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"That's Not Fair!"

Creating Compensation and Employment Policies in a Family Business

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A common anecdote told by family business advisors quips that the first three things a baby learns to say are: Mama, Daddy and "That's not fair." After working with family business owners for more than 15 years, I can understand why.

One of my client families consisted of four siblings and their mother who each owned 20% of a large logistics company in the UK. In their last shareholder's meeting, an argument erupted about whether Anne, the third oldest, had the right to borrow 5 million Euros from the company, even though the family loan policy clearly forbade it.

As tensions increased, I noticed how quickly the arguments for and against Anne's loan started marching back through time. Remarks about who got what money last year turned into a heated discussion about the cost of a particular grandson's college tuition. This was rebutted by a comment about who paid for another sibling's divorce.

In an attempt to restore calm, I asked Anne why she believed her request was valid. She identified an opportunity to invest in raw land in her neighborhood. I asked again if she felt that her circumstances superseded the family loan agreement. After more exchanges, the truth finally emerged: "Because daddy always gave more to them. I deserve this money."

Siblings and Money: A "Fairly" Complicated Relationship

The clear metrics of compensation (wages, bonuses, retirement, benefits, options, fair market value, etc.) would suggest that complications around family compensation are grounded in finance and accounting. However, I have found often at the heart of this emotional issue is the early-formed and long-standing quest for fair treatment among siblings.

We compare resources received from parents and grandparents with that of our siblings, even into middle age. Our children keep score in the same way. This dynamic lasts throughout the sibling relationship, which on average is the longest of our lives.

An analysis of 70 of my most recent client engagements revealed that many of them struggle over family members' compensation. A few interesting facts:

- 34 of the companies are controlled by one owner (49%), 31 by sibling partners (44%) and five by cousin groups (7%).
- In 60 of the 70 family companies (86%), siblings work together on a frequent basis (at least one day per week).
- Of those 60, compensation is a major issue in 54 family companies (90%).

- Of the six family companies that do not have compensation issues, three are publicly traded and three are third or fourth generation, high-functioning family businesses actively managing the relationship between the business and family.
- Of the 70 total companies, family member compensation is a significant issue in 58 of them (83%), regardless of whether siblings work together.

In summary, 90% of my family business clients in which siblings work closely together have trouble dealing with family compensation.

Socialist at Home, Capitalist at Work

> **"From each according to his ability, to each according to his need." Karl Marx**

Why does compensation in a family business cause so much heartburn? Much of the blame can be placed on parents and the incongruity between how we behave at home and how we behave at work. I call it "split economic personality disorder." By and large, we are socialists at home and capitalists at work. Family compensation tensions can often be traced back to these clashing economic philosophies.

When it comes to home economics, we lean left. Predictably, and for good reason, we give time and money more liberally to the neediest children. At the same time, the child who produces more benefit for the family — helping around the house or earning money to defer car insurance costs — is rarely rewarded.

However, once we pull out of the driveway and head to work, we become free-market capitalists intent on productively employing our resources for personal gain. Gain that largely results from finding, hiring and retaining skilled, productive and trustworthy employees. We know that our chances of increasing our capital improve if we lead and reward our people based on principles of meritocracy: governance that distributes responsibility, power and resources based on merit and achievement rather than relation, popularity, seniority or age.

It seems logical then, that a child would expect socialistic economic principles to apply on their first day at the family company. "After all," they might surmise, "it's the same boss." Not so, dear child. You've stepped from one economic reality into another. The key challenge is how to help the child understand and respect the difference.

Two Organizations, Two Different Worlds:
Direct Comparison of Family and Business Characteristics

Family	Business
Resources doled out based on need	Resources awarded as a result of achievement
Emphasis placed on achieving "equal" treatment	Emphasis placed on achieving "fair" treatment
Warm and fuzzy success metrics (love, respect)	Hard, quantifiable success metrics
Relationships due to marriage and birth	Relationships as a result of choice
A sense that the relationships are permanent	A sense that the relationships are temporary

Start with the Golden Goose

Before owners need to worry about compensation for family members, they must first create a golden goose: a profitable, growing business. They need to communicate clearly and often that protecting the goose and her golden eggs is a primary objective and family responsibility.

Though simplistic, many of my clients use this golden goose analogy. Protect the goose from the fox (primary competitors) and it will lay golden eggs for its owner. If the owner gets too fixated on the eggs, the fox will kill the goose. Dead geese don't lay eggs, and families miss the profits when they're gone.

A well-managed business provides economic and psychological benefits to the family. In return, when the family is treated fairly and cared for, they provide the same for the business. Each complements, supports and strengthens the other.

