Compensating the working family

Tom Davidow kicks off our focus on remuneration by taking a look at how family businesses should compensate family members who are active in the company. This must be appropriate and fair or else the dynamics of the family may suffer - - -

In a climate where million dollar CEO salaries, bonuses and benefits in publicly traded companies are so huge that the public cannot relate to them, family-controlled Aflac Inc. has become the first US public company to empower shareholders to vote on executive compensation.

At the beginning of May, they overwhelmingly approved the company's pay-for-performance compensation policies - a strategy put forward by second-generation chairman and CEO Daniel P Amos.

Amos's gesture is based within the value system of Aflac's original founders and those values still exist in the culture of the business and within the boardroom.

By giving his investors a non-binding vote on compensation, Amos is endorsing the principle of listening to stockholders' opinions about compensation - specifically, his. He has also indicated that Aflac is a company of values and principles, which can only add to its credibility and its stock's value.

A VALUES-BASED SALARY

Values and principles are the soundest basis for resolving almost all family-owned business issues, including questions about remunerating family members who are in management.

Every family business has an investment in family, and in many instances expects the next generation to have some interest in the business. They send the implicit message that the next generation's remuneration package will include the benefits that a successful family usually enjoys: cars, nice vacations, homes, etc.

While families are entitled to the benefits of their success, it is important to differentiate benefits from a remuneration package. The latter ought to depend on a family member's level of authority and responsibility within the organisation. An absence of criteria can corrupt your adult child, your senior people and your remuneration structure within the organisation.

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HOW TO IMPROVE REMUNERATION ISSUES IN A FAMILY BUSINESS:

1. Create job descriptions.
2. Review positions with family members, concentrating on the scope of responsibility and authority.
3. Establish individual performance goals.
4. Establish a base salary consistent wiht positions similar to theirs, and a bonus based on achievement of goals.
5. Integrate a family quotient when it seems appropriate.

Employees do not resent it when family members benefit from opportunities that arise as a consequence of their positions, but they do resent it when family members receive high salaries unwarranted by position or performance. An undeserved salary is also unhealthy for the family member. It inflates his sense of self worth and diminishes his chance for performance. The parents may wonder why he continually performs badly. Why shouldn't he? Behavioural theorists Pavlov and Skinner have demonstrated that rewarded behaviour tends to repeat itself. Remuneration is a reward system. An adult child rewarded for non-performance will continue that behaviour.

Frequently, entrepreneurs/founders grow up with very little. Once they become successful, they want to give their children what they never had. Their habitual generosity, which can take many forms, conditions their children to expect it.

When those children become adults, a change in the rules comes as a rude awakening, disrupts the giving/expecting dynamic, and can cause hostility and disappointment. Consequently, everybody avoids the issue.

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At the other extreme, a family member's remuneration is attached to a market based study comparing remuneration for a position held in the family to the remuneration for the same position in a company similar in size and industry. Although this is the most desirable way to determine salary outside a family-owned business environment, in family-owned businesses there is always a grey area - the acknowledged overlap of family and business.

In a third-generation family business with which I worked, three brothers in the second generation had a total of eight children, all stockholders. Two of those children worked in the business, the other six did not. The two who worked in the business were not on a management track. Their compensation did not allow them the lifestyle that the success of their family would suggest, nor did it reflect the enormous stress they felt of having no appropriate place to talk about being a family member in the business and working with non-family staff.

Taking that stress and responsibility into account, the three brothers suggested that a family quotient be added to the remuneration package. They ran the idea by their Family Council, comprised of the second and third generations and their spouses - not for their approval, but to insure transparency. By sharing their thoughts, they sought to mitigate any resentment that non-management family members might have towards their cousins for receiving a bonus just for working in the business.

The non-management members understood the difficulty their cousins faced, and appreciated the value of having family members from their generation in the business. They recognised that their cousins provided needed insight about the business's climate and the employees' morale: that they were the watch guards for the family's values as they were acted out in the business on a daily basis.

REWARDING FAMILY MEMBERS FAIRLY

Family businesses formed just to make money are doomed to failure. Similarly, family businesses that stay together just for the money will not last. Family businesses are about relationships. Among their benefits is the depth of relationships that families experience when they work together, solve problems together, and prosper together.

When remuneration becomes a hot issue for family members, it is symptomatic that either the family or the business has drifted away from its core values; or that there is an underlying family issue yet to be addressed.

For example, equal pay for unequal performance can be very divisive. How can you pay one sibling more than another when the lines of authority are blurred and areas of responsibilities are not clearly articulated?

