinions regarding the nature of the relationship between family firms and ethics are warranted. It seems that having a high percentage of participating family members, across multiple generations, who share values and who desire to keep the business in the family is a recipe that is likely to result in a more ethically focused firm. This is especially true if the firm practices inclusive management and has a relatively low percentage of family ownership.

Our second hypothesis built on the ethics and corporate social responsibility literature to submit that ethical focus is positively associated with firm performance. This hypothesis was supported, adding further credence to the recent findings in that literature (e.g., Orlitzky et al., 2003).

Our last hypothesis proposed that ethical focus would mediate the relation between our involvement measures and firm performance. Results were consistent with the inference that a mediated model exists (either fully or partially depending on interpretation). Based on our analysis, ethical focus is indeed one conduit whereby a firm can translate its family involvement into financial results. This relation suggests that studying the fields of ethics and family business together holds promise for future research.

Limitations

Despite findings in support of all three hypotheses, it is important to note that limited research has addressed these relations and that further empirical inquiry is needed. Along these lines, we highlight a few limitations of the present research. First, the sample examined family businesses only in the United States. It is plausible that there could be important national and/or cultural differences in the relations among family involvement, ethics, and firm performance. Future research would be well directed to build on work such as Perrini and Minoja (2008) and explore issues such as these. Specifically, there may be differences between Eastern (e.g., Confucian) and more Western (e.g., European and North American) views on family, kinship, and marital ties—indeed, social systems may vary in acceptable norms and behavior. In some cases, norms may support family involvement, and in some cases family involvement may be viewed as objectionable (i.e., Banfield, 1958).¹ Research examining these cultural and/or national differences may prove beneficial and insightful.

In addition, within the 2007 AFBS, family ownership is relatively invariant. The businesses included in the 2007 AFBS are family-owned businesses, and thus we are not able to draw inferences regarding the potential differences between family-owned and non-family-owned businesses. It is likely that future studies examining the differences between family-owned and
non-family-owned business could highlight important theoretical and practical insights that the present research could not examine. Along these lines, we strongly encourage future research to explore alternative ways in which family involvement, as well as family influence, can be empirically assessed.

Another limitation is that the ethical focus questions were included on the 2007 AFBS for the first time. Thus, we can make no evaluations regarding any global changes in the ethical focus of businesses over the past 5 years. Furthermore, the items regarding ethical focus required individuals to reflect accurately on their own ethical focus. Although confidentiality and anonymity were ensured in the survey, social desirability and perceptual inaccuracy may play a role in participant responses. Consequently, future research could use longitudinal designs to assess changes in levels of ethical focus (and involvement) over time, rated by multiple people, and then examine subsequent changes in firm performance over 1-, 3-, and 5-year time frames.

An added limitation (and area for future research) is related to our examination of a firm’s financial performance. We focused on only one objective financial outcome: income (earnings before interest expense and taxes) as a percentage of sales. However, this is an imperfect measure of financial performance. Future research would be well advised to examine the relations among involvement, ethical focus, and performance using additional hard outcomes (e.g., return on assets, return on investment, return on equity, asset turnover, financial leverage). However, it is important to remember that these accounting proxies have inherent limitations. Therefore, though we assessed only one objective outcome, future research may discover important relations among involvement, ethical focus, and subjective performance outcomes (e.g., performance comparisons with competitors, personal goals being met, overall well-being) that may be important benchmarks within small family-owned businesses.

An additional shortcoming common to all cross-sectional, nonexperimental research is the failure to assess causality. The model presented here proposes that the involvement–performance relation is mediated by ethical focus. Future research could explore whether involvement is related to performance and, thus, if higher performing firms have more opportunity to discuss the ethical focus of their decisions with key stakeholders (e.g., customers, shareholders, coworkers). In other words, performance could mediate the family involvement–ethical focus relation. Certainly, a relation between fighting for survival and being less ethically aware has been proposed and supported in other contexts. Rawwas, Patzer, and Vitell (1998) found consumers in war-torn countries (e.g., Northern Ireland and Lebanon) to be less ethically sensitive than other nations. Future research on the temporal precedence between ethical focus and firm performance is warranted.

