

Compensation in a Family Owned Business

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Help! We're a second generation, family owned and operated business. We have family members from this generation working in the business. All the stock has been passed to this generation. Now we have to figure out how to go forward. We have to figure out roles, responsibilities and compensation. What makes it complicated is that we have different skill levels, different personal goals regarding hours worked, and different preferences for work we do, and don't want to take on. How do we set things up, so it's fair for everyone?

Big question! One of the most divisive parts of family owned business is the issue of compensation. When it comes to sharing the wealth among family members, it's not just about money, but also about power, recognition, position, and future prospects. The discussion of compensation is complicated by years of personal history.

In many family-owned businesses, the younger generation has worked in, and around the business, for most of their lives. Expectations that they will join the business run high. Parents strive to build something for their children to own and operate. They hope to make a better life for their children, and their grandchildren. Out of expectation, the next generation develops a sense of entitlement. They come to believe that the

business is, and should be there to provide for them.

It is a big transition from entry to ownership. The next generation starts out by filling specific roles, taking direction from mom or dad, doing what they are told. From there, they have to learn to take responsibility for running the business. That transition can be a difficult one. Many children, coming into the business, take years to make the leap from dependent child, to skilled owner. Some never make it.

If, in the next generation, there is a big gap in years, from eldest entrant to most recent, struggles may surface. The elder children forget how much they had to learn and how many mistakes they made in their early years with the business. The youngest entrants want the same degree of authority, autonomy, responsibility and compensation they see their older siblings holding, forgetting it took their siblings years to earn the rights they now hold.

The bottom line - the business must grow, to support the additional income demands that come with adding more family members to the payroll. Most second generation players enter in their 20's and 30's, and expect to stay into their 40's or later. These are the most significant personal income growth years. During this period, most people build families, acquire houses,

join clubs, and contribute to college tuition funds for their children. At the same time, mom and dad are starting to think about their retirement, and may be relying on the business to provide for that. All of this takes money, and more money, each year. Expanding the business is a core requirement, if it is to support the financial demands that come with adding family members of the next generation.

So, how do you share the wealth, fairly? Let's talk about base compensation, incentive compensation, and distribution of ownership. Before talking about each area, let me also remind you that one of the goals of most family owned business is to provide a standard of living to each family member. It could be a family goal to insure that each family member who works in the business is assured of earning \$100,000, for example. Then you will have to work through ways to provide incentives for the most highly motivated family members to earn well in excess of \$100,000. At the same time, those highly motivated members will have to deliver significantly higher revenue and profits, to justify the higher payout, and keep the company healthy as its salaries and bonuses increase.

Marking basic salaries to the marketplace can help to reduce conflict over uneven workloads. Define the job or jobs that family members fill, the same way you

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would if they were employees. If they fill several jobs, define each one. Benchmark each job against the open market. Go look at SalaryExpert.com to define job and salary parameters. Figure out what a person would get paid, in base pay, if they worked in another company and did similar work.

If anyone in the family is disturbed because they are not making enough salary, make it clear what they would have to do, to take on more work. Find out what additional work they are qualified to perform. Define additional training required, that would lead to an increase in base compensation.

If there are concerns regarding performance, conduct a fact-based review. Even though a family member is involved, you can still follow good basic management principles of regular reviews, with positive and negative fact-based feedback. It may seem uncomfortable to tell a sibling where they are falling down on a job, but in the end, it's better than letting them think that everything is okay when it isn't. In fact, every owner benefits from objective, honest feedback, designed to provide insight into what they are doing well, and where they need to make improvements.

Don't forget about cost of living increases. Right now, costs are going up for gas, heat, electricity,

groceries. Budget for cost of living increases, for everyone in the company, not just family members.

Finally, with each job, establish a range of compensation, from low to high. Make it clear, just as you should with employees, that the range is the range. Once a person maxes out salary in that job, the only way to increase income is to take on additional responsibility by adding more job tasks to the individual workload.

Now let's take a look at the role of incentive compensation. Incentives matched to delivery of the business' strategic and tactical goals can help eliminate conflict over uneven contribution. Define the company's overall goals for increased revenue, increased profit and customer expansion. Ask family members what they are willing to commit to delivering, relative to one or more of the company's goals.

You want to focus family members on key success measures. Give family members an opportunity to share in the success they created. Encourage personal initiative, and reinforce individual and team efforts that cause the company to improve and grow.

Different people can have different compensation plans, depending upon what they are assigned to do. Establish personal goals and objectives for

each individual who is expected to participate in the compensation plan. Define specifically how each individual will qualify to get paid incentives.

Individual bonus plans can be tied to revenue growth, profit enhancement, improvements in efficiency, expansion of customers. The parameters have to be very specific, and matched to the company's long and short term plans. Define reasonable compensation models, such as you might be willing to share with a top employee who was not a family member.

Be sure that the incentives match the value of the outcome. For example, you may realize that bringing in 2 highly profitable new accounts, equates to increasing 20 existing accounts by 10%. Those two may take different efforts to produce the outcomes, but that is irrelevant. The reward is based on the value of the outcome.

Once you decide on what, and how you expect to reward performance with incentives, publish the compensation plans. Measure individual performance against the plans. Issue payouts monthly, quarterly, or annually, as defined by the plans.

Now it's time to look at ownership. Increased ownership means an increased share in the wealth which results from growth in profit and revenue. It is normal

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in big companies to have a pool of treasury stock reserved for individual awards. You can do something similar in small companies.

It is possible to establish rules for distribution of ownership, tied to contribution of profit and revenue. This can help eliminate conflict over entitlement. If the company grows, and becomes more successful, it is worth more, and the people who helped to make that happen have the potential to increase their share.

Again, you will need a compensation plan, defining the conditions under which someone can earn, or purchase, additional shares of company stock. If there are concerns about decision making power getting out of balance, you can consider distributing ownership through non-voting shares, or phantom stock plans.

Set up a pool of stock, which can be issued as a reward for meeting individual or team goals. Establish stock options, which give individuals the right to purchase additional stock under certain performance conditions. Allow family members to buy in, and increase their commitment to the company's future, by establishing plans where they can exchange bonuses for stock, or where they can earn the right to acquire additional stock as payment for a specific job-well-done.

Finally, when working through issues of compensation among family members, be cautious about going it alone. This is a complex issue, and one in which advisors and referees can help preserve a sense of balance as you work through the challenges. Be prepared for multiple meetings, in which you solve a little bit at a time. As you negotiate, you have to allow all parties time to adjust, and opportunity to consider the proposed solutions. Expect to compromise. And remember to negotiate with dignity and respect.

Looking for a good book? Try *Family Business Compensation* by Craig Aronoff, or *The Family Compensation Handbook* by Barbara Spector, or *Keep the Family Baggage Out of the Family Business* by Questin Fleming.

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