Remuneration based on intuitive judgment rather than behavioural measures also creates tension and

FAMILY VIEW: EVERYONE HAS EQUAL COMPENSATION, NOT EVERYONE'S EQUAL

Stephen Singer (pictured) is the second generation president of US-based Merchants Automotive Group. Founded by Irving Singer in 1962, "Merchants Motors" began as a small automobile dealership in New Hampshire. Today, MAG is a $200 million business with more than 200 employees. It is run by Irving's sons: Stephen, Robert, Alan, Jeffrey, Gary, and son-in-law Michael Sydney.

"We all came into the business after we finished school in the 1970s," Stephen exclusively tells Families in Business. "We were all single, living at home and had a few bucks in our pocket, so compensation wasn't a major issue at the lime. My dad had decided, however, that all the children would receive the some salary. It's kind of a socialistic concept because there were differences in our efficiency and contributions.

"Since we are now nearing the end of our business careers - we are in our mid- to late-50s and early 60s - it doesn't seem like it would be timely or efficient to change what we have had for 35 years. That is not to say there haven't been discussions about it but we hove a very important concept that is vital to the success oi our company - it's a Hebrew term, 'Shalom Bayit', which literally means 'peace in ihe house'. In order for us to be successful we hove to get along. If one brother is making X amount of money and the second brother Is making X+Y, it's going to cause some dissention.

"I think this remuneration strategy requires a certain type of family because your goal is the greater good not the individual. If everybody is honest and comes to work to contribute as much as they can, then it works. If you have a family with five siblings and three of them come to work highly motivated and very focused, but the other two would rather be on the golf course, then there are obviously potential problems. In a situation like that, you need to base your compensalion on productivity.

"Our company has been successful, but like any business there are peaks and troughs. Over the past five years we've changed our philosophy a little bit. We are good dealmakers - we know how to moke a deal - but we are not necessarily good managers. There's a signilicant difference between being a good manager and being a good deal maker. Managing the company in terms of being o CEO, CFO or COO is not what we're best at. Several of the brothers have tried, but they didn't feel comfortable doing it and they didn't feel successful.

"So we have brought in professional managers, including a CEO and a CFO, and we are currently interviewing for a professional COO. Those people have really helped to make us very much more successful."

hostility in the family. Equal pay for siblings who contribute at different levels to the business will lead to resentment and tension.

In a fourth-generation family business I work with, the second-generation patriarch is the keeper of the values. As he puts it, "If I cannot take care of my family, what kind of man am I?" He had three sons and one daughter who were all on the management team that ran the day-to-day operations, had equal responsibility and received equal pay. He had another daughter who had less responsibility - she worked part time - and lacked previous experience through which she might have developed the skills and knowledge necessary to justify her place on the management team. Her only qualification was that she was a family member. When she expressed her resentment at being excluded from the management team, the patriarch and the team disagreed, but offered her a training programme. She left midstream.

Of the fourth generation's eight members, three qualified for their management training programme and have been recently elected to the management team. Generations three and four receive the same pay since they are all management team members. The five other members of the fourth generation are paid according to their jobs within the company.

This family appreciates the value of hard work, believing that one's quality of life is defined qualitatively and quantitatively by how hard one works. They offer no rewards without it. They manifest the overlap, or grey area, through their policy that while family members can be and have been fired, unlike non-family employees they are all given as many chances as they need. The patriarch's commitment to taking care of his family manifests in his ongoing willingness to provide opportunities to family members.

CLARIFYING ROLES AND INTRODUCING ACCOUNTABILITY

Family members need formal titles to articulate their levels of responsibility and authority. It is much easier to establish a standard when there is data to support it. A lack of discussion about the rationale for a family member's compensation can cause tension. Introducing a more formal process for compensation reduces that edge.

The next critical step is to introduce accountability into the system. Family members are entitled to a formal evaluation process - the best way for them to learn about their strengths and weaknesses. It gives them the opportunity to learn and grow other than through the frustrating method of trial and error.

Formal accountability/performance evaluation helps avoid costly errors. Each person ought to establish a list of goals - either skill sets or financial targets - and then be compensated based upon the achievement of those goals. Remuneration criteria that lack accountability are not effective.

The recent actions of Daniel P Amos of Aflac brought his family's principal/value system of evaluation and accountability to a new level. As is the case with almost all family business issues, the answer to the question of compensation lies in the articulation of family values, establishing family and/or business governance to oversee those values, and ongoing communication. ●

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