

Compensation Planning: The Unsung Hero towards Strengthening the Business while Preserving Family Harmony

By: Shawna Lecuyer, The Family Business Consulting Group

The process of designing a compensation plan has been described by many as "art rather than science." Arriving at a plan that blends the appropriate balance of motivation, recognition, and positive return on investment in the talented individuals who drive your business' success takes careful thought and consideration. It can be a daunting task in any organization to begin this process, but when family employees are added into the mix of business talent, the layers of complexity compound.

In business, the decisions surrounding pay and promotion are based on merit, and not all effort or contribution is the same. In the family system, elements of fairness are often drivers of decision making, with an emphasis on equality. How do family business owners reconcile with notions of fairness in an environment typically set up around merit? Some, understandably, avoid the topic altogether.

Compensation as a subject can be difficult and running the business as a family is already challenging on its own. Some families include the subject of compensation topically in their family employment guidelines. Perhaps they state that family employee compensation will be based on the "market rate." While this gives some direction and doesn't leave the subject untouched, it lacks clarity or the level of depth that will allow a potential family employee to feel empowered or make the most informed decision when it comes to the all too important decision around joining the family firm.

Clarity is Key

Adding specificity to employment guidelines in the form of a well-developed compensation philosophy and setting expectations for working together is key to bringing clarity and alignment. It means moving away from generalizations and embracing more structure which can feel awkward,



especially in a system where formalities may not be a norm. It helps to look at this process through a lens of making steady progress, rather than landing at a place of perfection. To get started, consider the following questions as you establish new or evaluate existing employment guidelines:

- Is the path to employment within the family business understood?
- Who sets goals for the family employee and who will be responsible for evaluating their performance?
- Are there circumstances where a family employee may be fired?
- Do we have clear job descriptions and are family employees expected to meet the criteria for the job? When might a family employee be treated differently or receive special consideration?
- How is pay determined? If it is based on "market," have we defined what the market is for the family business? If so, is it clear in the guidelines?
- Is the family's compensation philosophy articulated? Does the board of directors or Human Resources

understand the philosophy and is it embedded in a compensation plan?

- Do we incentivize team contributions and if so, how will the family employee see their contribution to the team? Is it part of merit increase? Bonus? Profit Sharing?
- What factors determine a merit increase? Who will be responsible for determining the merit increase for the family employee?
- How will promotions be handled and who determines a promotion has been earned? How is pay impacted by a promotion?
- Does compensation differ for family vs. non-family employees? If so, in what ways? Does the family employee understand this difference?
- Has the family differentiated between compensation for performing the duties and functions of a role within the family business vs. remuneration for being a shareholder?
- Are there processes in place to ensure the guidelines are being consistently administered?

Leveraging Governance

Board and family governance systems can play an important role in setting expectations, monitoring, educating, and ensuring consistency in family employment practices. Objectivity around sensitive topics such as family employment, career pathing and succession planning along with the compensation practices that support these elements of the family employee's career is critical to a successful outcome.

Leveraging governance systems by having regular touch points with and reinforcement for compensation and employment practices allows the needs of the business and the interests of the family to converge in greater harmony. Following are just a few ways that Board and Family governance can be leveraged in support of consistency and transparency:

The Family Council:

- Plays an important role in communicating the family's expectations for family employees, thus reducing misunderstanding and disputes
- Serves the crucial function of educating the family

on employment guidelines, compensation practices, stewardship and serving as a family ambassador in the business

- Ensures that all family voices are heard, and processes are in place to resolve disputes
- Crafts guidelines that align the family's values with business objectives
- Serves as a forum to discuss matters openly, fostering transparency and trust

The Board of Directors:

- Has a critical oversight function, particularly with the design, implementation and ongoing administration of compensation programs that incent, attract and retain both family and non-family employees; may delegate portions of this responsibility to a Human Capital Committee that has a touch point with Human Resource leadership
- Can help blend familial expectations with merit-based compensation systems that will sustain the business
- Ensures objective criteria is in place for establishing salaries, bonus and incentives
- Mitigates risk to the organization by ensuring consistency in compensation practices
- Provides support and counsel to management when family expectations or challenges arise that lead to misalignment with established guidelines or protocols
- Validates appropriate career pathing and succession plans for key roles
- Ensures compensation practices continue to meet the emerging needs of the business and family

If you do not have a functioning board with some independent board members, this may be a time to consider building a high-functioning board that can help build objectivity around the oversight of compensation. The addition of a Human Capital or Compensation Committee can assist the board in fulfilling its oversight responsibility by evaluating CEO performance, recommending compensation structures for senior leadership, ensuring the implementation of the compensation philosophy along with policies and programs that support the business strategy. The combination of a functioning board with the diligence

performed by a Human Capital Committee supports objectivity and serves an important advisory role to management, making the topic of compensation far less difficult.

Preserving Family Harmony

Incorporating fairness and equality in a system where personal and professional lives are intertwined is no small feat. Disputes often arise around compensation when clear expectations have not been developed or communicated, causing misunderstanding and mistrust.

Family dynamics can further complicate matters when ideas of what is "fair" or "equitable" are at odds within the family system. Sometimes family complexity and assumptions of motive or intent cloud member judgment along the way. When the family is struggling to converge on key elements of their compensation philosophy, it may be helpful to ask the following questions:

- Are we crafting guidelines that incentivize the right behaviors from the family employee?
- Do our guidelines help us to be better stewards of the business?
- Are we aligning family and non-family employees in terms of performance and expectations? If not, what gaps are we creating?

- If we move forward with our guidelines, what are the implications on our family's harmony? How will that impact the business and all its stakeholders?
- Have we created enough clarity for the broader family through our guidelines and processes? Are they empowered to make a fully informed decision about joining the family business?
- Did we include contingencies and methods for settling disputes in our systems and processes?
- Did we endeavor to promote fairness and meritocracy while upholding important financial disciplines?

The work we do, and the compensation associated with it is so very personal and connected to our identity. It signals our worth within a system and assigns value to our contributions. Therefore, it isn't a surprise that conflict naturally arises around the subject of compensation. Unfortunately (or fortunately) it may become the impetus for discussion around a complicated topic rife with emotion.

Proactively addressing this topic by including transparency around processes and providing clarity about expectations can make a tremendous difference. While it may not prevent all conflicts around compensation, it certainly allows a framework for productive dialogues that can safeguard relationships within the family.

Shawna Lecuyer is a consultant with The Family Business Consulting Group.

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