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"Houston, We Have a Problem" with Family Pay: How Do We Fix It?

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Compensation of family employees may create problems for family members in the business as well as those who are not.

1. **Problem for siblings and cousins who do not work in the business:** A family employee paid too much, justified by a father's view that all family employees must have a community image of success;
2. **Problem for the underpaid cousin:** A family member paid too little for her position to avoid a cousin's taking offense at a salary that exceeds his;
3. **Problem for the whole family:** Conflict is simmering over generous pay and perks available to the family members employed in the business and the small or nonexistent dividends available to all others; and
4. **Problem for the most capable family employee:** No matter what job a family member takes, the pay is the same as all other family members.

Families create problems on all sides with compensation issues — by paying above market salaries or well below, by giving generous salaries and perks to those in the business or by paying family members equally regardless of position. The journey of successful family business management and governance eventually leads to the realization that the best way to handle family compensation is to make it fair and equitable based on market and merit. The question then becomes, how do we do it?

Step One: Communicate the Intention to Conduct a Compensation Evaluation

The first step is to assess how current base pay for family members compares with that of other family employees, other employees and, finally, similar positions outside the firm. In taking this step, it is important to inform the family in advance about a compensation assessment. Moving forward without involving the family on an issue as emotionally charged as pay breeds resistance and conflict.

Determining fairness is a job for an objective outsider a compensation specialist. If you have independent directors on your board, it is time to get another return on this investment, as the outside directors can be a trusted source of objectivity as they participate in selecting a consultant, interpreting the consultant's report and following through with changes.

A compensation specialist will compare the job-related contributions dissimilar family positions make to the business, indicating how much more important one is as compared to another based on factors such as the consequences of making an error or the level of complexity of the job. This analysis also should consider unique elements of a job that exist because a family member is in the position.

Once family jobs are compared against one another and to other internal jobs, the next step is to compare them to positions outside the firm. Typically, good external comparison information is available from published salary surveys, trade group surveys and other sources such as executive recruiters.

And, as an additional benefit, this exercise forces families who have not clarified job responsibilities and positions to do so. It becomes obvious that jobs are not well-defined or constructed when one is forced to categorize and compare them to the broader market.

Step Two: Overcommunicate and Set a Goal

As a result of the first step, you will know how closely pay for family jobs matches the labor market and how jobs compare with one another internally. Whether or not initial suspicions about the fairness of pay are supported, you now have an objective benchmark for family positions, which lessens conflict resulting from one family member's assessment of what another family member ought to be paid. This alone may be worth the cost of the analysis.

With this objective benchmark in hand, the family then can determine its goals for the compensation structure. Assuming that fair and equitable pay is the goal, a special family meeting or a Family Council session will allow for open communication on how adjustments will proceed. Educating the full family (including spouses) and utilizing an outside expert will lessen the chance of misunderstandings and perceptions of unfairness. To overcome change resistance, one argument used by many families involves illustrating how continuation of the current family pay system will lead to unfairness in the next generation.

Step Three: Changes

It is rarely appropriate to decrease pay. Freezing the compensation of family members who are overpaid while making normal increases to others' compensation eventually will erode the difference. Gradual transitions ease the pain; after all, it probably took a long time to reach the current status. It may be the case that you will have to wait until the next generation to make all the needed changes. Advance notice of a date when changes will occur allows individual family units to plan for adjustments to their income. As in the overpayment situation, family positions that are underpaid can be addressed through corrective increases over a period of a few years.

If it hasn't been accomplished already, decide once and for all that family pay for a job will be separate from any form of ownership distributions or gifts. One method for making this transition is to provide a one-time distribution, essentially three to five years' worth of the overage, with the base pay set to the market immediately. An alternative would be a gradual decrease (weaning) of the overage, with immediate clarity about how much of the total amount is pay for the job and how much is for family-member status. In either case, an individual could quickly understand what is fair pay for his or her position yet would not have to immediately adjust to it.

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