The Family Business

COMPENSATION HANDBOOK

Practical and perceptive advice on rewarding and motivating family and non-family employees

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The seven-alarm fire of family business compensation

Each member of a family business perceives compensation fairness issues from his or her own perspective. But the company's long-term strategy should be the prime consideration.

By Gerry Murak

Compensation is always a hot topic in any business. But in a family business, it's a burning topic that can often be classified as a "seven alarmer." If the company owners don't address compensation issues with a long-term strategy in mind, they can expect these issues to rekindle in the future with greater consequences.

In a family business, fuel gets added to the compensation fire in many different ways. Here are some of the logs that can be thrown on the fire to inflame the emotions tied to the issue:

- *"This relative needs the extra money because he's building a new home."*
- *"He needs to get caught up to what his brother/sister earns."*
- *"They should be paid more than the other managers—after all, they're family."*
- *"So what if times are tough at the company—we own the business."*
- *"I ought to be paid more. Look at what we're paying our new hire—and she isn't even a family member!"*

There are seven "alarms" that can be set off during a discussion of compensation in a family business. The first alarm is sounded by the relative whose compensation is in question, based on how he or she perceives the issue. The second alarm is set off by the employee's spouse or significant other. The employee's siblings, parents and children sound the third, fourth and fifth alarms. The final two alarms are sounded by the company's key non-family managers and its board of directors or advisory board.

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The first alarm: The individual's perspective

When family employees think about compensation, they wonder what's in it for them. They may harbor thoughts such as: *"After all, I've put up with Dad/Mom and this business from birth"*; or *"I've worked hard, and I deserve more."* Emotions and family issues frequently get thrown into the mix. Critical questions to ask in determining a family member's compensation are:

- Does the family member's position fill a critical business need? In other words, if the business were in survival mode, would this position still exist if it weren't filled by a family member?
- Was the family member the most qualified for this position from the available market of candidates inside and outside the company—or was a job created for him?
- Were any concessions or compromises made for the family member when she was hired? In the most extreme cases, the hiring decision is rationalized with statements like, *"She couldn't find a job elsewhere"*; *"She couldn't keep a job anywhere else"*; or *"She was just laid off from her other job."*
- If the relative were to circulate his résumé in the open market, would he actually get offers? For what type of position? And for what pay range?

A word about salary surveys

The Internet and trade publications offer an abundance of wage and salary surveys. But one must be careful about picking a salary or range off a survey. How large was the survey sample? What region of the country did the survey examine? How big were the companies surveyed? Are job descriptions included in the survey, or just titles? Are the surveys comparing "apples to apples"—similar businesses in similar markets? If the survey was taken in New York City, and your company is in rural Idaho, the results won't necessarily serve your needs. Always use multiple survey sources and consider your local job market.

More critical than survey results are your company's overall strategy and financial health. One family business I know routinely took significant dollars from its credit line to pay hefty bonuses to family members. Needless to say, it *was* a nice family business that is now *out of business*.

Preventing family 'fires'

A little prevention can go a long way when it comes to family business compensation. For example, it's advisable for the founder's offspring to take a hiatus from the family business. Long before the children need to decide whether to attend college or just keep working in the family business, a very important ground rule should be established: Any successful combination of higher education and work experience totaling a minimum of ten successive years must be completed before family members can apply to fill a *bona fide* vacancy in the family business. This may seem harsh, but ten years isn't very long when one considers that many students now take five or six years to earn a college degree because of changes in majors or learning institutions. Five to ten years' experience outside the family business, in our free economy, will establish the family member's fair market value.

Re-read the above paragraph and you will notice it says "*successful* education and work experience." Would you consider hiring an unsuccessful non-family member to fill a key slot in your family business? You must consider whether you are running a business or a social service agency.

Entry guidelines for the next generation should be discussed and established in a family council meeting and communicated long before college or work decisions are made. These guidelines must be communicated annually to all family members, whether they work in the company or not. The absolute worst time to set this policy is when a family member expresses a desire to work in the business. In that scenario, the family member looking for entry into the family firm feels the requirement was made just to keep her out. On the other hand, a strategic policy established in advance will greatly assist the continued growth of the family business and serve as a component of the corporate compensation strategy.

Non-family members need to know of these policies, as well. They know that blood runs deeper than business. Key non-family managers often wonder whether unqualified relatives will displace them. Open communication of such a policy can bring peace of mind to these essential employees.

Fire-fighting strategies

To develop an effective compensation system, you should consider the following issues:

- *Most important:* What is the company's overall strategy? What products or services will be expanded or contracted? Is the business on the cutting edge or in a mature market? If the answer to these questions is, "We don't have a specific strategy," then the long-term survival of the business is at risk.
- How well does the company attract and retain employees? What is the turnover rate for various positions?
- Is there a plan for salaries to lead, match or lag the competition or local companies for the various positions needed to support the company's strategy?
- Would the current rationale for compensation of family members be affordable if the same criteria were spread across the rest of the organization for non-family members?
- Are the current dollars invested in individuals—family and non-family—yielding a comfortable rate of return?
- Draw up a complete organizational chart with everyone's name on it, and pencil in each employee's *total* annual compensation (wages, benefits and any perks, such as cars, condos, expense accounts, charge cards and club memberships) next to his or her name. Then scan your organizational chart for internal equity and fair market value. Are managers who have comparable responsibilities (related to the number of direct reports, department budgets, etc., that they are responsible for) receiving comparable total compensation?
- How well does performance match compensation? Is compensation based on performance or longevity? Are non-performers overcompensated? Are non-performing family members given a "forgiveness factor" because they're family? Nothing discourages key non-family managers more than learning that non-performing family members are overcompensated relative to their performance.

Before you go about modifying compensation in your family business, you need answers to some basic questions. Reviewing the alarms that can be set off during a discussion of compensation, and dealing with the issues honestly, can help avoid a "seven-alarm fire." Fairness will put out fires and allow the family business to focus on critical issues like continued profitable growth.