Family Business and Positive Psychology: A New Planning Paradigm

By Scott E. Friedman and Eliza P. Friedman

Background

Family business is big business. There are approximately 5.5 million family businesses in the U.S., accounting for 75% of all new jobs generated and nearly two-thirds (64%) of the nation’s gross domestic product (GDP). It is estimated that approximately 60% of all publicly held U.S. companies are family-controlled.1 A recent article published in the American Journal of Economics and Business Administration suggests that 90% of all businesses in the United States are family owned or controlled.2

In spite of their enormous influence on our economy and culture, and at a time when the largest wealth transfer in history has begun,3 the dynamics of family businesses remain extremely challenging. Sadly, approximately 70% of family businesses fail to successfully complete a transition to the second generation, and a staggering 90% of family businesses fail to complete a transition of ownership to the third generation.4 The commonality of family business struggles is often expressed through the well-known proverb “shirtsleeves to shirtsleeves in three generations” and brought to our attention through endless published accounts of prominent business families, including Gucci, Guinness, and Gallo, whose infighting has become known through the public litigation process.5 We are quite confident that anyone who works with family businesses on a regular basis has his or her own personal experience involving family business dysfunction and crisis.

Despite family business struggles that go back to Adam and Eve (whose son, Cain, worked their fields and whose other son, Abel, tended their sheep, until a jealous Cain killed his brother) and, more recently, in spite of

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1 American Journal of Economics and Business Administration
2 American Journal of Economics and Business Administration
3 American Journal of Economics and Business Administration
4 American Journal of Economics and Business Administration
5 American Journal of Economics and Business Administration
endless professional seminars on subjects like succession planning, not much has changed, and family businesses continue to struggle.

Famed jurist Learned Hand anticipated the need for new planning strategies when he asked, “How long shall we blunder along without the aid of unpartisan and authoritative scientific assistance in the administration of justice, no one knows; but all fair persons not conventionalized by provincial legal habits of mind ought, I should think, unite to effect some change.”6 The fact that so many families in business together continue to struggle – including some of the wealthiest and most successful families who have access to preeminent professional advisors – suggests that this is a field desperately in need of a new planning paradigm.

Thankfully, we no longer need to blunder along. Insights and advances in science – particularly the fields of evolutionary biology, neuroscience, and positive psychology – suggest new planning strategies for lawyers (and other professionals) working with family businesses. Many of these insights have become well known through bestselling books like Blink by Malcolm Gladwell and Thinking, Fast and Slow by Daniel Kahneman. Others have been addressed in prestigious journals like Harvard Business Review, which devoted its January-February 2012 cover story to the correlation of happy people working in “positive” cultures with bottom-line business success.7 As a result, many more insights are familiar, or accessible, to lay audiences, and translatable by professionals into actionable ideas, plans and strategies. The balance of this article explains both why appreciating certain basic (and easily understood) scientific insights are important, and how these insights can be applied in practice to help family businesses.

Understanding Family Business Problems Through Science

In Thinking, Fast and Slow, Nobel Prize–winning author and professor Daniel Kahneman observes that “[b]y and large . . . the idea that our minds are susceptible to systematic errors is now generally accepted.”10 For example, natural selection favored the development of the “fight or flight” response to danger – both real and perceived – by enabling our ancestors to react almost immediately when faced with situations where a delay would be fatal. While modern civilization has reduced or eliminated many of these threats, our brains continue to react in fight or flight mode when we feel threatened, regardless of whether or not these are “real” threats.

Dr. Dan Baker describes this phenomenon in his bestselling book What Happy People Know:

The forces of evolution, by their very nature, endowed [our neurological] fear system with tremendous power, because in the brutal early epochs of mankind, it alone kept us alive. It gained us the hair-trigger capacity to spring into action at the first hint of threat. The automatic fear response became faster than the process of rational thought, faster than experiencing the feeling of love, faster than any other human action.

. . . Unfortunately, in modern life, what is good for survival is often bad for happiness and even for long-term health.11

Inside a family business, stakeholders might experience countless types of “fear,” such as fear that they are undercompensated, that someone else is overcompensated, that they don’t have sufficient control, or that they are losing control. Parents might fear that their children won’t get along while grown children fear that their children might not have a family business to work in. These
and many other fears manifest themselves in negative (and counterproductive) behaviors like greed, arrogance, anger, insecurity, turf-ism, lying, cheating – all of which are simply modern day forms of fighting or fleeing.

