

For Business Advantage, August, 2005

FAMILY BUSINESS FORUM

Family Business Compensation

By Donald Levitt

Family businesses have been distracted, disrupted and even destroyed by compensation issues ever since the dawning of the first family business. “Compensation confusion” usually sounds something like this.

“We’re all equal in the family business, aren’t we? So why does my brother think he should make more than me?”

“I gave my son a raise because he and his wife just bought a new home and have a new baby. What’s wrong with that?”

“I can’t believe how greedy my sister and brother are. Their salaries and perks are just ripping off the rest of us who are shareholders.”

“I started this business from scratch and made it what it is. You’re darn right I think I should continue to get the biggest salary in the company during my retirement.”

Role Confusion

Much of this “compensation confusion” arises from role confusion: mixing up the roles of employee, shareholder, and family member. Compensation gets confusing when it is used as a tool for parenting (e.g., helping children who need more money; reducing sibling rivalry) or a tool to reward ownership (e.g., paying family member owners more than their jobs merit). These ideas seem appealing at first, and may work for a while, but they usually sow the seeds of future animosity and discontent.

A Rational Approach to Compensation

Compensation is first and foremost a business tool – a tool to motivate employee performance and achieve strategic business goals. Family businesses which use compensation in this way find that both family member employees and non-family member employees can get excited about helping the business to grow and be successful.

This does not mean that a family business compensation plan needs to be rigidly tied to the market value of jobs as might be the case in a publicly-held company. Some family businesses may indeed decide to go this route and pay all family member employees at

market value (with market value based on the complexity of the job and not just on the job title – because family member employees often receive titles far more grand than their actual jobs merit). Other family businesses may legitimately decide that all family members who are owners should be paid the same regardless of their job – to encourage a feeling of “partnership” and working together to grow the business and shareholder value.

Talking About Money

Most founders/entrepreneurs avoid talking openly with family members about compensation. They fear creating animosity between family members, or even fear that family members might question the founder’s compensation! This informal and secretive approach often blows-up when ownership and management start to transfer to the second generation. At that point it becomes impossible to maintain secrecy, and all of the suspected inequities come to the surface.

Rather than hoping that secrecy can be maintained, a better approach is to talk openly with employees, family members, family member spouses, and shareholders about the company’s approach to compensation: the business purpose of compensation; how compensation is determined; and how different jobs have different levels of value to the company (and thus are compensated differently). This is also the time to clarify for family members and shareholders that they are all responsible for their own financial well-being – and should not expect the business to be their “parent” and “help them out” when needed. Parents can, of course, help their children out, and shareholders can be rewarded for their ownership – but these roles should be clearly differentiated from compensation.

The Tip

Maintaining control over pay while keeping everyone happy (or at least reasonably happy) may seem like an impossible goal – but formally and carefully distinguishing between the roles of employee, family member and shareholder can be the foundation for a successful approach to family business compensation.

Donald Levitt, president of Levitt Consulting, helps family businesses to succeed as both a business and a family. More information about this month’s topic, and other family business issues, can be found at LevittConsulting.com.