Teach Self-Sufficiency and the Owner's Mentality

Once the golden goose is healthy and safe, begin preparing the family for entering the business. Following are successful ideas from other client families:

Extol the virtues of self-sufficiency and autonomy.
One client makes time to talk with his children about the satisfaction he feels from earning money and being able to spend it how he wants. He points out that he is also able to control his schedule and attend important family events because he works as his own boss.

Help them find their "thing."
Another client encourages her grandchildren to pay attention to where they are most successful. She suggests they will be happiest in life if they can figure out their "thing" - the unique talent or skill that they can productively and enjoyably apply in order to make money.

According to one of my most successful clients, "The people who cause the most problems in an organization are the ones who aren't good at anything." All people are good at something, but many don't know what it is or how to use it productively.

Encourage the Owner's Mentality.
One of my clients has a life slogan: Make stuff better. He buys businesses, improves them and either sells them or takes them public. He actively teaches his kids this concept by helping them buy, fix and sell things like bicycles, wagons, dollhouses and skateboards. His objective? Show them that owners are interested in increasing the value of what they have.

Next time you are riding bicycles together, ask your child if they would rather own or rent a bike. If your children are older, you might ask them if they would rather own or rent a car. After they respond, ask them why they chose their answer.

Use the discussion to help them see that owners can control and personalize their "stuff". Perhaps they would choose to paint the bike red or put a video game console inside the car. If they own it, they can do with it whatever they want. They can use it, rent it out to others or sell it. If they rent it from someone else, they do not have the right to change it.

Meet as a family council.
Create an agenda that focuses on the interaction between the business and the family and how both should protect, sustain and complement each other. Ideally, the family council should meet for half a day at least twice a year.

Talk about money and wealth.
Share information about what benefits family members can expect from the family business such as employment income, insurance, vacations, vehicles, retirement funds and comfort. As they increase in age and maturity, be more specific about dollar amounts.

Define a Family Employment Policy

As children mature and become more aware of socio-economic status, they will hear about worst-case family business scenarios. If they have been appropriately included in family wealth and business discussions, they will understand the need for a family employment policy.

Working together and inclusively, develop a policy that specifies the following:

- Why a family employment policy is important
- What behavior and performance family expects of family employees
- Age requirements
- Formal education requirements
  - o Degrees or technical certifications
  - o Acceptable institutions (accredited universities, licensed training schools)
- Required skills such as technical, financial/ accounting and leadership
- Outside work experience requirements (I strongly recommend this)
- The hiring process with specifics about who decides and how

Develop a Performance Evaluation Policy

Take the time to get this policy right. Include family members whose children may someday hope for a job at the family company. Draft a number of iterations before finalizing. Invite family members to voice their opinion and to make concrete recommendations. Keep appropriate meeting notes.

Make sure the message is clear: As owners and future owners, the family wants only the best and brightest business leaders in their company. Others need not apply. Once the policy is completed, remind family members that this policy can only be changed by unanimous vote of the family council.

Reduce Personal Risk Detectors for Non-family Managers

Once the family employment and performance evaluation policies are complete, there is great value in sharing it with management. Non-family managers (NFMs) have highly-tuned personal risk detection systems that constantly scan their work environment for family trouble. If a next-generation family member is approaching the age of full-time employment, NFMs become aware that their risk of being replaced by a family member increases.

Their response is predictable. They begin dusting off their resumes and reaching out to friends and associates in their professional network "just in case." As a result, productivity declines and profitability may dip. If a family employment policy is in place and communicated well, NFMs can stop worrying about unfair job competition and get back to work.

Establish a Family Compensation Policy to Fit the Owner's Mentality

Compensating family members is straightforward once family members understand the concept of the Owner's Mentality. Owners want their businesses to grow profitably and in order to do so, they need excellent managers who make excellent decisions. Owners understand that overpaying under-qualified managers, whether family member or not, doesn't make sense.

The family compensation policy should clearly outline key guidelines:

1. Any advantage given to family members working in the business will be seen by employees as family socialism superseding free-market capitalism.
2. Family employees will be compensated in the same manner as non-family employees, period.
3. Compensation levels will be determined by fair market value analysis.
4. Family employees are expected to live within their financial means and not encumber themselves with excessive debt or rely on special disbursements for their living expenses.
5. Only compensation that is part of an existing employment contract will be provided through the company.

Piece the Puzzle Together

The question of how to compensate family members in a family business seems technical at first blush. Decisions about fixed and variable pay, benefits and incentives, stock options and perks, retirement and fair market value can seem overwhelming when mixed with the emotional energy of family relationships.

But when viewed from the vantage point provided by the Owner's Mentality, compensation for family members becomes another piece of a puzzle. A colorful, energizing, maddening family business puzzle that is complex and constantly changing and must be handled lovingly, carefully and fairly.

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