Over time, such negative emotions and behaviors almost inevitably lead to infighting and short-term thinking that, in turn, results in wasted time and resources, decreased productivity and diminished bottom lines. The Gallup organization estimates that U.S. companies lose $360 billion each year due to lost productivity from employees who don’t work well with their supervisors. No less important are the attendant resulting personal costs, including depression, frustration and anger that can cause high blood pressure, heart attacks and strokes.

Professor Kahneman’s observation about the susceptibility of our brains to systematic errors extends far beyond those errors that result from our uncontrolled and ineptly deployed “fight or flight” response to modern day slights. Over time, and left unmanaged, our inherited propensity for systematic errors in how we process information can prove disastrous in a family business, as decisions driven by fear, irrationality, forgotten promises, inattention and simple incompetence can diminish trust as family members come to view each other as unreliable, insincere and incompetent. These views make virtually impossible the collaboration required to work together successfully in business. This explanation is supported by accumulating data, such as a survey of 3,500 families by Roy Williams and Vic Preisser, which found that only about 5% of family business failures in this data pool were attributable to poor tax and financial planning. Instead, most of the failures were attributed to intra-family mistrust and miscommunication.

While insightful advisors have long encouraged attention to organizational dynamics and related psychological insights, there has been a general reluctance by professionals and their clients to do so for a number of factors. These include (1) misconceptions that these are “soft skills” that simply aren’t useful in a sophisticated business, (2) the fact that benefits have been difficult to quantify, and (3) just plain ignorance of the nature of the advice being offered (and often misunderstood as advice to “not worry, be happy,” or look in the mirror, smile, and tell yourself that today will be a great day).

Fortunately, there are antidotes to the various challenges posed by our evolutionary legacy that are informed by science, principally the developing field of positive psychology, that suggest new planning strategies to complement traditional ones. Importantly, these new strategies and insights are sophisticated, empirically validated, and demonstrably correlated to enhanced productivity and bottom-line success and, best of all, relatively easy to implement.

The Science of Positive Psychology

Positive psychology is the scientific study of factors that contribute to the optimal functioning of people, groups and organizations. This field of study offers important insights into the correlation of a positive workplace culture with individual happiness and organizational success. Shawn Achor, a former professor at Harvard who is now a prominent consultant to major organizations around the world, provides a wonderfully readable account of some of the voluminous data on this subject in *The Happiness Advantage*. For example, Achor notes that

1. happy people (where happiness is defined as “the experience of positive emotions”) are more productive, work longer hours and take fewer sick days compared to unhappy people;
2. people who express positive emotions are more effective negotiators than those who are neutral or negative;
3. happiness increases dopamine and serotonin levels, which increase neural connections and allow us to be more thoughtful and creative; and
4. teams with encouraging managers perform better than teams whose managers praised them less.

Findings like these explain why organizations with positive cultures are less burdened by “politics” than are their counterparts with negative cultures. They also have higher morale, spend more time engaged in strategic thinking focused on the pursuit of exciting possibilities (rather than negative energy expended on problem solving), and are able to attract and retain great talent. Individuals working in organizations with positive cultures build strong interpersonal relationships and generally enjoy work. These findings also explain why organizations with positive cultures outperform those organizations with negative cultures. As Shawn Achor explains, happiness does not follow success; by fueling performance, it precedes it.
Family businesses can significantly benefit from these insights and, in so doing, increase their likelihood of succeeding over the generations by following seven simple steps.

