Balancing Fairness and Merit: Tackling Remuneration Challenges in Family Businesses

In family businesses, remuneration decisions are rarely just about money, they touch the heart of family dynamics, fairness, trust, and long-term sustainability. This becomes especially evident in scenarios where family members perform different roles but expect equal pay due to familial status, such as a father working with his sons, each with varying responsibilities, contributions, and capabilities.

The Challenge: Equality vs. Equity

One of the most common and delicate issues in family business remuneration is distinguishing between equality and equity, two concepts that are often confused but have very different implications.

Equality means treating everyone the same, regardless of their role or contribution. While this may seem fair on the surface, especially in a family context where emotions and relationships run deep, it can create significant problems when applied to compensation. Family members may expect equal pay simply because they share the same surname or ownership stake, without considering the actual time, effort, or value they contribute to the business.

Equity, on the other hand, focuses on fairness, compensating individuals based on their responsibilities, performance, experience, and impact on the business. It recognises that different roles require different levels of effort and expertise, and that compensation should reflect this.

For example, if one sibling works full-time managing operations while another contributes on a part-time basis, paying them equally can lead to resentment, loss of motivation, and long-term conflict. However, both may expect identical pay “because we’re brothers” and over time, this imbalance can undermine both family relationships and business performance, especially during succession planning.

What research shows:

While classical agency theory suggests that pay-for-performance schemes are not applicable to private family businesses, a study by Michiels et al., 2013, challenges that view with data from 529 privately owned U.S. family businesses. The findings indicate that CEO pay is indeed influenced by objective performance indicators. Moreover, this link between compensation and performance is more pronounced in firms with concentrated ownership and those in the controlling-owner phase. The study also notes that non-family CEOs tend to have a slightly stronger performance-based compensation link compared to their family-member counterparts.

A study by Fernández Méndez et al. (2021), using data from Australian listed family businesses, applies the Behavioural Agency Model (BAM), which is a theory that explains how decision-makers balance personal risk and firm performance, especially when their wealth and identity are tied to the business. It uses this model to explore how ownership and leadership structures influence executive pay. The study found that family firms with family CEOs tend to offer lower total and variable CEO compensation and maintain smaller pay gaps between the CEO and other top executives, reflecting a more conservative and risk-averse approach to remuneration. However, this pattern changes in multi-generational firms and those led by non-family CEOs, where both total compensation and performance-based incentives increase significantly. These shifts suggest that as family firms grow and professionalise, their pay practices become more aligned with market norms and less influenced by the protective behaviours typical of earlier generations.

While early-generation family firms often prioritise non-financial goals like family unity and legacy, research based on the Socioemotional Wealth (SEW) approach and the Behavioural Agency Model (BAM) shows how these values influence management practices, including how performance and people are rewarded. The SEW is a framework highlighting the non-financial priorities of family firms, like family control, identity, and legacy, that strongly influence strategic decisions. A study by Peláez-León and Sánchez-Marín (2023), based on 453 Spanish medium-sized private family businesses, found that a strong desire to preserve SEW increases the likelihood of adopting High-Performance Work Systems (HPWS). This influence is particularly pronounced in high-risk firms whose management is mainly controlled by family members and by the second generation.

Solutions: Balancing Family Harmony with Business Logic

Family-owned businesses must address two key compensation challenges. The first involves establishing a system that is seen as equitable, rewarding family members working in the company appropriately while also respecting the interests of family shareholders who are not involved in the business. The second challenge is to design a compensation framework that can attract, retain, and motivate qualified non-family executives, ensuring the business remains competitive and professionally managed.

Compensation in family businesses should reflect the company's structure, industry, and long-term goals. While approaches vary, four common models are typically used:

- **Salary-based** – Family members earn a fixed salary based on their role and responsibilities, similar to non-family employees. This is the most widely used model.
- **Performance-based** – Bonuses or incentives are tied to individual or team performance targets.
- **Dividend-based** – Family shareholders receive profit distributions in proportion to their ownership, regardless of their involvement in the business.
- **Equity-based** – Ownership stakes or stock options are used to reward long-term contribution and foster commitment.

Establishing a fair and transparent pay structure helps ensure all family members feel they are treated fairly and reduces the risk of future conflict. The following best practices can support the development of an equitable compensation system:

1. **Differentiate Roles Clearly**

Start by defining **clear job descriptions** and setting Key Performance Indicators (KPIs) for each family member involved in the business. KPIs provide measurable goals that help track individual performance objectively. When combined with a role-based compensation structure, this approach ensures that pay is based on responsibilities, contribution, and results, rather than on family hierarchy or birth order.

2. **Align Pay with Role and Contribution**

It is important to distinguish between compensation for work and returns on ownership. Salaries should be based solely on the actual role, responsibilities, and performance of each family member, not their ownership stake or family status. While all family shareholders may receive dividends proportional to their ownership, paycheques must reflect the value of the work done.

3. **Use Market Benchmarks**

Paying family members according to market standards is essential for ensuring fairness and objectivity. This is done using external salary benchmarks to determine what similar roles earn in your industry, helping to remove emotional bias from pay decisions and supports transparency.

For example, if a family member works as a welder, their pay should reflect the going market rate for that role. A highly skilled, experienced family member should earn at the top of the pay range, while someone with less experience or lower performance should be paid accordingly.

4. **Regularly Review Compensation**

Regularly reviewing how family members are compensated helps ensure everyone feels they're being treated fairly for the work they do. Where possible, include measurable performance indicators, such as client satisfaction or retention, project completion, or leadership responsibilities, to make evaluations more objective and merit based.

Involving family members in reviewing each other's pay promotes transparency and reduces the risk of resentment or perceptions of favouritism. This is especially important during succession planning, when unresolved concerns about past compensation can lead to conflict or claims to a larger share of the business.

5. **Communicate Openly and Document Agreements**

While verbal discussions about pay are common in family businesses, it is crucial to put compensation agreements in writing. A written record adds clarity, ensures transparency, and helps prevent misunderstandings, especially during succession.

If a key decision-maker becomes unavailable, having documented agreements allows the business to continue operating smoothly and provides answers to any questions about pay. It also supports a smoother ownership transition by giving successors a clear understanding of existing financial commitments and expectations.

6. **Create a Remuneration Committee**

In smaller family businesses, compensation decisions are often made informally, influenced by personal relationships rather than clear criteria. Engaging external professionals, like our experienced team of accountants, introduces objectivity and structure into the process. We help set clear, role-based pay frameworks and ensure that remuneration aligns with both contribution and long-term business goals.

As family businesses grow, the need for formal governance increases. Establishing a remuneration committee becomes valuable, and we can support this by acting as independent advisors, helping benchmark pay, guide decision-making, and maintain transparency. Whether your firm is small or scaling, we provide the clarity and accountability needed to support fair and effective compensation practices.

Final Thought

Remuneration in family businesses is as much a governance issue as it is a financial one. Without structure, what begins as a family advantage can quickly spiral into a source of conflict. But with clear principles, open communication, and fair processes, families can align incentives with values and build businesses that reward both blood and contribution.

References

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