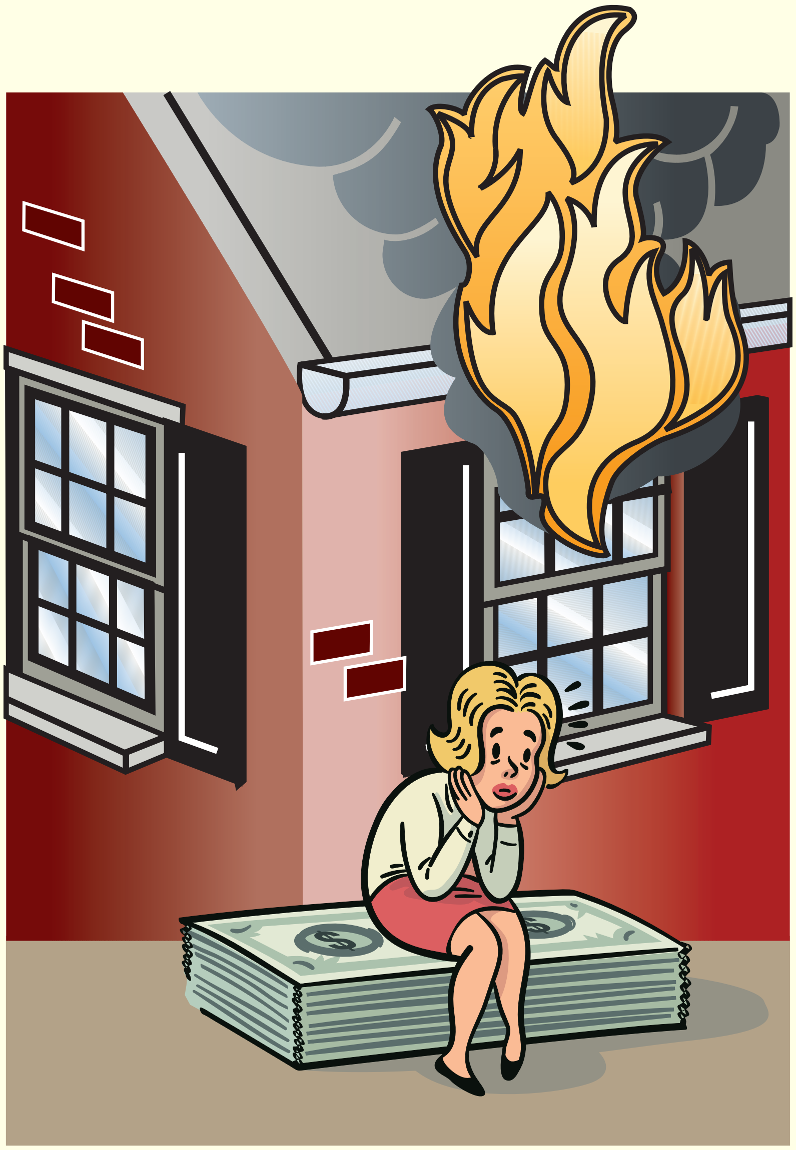
The Seven-Alarm Fire Of Family Business Compensation

by GERRY MURAK



Compensation is a hot topic in any business, but for a family business, it's a burning topic that can often be classified as a "seven alarmer." Agency owners who don't address these issues with a long-term strategy can expect them to rekindle in the near future with greater consequences. Here are some of the logs that can be thrown on the fire:

- "I need the extra money to finish building my 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."

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. 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 advisors.

The First Alarm: The Individual's Perspective

When family employees think about compensation, emotions and family issues often enter 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 or was the position created just for them?
- Was the family member the most qualified for this position from the available market of candidates inside and outside the company?
- Were any concessions, compromises or special deals made for the family member when they were hired?

The Second Alarm: The Spouse's Perspective

If the spouse or significant other works in the business, then the questions identified within the First Alarm section must be asked about the spouse's position. All too often, combined "sympathy" compensation packages are developed. "Creative" plans are often developed to disguise the fact that a family member is being paid more or less than what they are actually worth. Whenever any part of an employee's compensation has been changed, the home discussion that evening centers on whether the change was fair. These at-home discussions seldom cover the key elements of strategy or fair market value. Instead, they take the form of "What did your sister or brother get for a raise?" Keep compensation discussions tied to the business strategy, the financial health of the business and the fair market value of an individual's performance.

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The Third Alarm: The Siblings' Perspective

Siblings in family businesses are often concerned about whether their compensation is equal. If it isn't, compensation discussions can turn into arguments about who loves whom more. If siblings feel their brother or sister is paid too much or that they themselves are paid too little, the answers to the questions identified within the first alarm section regarding any family member's compensation should provide clarification.

The Fourth Alarm: The Parents' Perspective

Parents shouldn't be a factor in compensation. Can a dad or mom go to the CEO of General Motors and say, "Come on, give my daughter a little more — she's trying really hard to do a good job"? Yet in family businesses, parents try to influence each other to change compensation for their children. If a parent tries to influence compensation from a family or emotional perspective, "Just say no!"

The Fifth Alarm: The Children's Perspective

Grandchildren who work in the business can put another spin on compensation. If the grandchildren are in the business, see the answers in the first alarm. If they aren't working in the family business, are they being used to influence compensation because they

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need braces, or need private school or college tuition? "Just say no!"

The Sixth Alarm: Non-Family Employees' Perspective

Family businesses must be able to attract and retain key non-family managers. No matter how hard the family tries to conceal the relatives' compensation and/or benefits, word gets out. The non-family manager may wonder whether they will be passed by for a spot they earned through their performance. If the non-family key manager is exposed to these dilemmas and fairness is overlooked, they may feel they have no choice but to move on. Such situations can be easily verified through third-party exit interviews.

The Seventh Alarm: The Board's Perspective

All too often, board members or advisors are put on the spot when asked for their input regarding the compensation of family members. Many family business boards include the owner, family, friends, their banker, lawyer and accountant.

At least one or two board members should have management experience in a closely-held business. If compensation experience is lacking, consider contracting an outside third party to handle compensation issues.

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? Are job descriptions included in the survey, or just titles? Always use multiple survey sources and consider your local job market.

Preventing Family "Fires"

A little prevention can go a long way when it comes to family business compensation. Having children spend time working outside the business is a great start. Any combination of higher education and successful work experience totaling a minimum of 10 successive years must be completed before they can apply to fill a bonafide vacancy in the business. Five to 10 years of work experience outside the family business will establish their fair market value.

Re-read the above paragraph and you will notice it says "higher education and work experience." Would you consider hiring an unsuccessful non-family member to fill a key slot in your family business?

Entry guidelines for the next generation should be discussed and established in a family council meeting and 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. 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 these policies as well. Open communication of such a policy can bring peace of mind to these essential employees.

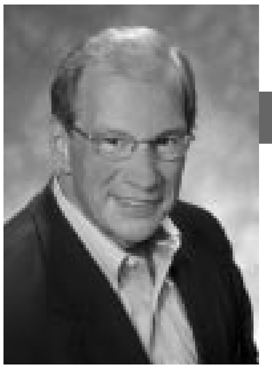
Firefighting Strategies

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

- Most important — What is the company's overall strategy?
- How well does the company attract and retain good employees? What's our turnover rate?
- Is there a plan for salaries to lead, match or lag the competition or local companies for the various positions needed?
- 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) next to their name. Then scan your organizational chart for internal equity and fair market value.
• How well does performance match compensation? Is compensation based on performance, longevity or bloodlines?

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.



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