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Compensation Strategies for Family Business

By Thomas Hurley

Compensation is an emotional topic for both business owners and employees. Organizations are constantly trying to balance the bottom line with paying its workers fairly. That balancing act can become more difficult in a family business if a compensation strategy is not clearly defined. Family harmony (or lack thereof) adds additional emotions to the already passionate topic of compensation.

As family businesses grow, so too does the compensation and rewards structure to engage and incent your most valued assets, your people. In the start-up stage, there are few employees, very little structure, and most, if not all, team members are part of the family. As the company grows the need for business structure and processes surfaces. At this stage, non-family employees often have increasing authority and control.

It's an opportunity for owners to reach consensus on how to:

- Compensate non-family employees. Family businesses are continuously challenged to create compensation packages to attract and retain key non-family talent with a unique skill set and experience needed to run the business.
- Fairly compensate and differentiate pay among family members. What is the appropriate compensation balance for hard-working and strong performing family members working side-by-side with less motivated and less competent family members?
- Companies that fail to thoughtfully plan will ultimately lose the battle. Studies show that fewer than 5% of family companies survive past the third generation. This offers an opportunity for family business to develop a compensation strategy that provides clear guidelines on paying its employees resulting in a much greater chance of survival.

Compensation strategy best practices include:

- Family members participate in the same compensation plans as non-family employees (an exception is often made for long-term incentive plans where family members who own stock may not participate in a long-term incentive program for non-owner key employees);
- Roles for all employees are defined in job descriptions and performance goals are developed;
- Base salaries are based on job duties and set at market value;
- An effective pay for performance system is implemented to deliver annual incentive compensation tied to the financial and operational results of both the company and the individual employees;
- A long-term incentive plan is implemented to attract, retain, motivate and reward non-family key employees who help drive the growth and success of the business;
- The owners are committed to honest, open and constructive communication with employees on performance expectations and feedback as a basis for pay decisions.

Long-term compensation plans are becoming more prevalent in family businesses. These plans are tools to recruit talent and provide the "golden handcuffs" to retain key employees. Family businesses benefit by having key individuals participate in the strategic decision making with accountability for the long-term sustained growth in the value of the company. It's the best of both worlds having long-term compensation plans aligned with both the interest of key employees and owners.

Family businesses have several long-term incentive plan designs to consider based on their objectives. Non-equity based plans are most commonly used; examples of such plans include phantom stock, stock appreciation rights (SARs), and performance units plans. The value of the incentive award is tied to the value of the company; however, plans generally avoid direct stock ownership and related issues. The typical plan has a vesting schedule that is tied to future service with forfeiture provisions if a key employee leaves or is terminated.

A family business will better position itself to succeed if it takes the time to define a clear compensation strategy. A balanced plan that delivers competitive pay and rewards linked to both short and long-term performance will help a family business compete for talent and position itself for continued growth.