Furthermore, and along the lines of temporal precedence, in the present research we offer a stewardship perspective as one way in which high family involvement relates to ethical focus. This finding needs further exploration. For instance, we discussed earlier how families such as the Astors and Carnegies behaved unethically to build their families’ wealth while knowingly reducing the well-being of others in America. In such cases, it is entirely possible that families behaving unethically could be acting as good stewards. Thus, we acknowledge that a stewardship perspective, in which good stewards are always believed to behave ethically, is a point of view that future research should critically examine. Overall, this limitation and the additional limitations discussed above provide substantial opportunities for future inquiry to build on the relatively unexplored area relating family involvement, ethical focus, and firm performance.

**Conclusion**

As this is one of the first studies to empirically explore the relations among family involvement, ethics, and performance, we encourage researchers to continue to pursue this line of inquiry. Overall, our findings indicate that involvement affects ethical focus and that ethical focus predicts firm performance. These findings may inform researchers and practitioners about the roles that ethics can play in influencing firm performance. In addition, the mediated model relating involvement, ethical focus, and financial performance provides a model through which future research can examine the relations among these constructs. We hope that the multiple lines of future research that these findings outline will
encourage additional efforts to explore these, and other, theoretically and practically relevant questions regarding how family involvement, ethics, and firm performance are related.

### Appendix A

#### Family Involvement Items

**Participative continuance**

1. How many generations have had ownership in the company? (1.58/0.85)
2. Which is the most recent generation to actively manage the company? (1.49/0.80)
3. How many family members are on the company’s top management team? (2.13/1.76)
4. Who do you anticipate will be the next owner(s)? Family member(s). (0.68/0.47)
5. Number of fulltime family employees working? (2.13/1.76)
6. Do you believe that your business will be controlled by the same family(ies) in five years? (0.85/0.36)
7. How strongly does the senior generation want the business to stay in the family? (4.05/1.35)
8. How strongly is the next generation committed to long-term business ownership? (3.92/1.41)

**Ownership and control**

1. What percentage of the company is family owned? (92.38/19.11)
2. What percentage of voting shares, controlling partnership interests or other separate control mechanisms does the family own? (86.83/27.69)

**Value congruence**

1. Please rate the extent to which . . . your family has influence on your business. (5.94/1.56)
2. Please rate the extent to which . . . as family, your personal values are compatible with the values of the business. (6.29/1.06)
3. Please rate the extent to which . . . your family members share similar values. (6.09/1.24)

### Appendix A (continued)

4. Please rate the extent to which . . . your family shares values with your employees. (5.94/1.33)
5. Please rate the extent to which . . . your family shares values with your customers. (5.93/1.33)

#### Professionalism

<table>
<thead>
<tr>
<th>1.</th>
<th>A manager’s qualifications (education, experience, etc.) are the only characteristics considered in hiring and promotion decisions.</th>
<th>1 2 3 4 5 6 7 (3.74/2.07)</th>
<th>Family members are given preference in hiring and promotion decisions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.</td>
<td>All employees are compensated (excepting dividends) based solely on their position and performance.</td>
<td>1 2 3 4 5 6 7 (3.15/2.00)</td>
<td>Family members are paid more than non-family members in comparable positions.</td>
</tr>
<tr>
<td>3.</td>
<td>This is a business, which happens to employ people from the same family.</td>
<td>1 2 3 4 5 6 7 (4.10/2.04)</td>
<td>This is a family, which happens to be in business together.</td>
</tr>
<tr>
<td>4.</td>
<td>We primarily get financial and professional satisfaction from this business; working with family is a bonus.</td>
<td>1 2 3 4 5 6 7 (3.59/1.98)</td>
<td>We primarily get satisfaction from working with family members; the financial rewards from the firm are a bonus.</td>
</tr>
</tbody>
</table>

Means and standard deviations are in parentheses.
Appendix B

Ethical Focus Items

1. How often are ethical standards discussed at board meetings? (3.49/1.30)
2. How often are ethical standards discussed at executive meetings? (3.61/1.23)
3. How often are ethical standards discussed at meetings with lower- and mid-level employees? (3.72/1.13)
4. How often are ethical standards discussed at meetings with customers? (3.55/1.16)
5. How often are ethical standards discussed at meetings with suppliers? (3.29/1.21)

Means and standard deviations are in parentheses.

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Notes

1. We thank one anonymous reviewer for insight into the differences in perceptions of family across cultures.
2. We thank one anonymous reviewer for valuable insight into these performance measures.
3. We thank one anonymous reviewer for valuable insight into the potentially interesting relations between stewardship and ethics.

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