**Step 1: Cultivate a Positive Culture**
In *What Happy People Know*, Dr. Dan Baker describes how the human mind evolved to allow not for only primitive behaviors like those driven by fear (“fight or flight”), but also more rational (“higher order”) thinking that allows us to create art and send astronauts to the moon. This modern brain functionality also allows us to experience higher order emotions, like love, compassion and empathy, and to appreciate the benefits of forgiveness. Dr. Baker argues that the human mind can’t be in a state of appreciation and fear, or anxiety, at the same time:

> [d]uring active appreciation, the threatening messages from your amygdala [fear center of the brain] and the anxious instincts of your brainstem are cut off, suddenly and surely, from access to your brain’s neocortex, where they can fester, replicate themselves, and turn your stream of thoughts into a cold river of dread. It is a fact of neurology that the brain cannot be in a state of appreciation and a state of fear at the same time. The two states may alternate, but are mutually exclusive.21

The more time spent using our higher brain functionality, the more we can begin to realize the benefits Shawn Achor has described. One easy step family businesses can take to help create (or reinforce) a positive culture marked by mutual respect and kindness is to develop a code of conduct. Typical codes might include basic rules of communication that encourage listening without interrupting, communicating critical feedback constructively and respectfully, asking questions to discover information (not to demean one another) and, when relevant, seeking to disagree “agreeably.”

Without a carefully thought out family meeting agenda, discussions tend to focus on problems that often shift to identifying blame for those problems. Family members who might feel like scapegoats often disagree, and disagreements turn into arguments (fighting) or claming up (fleeing), all of which reinforce a negative feedback loop. Even if fighting is avoided, the time spent on problem solving is time not spent on possibility seeking. As Jim Collins has observed, “managing your problems will make you good but building on your opportunities is the only way to become great.” Readers interested in learning more about how to spend time in the pursuit of exciting possibilities and opportunities, but work done by Dr. Barbara Fredrickson, the Kenan Distinguished Professor of Psychology and Principal Investigator of the Positive Emotions and Psychophysiology Lab at the University of North Carolina, suggests that families should consider aiming for a ratio of at least three positive encounters to every one negative encounter.22 Fredrickson and her colleagues have found that experiencing positive emotions enhances cognition and improves the quality of relationships. Over time, positive encounters enhance social bonds that endure into the future.

**Step 2: Educate and Prepare Family Members**
Starting in childhood, families can take steps to ensure that members are prepared for adult responsibilities, including, if appropriate, those that accompany working in a family business. Preparation might include, for example, educating children about the many dimensions of wealth through volunteer work, philanthropy, and household chores in exchange for an allowance.

Ground rules can be established to clarify the preparation required of a family member in order to work in the business. Some families might find it helpful to require a college education; others might require graduate degrees and/or experience working outside the family business. Family employment decisions should be based on both a need and a good “fit” between the job opening and a family member’s talents and experience. Too many parents have ignored Harry Truman’s observation that “the best way to give advice to your children is to find out what they want and then advise them to do it.” As a result, job decisions are often made on the basis of status, convenience, entitlement, or money, and not on the basis of helping individuals discover their interests, passions and skills. A variety of validated assessment tools can help ensure that individuals are assigned to fill a role based on their strengths and interests. Once employed, family members can be assigned positions that continue the never ending “preparation process” by building experience and understanding, including understanding clients, vendors, partners, and so on.

Ultimately, senior family members must prepare themselves to hand over their leadership reins to the next generation if the succession process is to be successful.

**Step 3: Foster a Culture of Understanding**
While the importance of effective communication is well known, experience suggests that families “under-communicate,” the unfortunate and unintended by-product of which is the impairment of intra-family trust and the quality of family relationships. Properly structured, family meetings can enhance trust by creating a forum for open and constructive conversations. Subjects that might be discussed include the history of the family business, family values, and other topics of interest (such as opportunities relating to the business, or roles of various participants). Family understanding might be enhanced...
through the use of genograms, a graphic way of organizing family information that can offer powerful insights into family culture and patterns. Families benefit not only from well-structured meetings with constructive agendas but adherence to a code of conduct that incorporates common “communications tips” (such as no cell phones during a meeting, repeat what has been said, if necessary, to ensure understanding, look someone in the eye when speaking or being spoken to, etc.).

Even though families benefit from a code of conduct and regular meetings, science suggests that there will always be inherent limitations in our ability to communicate effectively owing to the variety of mental foibles noted above. Accordingly, families would be well served to complement traditional communication improvement techniques with an increasingly appreciated leadership trait: humility. According to Bradley Owens, a Research Fellow at the Center for Positive Organizational Scholarship at the University of Michigan’s Ross School of Business, successful leaders admit their mistakes, highlight team members’ strengths and demonstrate their willingness to learn. Owens and other researchers continue to develop empirical data on the benefits of promoting humility, a value long recognized by many major religions and philosophers, confirming that humility is positively related to team cohesion, task allocation effectiveness and team performance. A number of great resources are available to help “teach” humility.

