

# McLean, Koehler, Sparks & Hammond

Certified Public Accountants/Business Consultants

## Principles and Pitfalls of Family Business Compensation

Compensation is a hot topic in any business, but nowhere is it more amplified than in a family business. In fact, a majority of family businesses rank family employee compensation second only to succession as a top concern. Well-managed family companies set compensation practices around established family business policies. They also work to avoid the common pitfalls associated with family business compensation.

At some point, most family businesses are faced with critical questions such as:

What does fair compensation mean among family members?

- Should we pay family members differently than non-family employees?
- How do we reward the different contributions that family members make to the business?
- What incentives can we offer to non-family employees without giving away equity in the family business?
- How can we avoid creating conflict among family members due to compensation disagreements?

Family businesses, like other businesses, must have an established basis for determining compensation. Thus, family business compensation questions can first be addressed by examining whether the current compensation system is a “business first” or a “family first” approach.

In a “family first” approach, family businesses typically pay all family employees at the same rate of pay. In a “business first” approach, family businesses generally compensate based on the market value of the job being performed. While there is no “one size fits all” approach to family business compensation, most experts agree that an ideal plan includes the following:

- Family members should be paid “fair market value” for their responsibilities and performance.
- The compensation system should be based upon performance, not seniority or longevity.
- Large distributions should be made only in profitable years and only after the other financial needs of the company have been met.
- Family employees should adopt lifestyles appropriate to their current level of income.
- High compensation or “phantom jobs” should not be used solely as a way to create tax savings.
- Family members working in the business and contributing directly to profitability should be rewarded at higher levels than those who don’t work in the business.
- Compensation should not be based on family members’ need or lack of need.
- Compensation should never be used to maintain control over family members, or as a subconscious way of resolving or avoiding emotional issues

As a family business, and the number of potential shareholders, continues to grow, the issue of compensation becomes even more critical. Many family businesses have found it beneficial to examine their compensation practices, in order to implement practices that are fair, communicated and understood by all, and that promote harmony and teamwork within the family business.

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McLean, Koehler, Sparks & Hammond helps owners and business leaders become more successful by providing innovative financial, technology and management solutions for every stage of their organizations' life cycle. MKS&H's organizational consulting division, Tandem Partners, specializes in people strategies that drive business results. For more information on this article or MKS&H, please contact Margaret Wilson at 410-296-6200 or via email: [margaret@mksh.com](mailto:margaret@mksh.com).

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