

THE **C.H.A.L.L.E.N.G.E.S.**[®] OF FAMILY COMPENSATION
IN FAMILY BUSINESSES

There are 10 basic “traps” many families in businesses fall into when making compensation decisions. These “traps” generate feelings of unfairness and family disharmony if not controlled. Rarely do the individuals controlling compensation, most often the parents, believe what they are doing is unfair.

A common “trap” often begins when one of the working children go to the parent to discuss their “needs.” The parent often assists in fulfilling the “need” by raising the individual’s compensation. As soon as they add to this individual’s compensation, the trap is set! Other family members working in the business, in this case, siblings of the individual in need, learn about the increase in compensation. Next, comes something we like to call the “slow internal burn.” Siblings discuss the situation among themselves resulting in feelings of unfairness toward the parents and distain toward the sibling receiving what is perceived as unfair compensation. They now believe they are being penalized for being better organized, better money managers or less frivolous than their “in need” sibling. The trap has sprung and here comes the next one; the involvement of the spouses. These are the people who *know* the number of hours and the dedication their significant others give to the business. They are now included in the “trap” and have also developed feelings of unfairness and disharmony.

Everyone is on the defensive and it is usually most obvious at family functions. Conversations are strained and there is little interaction between family members. Unfortunately, the issue is rarely discussed until everyone in the family is at their emotional breaking point!

Put the right rules in place concerning compensation for your family members. Be sure each of the working family members understands how compensation is determined. Put your compensation method in writing. Use the following guide to save you and your family from personal heartache and unnecessary disharmony.

C.H.A.L.L.E.N.G.E.S.[®]

1. **C**ontrolling how pay is determined in many family businesses is a matter of emotion. Here is what happens. John lives at home so he does not need as much money as Joe who is married, even though John is the President (looks like our “in need” example above!). The question that should guide compensation decisions: “*What is each job really worth in the marketplace?*”

2. **H**aving highly inflated paychecks to save on taxes. Paying higher wages to family members in an attempt to gain a savings on taxes, dividends, etc. is a practice which builds an “I deserve it” mentality. This can create more conflict in a family and a cash crunch in the “lean” times. Remember: *“Don’t create an entitlement attitude.”*

3. **A**ssuming your pay decisions will be ok with all family members. Set “pay policies” to avoid mistrust of your decisions and conflict between family members who believe you are “playing favorites.” Getting other people, trusted by all family members working in the business, involved in the “pay policies” will go a long way in adding creditability to the process. Placing these policies in a “Family Policy Manual” can be helpful as well. Questions: *“Should you be the only one making the pay decisions?” “Could a Board help?” “Who are other advisors trusted by all family members involved in the business?” “Would it be wise to use them in this process?”*

4. **L**etting wages for managers and dividends for owners be mixed. There must be a separation of pay for those working in the business and the return/dividends – owners’ distribution for the shareholders of the company. Managers as shareholders should receive the appropriate wage for their position AND a return for being a shareholder of the company. Managers should be paid for their contribution to the success of the company. A performance bonus for meeting certain established goals or benchmarks set by the shareholders should also be considered. These types of remunerations for individual contribution should NOT be mixed with what they could receive as shareholders. Remember: *“Fair is not always equal.”*

5. **L**eaving the finances of the company and/or how much dad and mom make, a secret. Many adult children do not understand the career opportunities they could attain because they do not know the financial reward the company can create. “I don’t want to go into the family business because I have watched how hard mom and dad work and I don’t believe they have ever made a lot of money.” Too often the current generation in a family business does not take the time to lay out the realistic opportunities concerning financial rewards and career growth for the next generation. Question: *“How can adult children make a career choice when they don’t know the opportunities?”*

6. **E**motional issues and threat of conflict should not determine pay. This leads to giving raises in order to AVOID conflict and/or to get other family members “off my back!” A very natural tendency of a family is to strive for family harmony and avoid conflict (even though some families will say the opposite is true). Using money as a way to achieve it NEVER works. Remember: *“Avoidance of conflict only adds to it.”*

7. **N**ot regularly or formally discussing individual performance expectations and results with each family member. When this is not done, family members do not know if they are being properly judged when raises and bonuses are distributed. Does everyone in the family business really understand what is expected of them? Evaluations **MUST** be realistic, based on specific job criterion and in writing. Remember: *“When I am not told how I am doing, I must be doing great!”*

8. **G**oals should be defined for each family member in the business when it comes to career development, retirement and/or life-style. Without them, it is often perceived that someone may be getting paid to do less. Another “trap” is set. There needs to be clear communication between generations so that everyone understands the financial expectations of one another in advance. Without understanding these expectations what one person believes they need to live on for retirement could cause the business to fail just as what another person believes they should receive as compensation could cause hardship for a retiring family member. Example: The same paycheck in retirement can create “cash crunch” and inter-family bitterness. Too big of a salary from the “next generation” can create hardship for the retiring family members. Remember: *“What I don’t know, I assume! Open communication is the key.”*

9. **E**stablishing other “perks” to keep family members happy instead of being honest about their productivity and contributions to the company can lead to problems. “Perks” should only go to those people in the company who contribute to the success of the company. Giving a “perk” to one family member because “they haven’t been to a hockey game in a while,” is not a good way to handle the extras that come along from vendors and other business contacts. I am all for extra perks for family members but they must be understood, controlled and earned. Remember: *“He who makes the most noise gets ... is a bad policy!”*

10. **S**etting a negative example to your working family members by overpaying yourself in wages. Set the rules and live by them. Remember: Actions speak louder than words. That doesn’t mean you don’t deserve the rewards of the company you have built. It does mean keeping wages as clear and understandable as possible. If you don’t, the next person in line to take over your position, may perceive that they now deserve the over inflated wages you were paying yourself. This can cause a great split with other working family members who find the gap between wages unfair. Owner equity withdrawals, quarterly distributions and other tools can be used to get money out of the company without corrupting the wage policy for family members.

Making compensation decisions in a family business is never easy. Without a clearly written policy concerning compensation for family members, conflict will arise and family relationships will be strained or possibly destroyed. There also may be a tendency to withhold information affecting company decisions due to a resentful “I am not getting paid for this” attitude.

Don't let these things happen to your family and business. Avoid the “traps” and keep your family in focus and your business on track.

We can help you create the best compensation program for your family in business.

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