**Step 4: Clarify and Commit to Core Principles**

There is a very successful entrepreneur who describes his decision-making style as “ready-fire-aim.” That approach worked for him over the years as he moved quickly and deftly to capitalize on opportunities that helped build a large and successful business. Family businesses, however, are inherently much more complex organizations than those controlled by a single entrepreneur, as they are made up of multiple individuals with some degrees of legal and/or practical decision-making influence who have their own distinct personal view about what is good for their business. As a result, a “ready-fire-aim” decision-making process that appears random and ad hoc can easily become divisive, with heated emotional arguments stemming from someone’s sense of unfairness.

Families can benefit from thoughtfully articulating and adhering to core principles, including a statement of values, a mission statement, a vision statement and appropriate policies. Indeed, the recognition that bottom-line profitability correlates with culture suggests that families would be well served by attending to a new “P/E ratio” (not simply the traditional price/earnings ratio): that of the number of “principled” actions and decisions to “expedient” actions and decisions. The goal is to function in an entirely principled manner or what we refer to as “P/E Max.” Decisions and actions that are inconsistent with core principles are referred to as “P/E Low.” Articulating core principles can serve as a decision-making compass, often helping ensure that families are not making ad hoc choices based, alternatively, from a “family only perspective” or a “business only perspective.” As Roy Disney wisely observed, “It’s not hard to make decisions when you know what your values are.”

**Step 5: Establish Professional Governance Structures**

Bestselling books like *Predictably Irrational* by Dan Ariely and *Freakonomics* by Steven D. Levitt and Stephen J. Dubner explain that many of the amazingly dumb decisions we make can be traced to brains that evolved to increase the odds of our ancestors surviving in dangerous times. This evolutionary heritage, however, is often ill-suited for modern day tasks and, so, we are prone to irrationality and overconfidence, as well as making biased or snap decisions, without recognizing it. To help counteract these tendencies, family businesses would be well served to seek advice and perspective from individuals who are capable of more objective (and less emotional) analysis. This is one of the most important benefits of forming a board of directors (or advisors) with capable non-family members. To ensure that family stakeholders (members and spouses) have a forum to communicate with each other, learn about the business, and ask questions, establish a family council for that purpose. The family council and board of directors/advisors can agree on the appropriate allocation of responsibilities and duties.

Family members working in the business should also be encouraged to learn skills that will be helpful in their continuing preparation for what the future brings. A variety of formal and informal learning opportunities exist, including reading, joining professional organizations like YPO or Vistage, working with an Executive Coach, or signing up for a college- or university-based family business program.

**Step 6: Preempt Conflict**

Individuals will always have differences of opinion. Constructively discussing those differences is a sign of a healthy family and a healthy business as such exchanges can promote creative strategies and powerful insights that often result in better decisions. The high rate of family businesses failing to transition successfully over the generations suggests that many disagreements are not easily resolved with differing perspectives being successfully reconciled. Lawyers often include a provision in a shareholder (or similar) agreement that specifies how conflicts might be resolved if and as they arise, typically by arbitration, mediation or litigation. Unfortunately, by the time a family gets to this stage, relationships are so impaired that it can be nearly impossible for family members to work together after “resolving” their conflict.
Accordingly, families should consider changing their planning paradigm to develop new mechanisms designed to help resolve differences constructively before they get out of hand. Strategies might include providing in an agreement an order by which disputes should be resolved: first by the participants directly, relying on agreed-upon core principles; then by seeking the advice of a family elder or a non-family director; and finally, perhaps, through the assistance of a mediator. Additionally, approaches based on collaborative law and game theory might be considered strategies to help preempt conflict. For example, We recently met with two brothers who asked us to help them unwind their business. We asked them to consider how much they would realize if their business assets were sold at auction in the very near term (hundreds of thousands of dollars) and then consider how much they would realize if they sold their business in a more thoughtful approach that might take as long as a year (millions of dollars). By appreciating the benefits of cooperating, the brothers realized their need to figure out how to compromise and get along.

