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COVER STORY

Relative Risk

Advisers say family businesses require specific job descriptions, goals

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MICHELE VIGNES was ready to manage almost every aspect of her family's professional staffing firm in New Orleans when she took over as CEO nearly a decade ago — except her brother's paycheck.

At the time, Vignes shared ownership in UP Professional Services, founded by her father, Joseph Wink Jr., with her four brothers. The staffing business was part of the Wink Cos., which included the flagship Wink Engineering. The youngest of the siblings, Joseph Wink III, also worked under Vignes, the fourth of five children.

Vignes said her father put a number of safeguards in place to make sure the ownership transition went smoothly before he retired in 2000, including assembling a board with members from outside and within the company. But Vignes said it was always her father who dealt with the touchier subject of how much she and her brothers were paid. When he left, the potential for conflict over pay escalated.

Ralph Maurer, executive director of the Tulane Family Business Center, said most family business struggle with a way to fairly compensate relatives and non-family workers. The right compensation structure can vary depending on the size of a business, outside ownership and how many family members are involved. The end goal is to keep and reward good workers, he said.

"Compensation means a lot of different things in the family business," Maurer said. "For the big business, it is tax implications and how you structure wealth. It can also be about creating career paths through the company."

Vignes relies on a compensation committee she created to set performance goals and approve raises for herself and her brother. Two board members and the company's chief financial officer serve on the committee.

She said there are still improvements that need to be made to the system, developing a written performance scorecard for her own position, for example. But having a system in place has prevented the kind of sticky decisions that could have torn the family business apart.

"It's crucial, I believe, to this whole scheme," Vignes said. "It brings sanity to what can be complete chaos."

PHOTO BY FRANK AYMAMI

Michele Vignes bought shares of UP Professional Services from three of her four brothers after her father, Joseph Wink Jr., sold its companion company, Wink Engineering, in 2009. Her younger brother, Joseph Wink III, now works for UP.

Pay market rates

Grant Coleman, an attorney with King, Krebs & Jurgens who advises family businesses, said many are either overpaying or underpaying relatives — and some err in both directions. He has seen some owners try to get around it by paying family members, usually children, equal salaries. That can be a disaster in the making, he said.

Coleman said business owners need to assess the duties of each working family member, find a comparable position on the job market and use data on average base salaries to determine the best pay range for that person. He suggests turning to job search websites for job descriptions and salary data broken down by geographic area, and he notes that many trade groups also survey members for average salary data within particular industries.

"At the end of the day, the analysis is this: If this person wasn't doing this job, somebody else would have to do it and how much would we have to pay them," Coleman said. "That's how much you have to pay them, no more, no less."

Put it in writing

Owners should also put performance benchmarks for family members on paper, Moon said. Written benchmarks can include specific incentive plans, such as a payment of 5 percent of base compensation for all in the plan if projected net income is met.

Moon noted that such plans should include management from within and outside the family. He also recommends that these businesses use clear performance plans to conduct annual or even quarterly performance reviews with employees.

"You have to rate everyone based on the merits of what they do," Moon said. "They have to perform and if they do not or cannot, they have to be let go."

Pay the kids more

Parents often use low pay as a way to teach children or grandchildren entering the family business the value of hard work. But Stephen Romig, an adviser with LaPorte CPAs, said paying young family members well can present a tax advantage as well as the opportunity to shape the next generation of ownership.

Children 17 and younger can earn up to $5,950 per year tax free, and parents who employ children for summer or part-time work do not have to withhold income taxes or payroll taxes.

"It's a great way to reduce what Uncle Sam takes out ... but it's not a free ride," Romig said.

He warns that a business will have to prove the hours a family member worked and that the wages paid were reasonable if audited by the Internal Revenue Service. That means all family members need to do real work for the business, Romig said.

Coleman noted tax planning should extend beyond what to pay children. The structure of the company determines whether it is more beneficial to pay family members more salary or more dividends. Owners of a C corporation, for example, must pay taxes on company profits and again on distributions of earnings to shareholders.

Businesses will need to also factor in recent tax law changes, such as a new 3.8 percent Medicare tax on dividends for families with incomes of more than $250,000.

Buy out outside owners

Advisers say ownership dividends and compensation for work done inside the family business should always be kept separate. Romig said it's not uncommon for second- or third-generation ownership of a family business to be shared among members who work in the business and those who do not.

That can set the stage for conflict over compensation.

"The best thing to do is to buy those other kids out for a fair price as opposed to having the outside kids feel that the inside child is reaping all the rewards," Romig said.

Vignes said buying shares in her family business from two of her three older brothers was an important step when UP Professional Services continued as its own business after Wink Engineering was acquired in 2009.

"If you co-mingle, it gets cloudy as to what is the value of the organization in my every day work versus what I should be compensated as an owner," Vignes said.

But Coleman noted that many companies cannot afford to take on debt to offer buyouts, particularly if they are borrowing money from a bank. One solution is to structure the ownership buyback over time. Businesses can also structure a buyout through an employee stock ownership plan or approach neutral hedge funds or angel investors to buy out family members, Coleman said.

Seek independent advice

Compensation planning can hit sensitive nerves in a family business. Big changes may require a business to seek outside advice, whether from a paid consultant, an executive cohort or a free small business workshop.

"In so much of family business, the personal gets involved," Moon said. "You have to really find a way to get the personal out for all reasons, not just compensation." •

Family factors

Most family-owned businesses struggle to find the right way to compensate working family members and non-family employees. Experts recommend businesses consider these factors when mapping out a compensation strategy:

Business size
Pay structures need to be more detailed the larger a business is. Small businesses may be able to get away with informal job descriptions, but businesses with multiple family members need to put descriptions in writing.

Tax liability
Depending on a company's tax structure, it may be more beneficial to pay family members through ownership dividends than a paycheck. Paying younger family members well can also help shelter income from taxes.

Outside ownership
Structuring pay can be tricky when non-working family members own a portion of a company. Working owners should consider strategies to consolidate ownership.

Source: CityBusiness staff research