

# Just Compensation

## How do you set fair pay rates in a family business?

Defining boundaries between family, business and ownership roles is key.

One of the most complex issues faced by farm operations is how much and in what way to compensate family members. All too often, a connection between love and money is felt but not discussed.

"Compensation is one of the most incendiary, explosive issues facing business families," says Henry Landes, president of the Delaware Valley Family Business Center in Sellersville, Pa. "It's not just about money, or even mainly about money, however," he cautions. "Conflicts around compensation often reflect other, more fundamental, long-simmering, unresolved family issues."

The first step toward resolving such resentments and arriving at fair compensation is to identify the varied roles family members

may hold—as offspring and siblings, employees or managers of the business and owners or future owners of the farm. Questions like "What do parents owe adult children?" and "Should siblings be paid the same despite different roles?" may seem too hot to handle, yet they lie at the heart of harmony in the family.

**Three circles.** Members of business families touch in three arenas:

1. The family circle, or circle of love, characterized by caring and support. It requires only that you be accepted.
2. The business system, a circle of competence. To compete in the marketplace, the business needs to hold high expectations of competence and performance for family and non-family employees. Value should be based on objective, rational standards.
3. Ownership, the circle of control. Ideally, owners exercise wise and prudent control of the equity invested in the business.

Members of the family circle may or may not hold a role in the business or ownership circles. Each of the circles may have some type of compensation attached. Frequently, family members may receive gifts from the elder generation as part of estate tax plan-

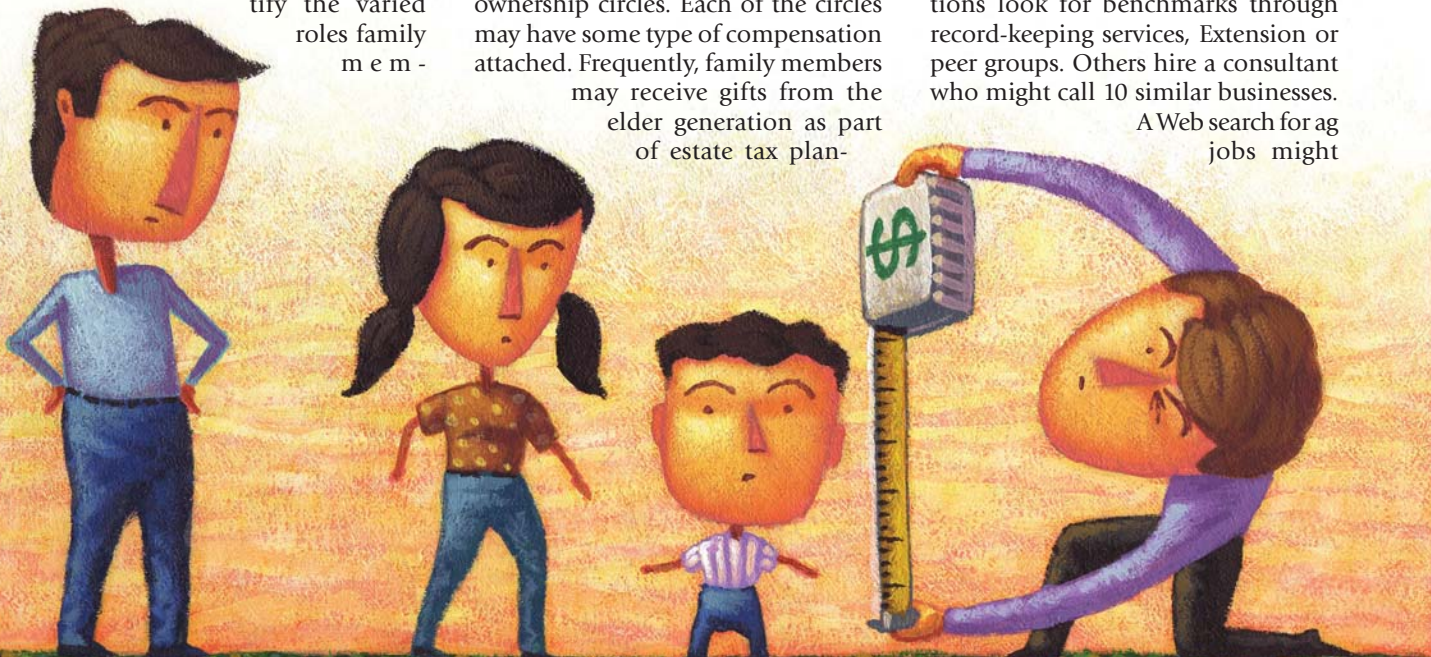
ning; salaries and benefits are attached to business involvement; and dividends or shares of the business relate to ownership.

**Measure it.** Few farms really analyze their compensation, which includes more than salary, Landes points out. Also included are benefits, bonuses, dividends and board fees. Calculate the value of things like housing or use of a truck.