**Step 7: Plan Holistically**

Because of the complexity of individual and family dynamics, only a few of which are highlighted here, “technically” designed plans that ignore human emotions and foibles are unlikely to work. Professional advisers must learn to appreciate these dynamics and expand their planning tool kit to address them. A more holistic planning process, informed by science, particularly the science of positive psychology, can offer enormous benefits. Many exciting opportunities continue to emerge on how more constructive plans can be designed. For example, traditional retirement planning might evolve to help senior family members think about how they might prepare for their “second-act careers” as much as they think about financial arrangements. Estate plans might benefit by focusing not only on the transmission of tangible assets like stocks, bonds and real estate, but also on the creation of an ethical will to transmit intangible assets like insights, experiences and lessons. Surveys suggest that parents worry about the impact money will have on their children: whether their children will spend beyond their means, will be ruined by affluence, or won’t do well financially. Holistic plans can incorporate strategies to help prepare heirs for their roles and to handle money.

Professionals working together can complement each other by sharing ideas informed by insights about family members, and, together, develop more informed and more successful plans. In a very real sense, a team of qualified professionals working together (perhaps even meeting together for regular quarterly meetings) can function much like a built-in and de facto advisory board. Professionals will enjoy the collaboration, and the family will benefit enormously.

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**Conclusion**

Albert Einstein famously defined insanity as “doing the same thing over and over again and expecting different results.” The unfortunate result of too many well-meaning and hardworking lawyers (and other professional advisors) who continue to limit their planning strategies to those based on traditional trusts and estates or corporate law practice tools is that family businesses continue to struggle and fail. It is time for the legal profession to develop new strategies and techniques that build on technically efficient traditional planning approaches while incorporating additional strategies and techniques that are based on a more nuanced appreciation of how the human mind works – and doesn’t work. The suggestions offered above should be considered in context: some families might benefit from a concerted effort to incorporate all factors; other families might already be working smoothly and may only need help with a single factor. Advisors can assess the family dynamics and develop a plan tailored for the individual family’s needs. Advisors who do so will function not just as tacticians but counselors and friends engaging in authentic discussions that are informed not only by legal insights but by experience and empathy as well. With a few simple steps, a family’s odds of successfully transitioning its business over the generations should markedly improve.

5. See Grant Gordon & Nigel Nicholson, Family Wars: Classic Conflicts in Family Business and How to Deal with Them.
8. Scott Friedman married into a successful beverage bottling and distribution company that was sold to a strategic buyer before the third generation succeeded to control. His experience, both personal and professional, along with his knowledge of continuing studies over almost three decades, has led him to this conclusion.


13. A few of the countless books and articles explaining with scientific precision these systematic errors include Harvard Professor Daniel Schacter’s description of how easily our mind forgets information in The Seven Sins of Memory; Daniel Ariely’s description of our tendency to think irrationally in Predictably Irrational; Malcolm Gladwell’s description of our propensity for making snap decisions in Blink, and Christopher Chabris’ and Daniel Simons’ description of how, all too often, we think we are paying close attention to what is happening around us when we actually aren’t in The Invisible Gorilla. On the lighter side, some of these many mental foibles are highlighted in You Are Not So Smart by David McRaney and, on the more serious side, Dr. Marc Schoen, a professor at UCLA Geffen School of Medicine, has written a book with the ominous title Your Survival Instinct Is Killing You.


17. Id., pp. 44–45.

18. Id., p. 45.

19. Id., pp. 43–45


21. Dan Baker, What Happy People Know, p. 81. John Milton expressed a related thought about the power of our minds when he wrote in Paradise Lost that “The mind is its own place and in itself Can make a Heaven of Hell, a Hell of Heaven.”


23. Barbara Fredrickson, Positivity 21 (NJF Books, 2009) (“unlike negative emotions, which narrow people’s ideas about possible actions, positive emotions do the opposite: They broaden people’s ideas about possible actions”).


25. Bradley P. Owens, currently an Assistant Professor at University at Buffalo School of Management, was a Research Fellow at the University of Michigan from 2009–2011.


27. See, e.g., U.S. Trust Survey of Affluent Americans, XIX.