In some cases, the intangible benefits of working with the family and owning part of the business may offset a lower pay scale than you would demand elsewhere. Lance Woodbury, a family business mediator with Kennedy & Coe in Garden City, Kan., mentions one son who came back from the city where he was a successful financial manager. "He came in on the bottom rung and was paid that way, but he's OK with that."

In determining salaries, one measure is to ask yourselves what you would be willing to pay an outsider to do the job, says Landes. Some operations look for benchmarks through record-keeping services, Extension or peer groups. Others hire a consultant who might call 10 similar businesses.

A Web search for ag jobs might



provide some guidance, as well.

"Compensation should be tied to a person's contribution to the business," says Landes. "Chances are a manager brings more value than a tractor driver. If two members of the family have comparable responsibility, then pay should be similar, but not if one is simply the hired man."

Management compensation can be pretty low on farms, and what the business can afford to pay often is based on how the operation does in a given year.

"In some cases, family members who are involved in the business actually receive less cash because it is assumed they eventually will receive the business assets," says Woodbury.

That eventually may be a long time off, however. In some families, assets haven't moved to the second generation by the time the third one is coming into the business, he notes. "The 40 or 50 year olds are still being paid at what should be a beginner level and have no equity. They feel they've invested 20 or 30 years and don't have anything to show for it."

The ownership circle can raise tricky money-related decisions, Woodbury adds. "It is important that those in the business ultimately have control of the assets." Yet parents often feel those very assets are part of their bequest to all their children—members of the family circle, whom they would like to treat the same.

"This issue can be dealt with once it is out on the table and discussed," says Woodbury. A few options include life insurance proceeds for off-farm heirs or a gradual buy-out by those in the business circle.

**Value or need?** A very basic decision the manager must make is what will payment be based upon? Equality—everyone draws the same salary—is probably one of the most common schemes, says Woodbury. In some families, it is based on need—how many children offspring have or the size of their house payment, for example. The third category is contribution or market-based—the relevance and value of what they are doing.

One workable method that considers all three circles might be to set a family floor—each family member receives \$20,000/year, for example;

## What do parents owe children?

It is best that children are brought up with awareness of their parents' values, expectations and beliefs from the start, but for families who feel that has not been done clearly, discussing feelings always beats not doing so.

It may be easier to answer what parents don't owe children than the opposite. Parents in a family business *don't* owe their children a free ride, a guaranteed annual income or protection from the trials of life. Although the family business can offer opportunity platforms and learning laboratories, each offspring must make it on his or her own merits.

Laying aside financial compensation, parents *do* owe children:

- a nurturing home
- a feeling that "I'm valuable for who I am, not for what I do or how much money I make"
- a mentoring relationship, modeling life-giving values that will endure
- a good education that equips children for whatever life brings
- the freedom for each child to live out his or her life mission, inside or outside the family business

Ultimately, the two lasting bequests parents can give their children are roots and wings.

— Henry Landes

then add a job differential in which management gets a higher amount than laborers; and finally, there might be a dividend or stock transfer related to the ownership circle.

Perhaps over time, the mix of income and equity shifts, says Woodbury. "Maybe entry level pays \$20,000 to \$40,000 and there is little ownership. After six or eight years, as offspring move into management, the salary climbs to \$40,000 to \$60,000 and they accumulate ownership. As parents shift ownership to the next generation, perhaps their income doesn't change much but their share of assets declines."

**Children keep score.** Probably the toughest issue to discuss is fairness in wages for working siblings. "Children may not know whether they are loved less than the children of other parents, but they are painfully aware when they are loved less than a sibling," observes author Frank Sulloway in *Born to Rebel*, a book about birth order and family dynamics. And offspring of all ages use money as a shorthand way of keeping emotional score in the family.

"There are few enlightened siblings who recognize different abilities and readily agree to unequal compensation," says Woodbury. "And mom doesn't help; she sees all kids as equal." There is no way around this mountain; you have to put it on the table and plow through it, he emphasizes. Even in some of the better cases, where contribution is recognized, the parents may see one child needs more than another.

Access to managerial power sometimes is the issue, says Landes. Maybe brother No. 2 is capable of serving as president, but brother No. 1 already has the job. "I know of one family business where the plan is for three brothers each to be president for seven or eight years."

Once the family has talked candidly about money and set expectations and policy, if a business partner can't be satisfied, he or she has choices. Sometimes in the process of discussing compensation, a family member leaves. That is not always a bad thing, says Woodbury; it may create a positive opportunity.

"That's one reason children should hold a job outside the farm," says Landes. "It allows them to get a good feel of their competency and fair market value."

**Ongoing.** Compensation policy is not an event, it is a process. Revisit it annually, advises Woodbury. Have a performance evaluation; is each player meeting the expectations? "A plan that's great one year might be only mediocre the next. Keep revisiting and refining compensation policies, keeping them relevant for family members and other workers alike."

When all is said and done, it doesn't matter what the arrangement is, as long as everyone agrees on it. ■