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Pay, benefits and incentives in family companies

Peter Leach Associates Ltd
The Family Business Management Series
Principles for owner-directors

Pay, benefits and incentives in family companies

The Family Business Management Series

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Other titles in the **Family Business Management Series** include:

- Family Governance in Multi-Generational Family Businesses
- Getting the family to work together
- Succession management in family companies
- The Family Business Rulebook
- The Role of Outsiders in Family Companies

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Preface

Family businesses have many things going for them - they tend to be flexible, reliable, proud, they can think long-term, have a strong culture and their people are committed. But they can also carry a daunting set of disadvantages - they can be rigid, inward-looking, unresponsive to change and sometimes swamped by emotional issues. It's a fascinating and complex mixture of advantages and disadvantages, costs and benefits, strengths and weaknesses.

Peter Leach Associates serves the needs of family business people, helping them to find a path through this complexity and to balance the ambitions and needs of their business with those of their family. All family firms are different - and there are no easy answers - which is why this **Family Business Management Series** of jargon-free guides concentrates on principles, processes and procedures designed to help families recognise and address the most important issues and conflicts that tend to arise.

This second guide in the series - **Pay, benefits and incentives in family companies** - focuses on people management issues. Conflicts between business values and family priorities can be particularly acute and troublesome in the context of human resource practices. Clear and explicit criteria must be drawn up relating to personnel issues and family members.

The contradictory forces are best managed by maintaining a firm distinction between ownership considerations (under which family employees are subject to family norms) and management considerations (under which business values are paramount).

The **Family Business Management Series** is an important initiative. It has been designed as a source of practical advice and guidance - pulling together some of the key research findings on family business management and the lessons of our experience over 25 years of helping family businesses. We hope it will contribute to the efforts of these firms to achieve continuity, growth and prosperity in the years ahead.

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People management and remuneration problems create more trouble for family businesses than any other issue apart from succession.

Chapter 1

Living in no man's land

When family and business priorities in family companies overlap this causes tension and conflict. Nowhere does this show up more clearly than in the context of people management policies.

People management and remuneration problems create more trouble for family businesses than any other issue apart from succession. Typical questions include:

- should a family member be recruited even though a more qualified outsider could be brought in?
- how should the roles of family members be determined?
- should family members be paid a family rate or a market rate for the job?
- how should family members' performance be evaluated?
- what's the best approach to motivating and rewarding non-family and family members?

The core problem

The primary objective is to ensure the effective use of human resources in family businesses, but there's the potential for huge problems centred on the ambiguous position of family firms. They are forced to inhabit a sort of dangerous no man's land at the border between two different social systems – the family system and the business system.

The differences between these systems and the conflicts they create are examined in another guide in this series (called **Getting the family to work together**). Family values and rules of conduct are based on emotional considerations favouring the care and development of the family; business values and behaviour emphasise performance and results and are based on successfully carrying out tasks.

Conflict between the systems is particularly acute and troublesome in relation to personnel practices. This guide examines recruitment, Additionally, the tricky question of non-family employees is examined (especially as regards managers and senior executives) – the challenge of recruitment, how these employees do or do not fit in and how to ensure the company maximises their contribution. Because employee motivation is such an important topic for family members and outsiders alike, the guide concludes with a discussion of job satisfaction and incentives, and the ways they can be combined to secure superior performance.

Contradictions and conflict

Exhibit 1.1 provides an overview of the clash between family and business values that apply to the main personnel issues in family businesses.

Exhibit 1.1 - Overlapping systems and people management

Family values	vs	Business values.
Recruitment Provide opportunities to relatives (particularly if they are your children).	vs	Take on only those who are most competent.
Training Provide learning designed to satisfy development needs.	vs	Provide learning opportunities designed to organisational needs.
Remuneration Allocate in accordance with family and personal development needs.	vs	Allocate in accordance with market worth performance history.
Performance appraisal Do not differentiate between siblings. Regard individuals as 'ends' rather than as 'means.' Note: adapted from Lansberg (1983).	vs	Differentiate between employees to identify the high performers. Regard individuals more as 'means' than as 'ends.'

Often contradictory forces are at work in the family and business systems. In the absence of clearly defined policies, it's not hard to imagine a family business leader, somewhere in the middle, being dragged first one way then the other, and agonising over what to do. These contradictions, and the conflicts they create, are built into the fabric of family businesses. The structural nature of the conflicts does not reduce the personal impact they can have on family business leaders who have to grapple with them. They come with the job, and the psychological stress they cause often interferes significantly with the efficient functioning of family firms.

The next chapter examines conflicts that arise (along with some ideas on what can be done about them) in relation to recruitment and training and development. Throughout this guide, a first generation family business – ie one that's still run by its founder – is assumed, although (unless highlighted) the principles discussed are equally applicable to second and subsequent generation family businesses.

Chapter 2

Strategies for coping

Clear and explicit criteria must be drawn up relating to personnel issues and family members. Maintaining a firm distinction between ownership and management considerations is the key to keeping the contradictory forces under control.

Recruitment

Under family principles, unconditional help should be provided to family members in need. So, very often, and regardless of ability or expertise, positions of authority within the family business are reserved for family members who, for their part, often feel they have a right to a job in the company. Also, some founders may expect their adult children to join the family business and commit their working lives to it, even if they may lack the aptitude, skills or motivation to be successful.

Case Note

The youngest son of the present managing director had been employed in a number of positions within the company but had not excelled at any of them. The son had been sent to work for other relatives but this was not seen as a permanent solution. The MD was conscious of the issue but could see no clear way to resolve the difficulty. On the one hand he was sensitive to the needs of his son while, on the other, he was aware of the potential harm that could result from the firm carrying a manager not able to make a full contribution.

Business principles demand that only people who are the most competent and suited for the job should be employed, but nepotistic recruitment policies based on heredity or the provision of a safe haven are still common. Ignoring business yardsticks and hiring individuals according to their family status could be a threat to the firm's effectiveness and, ultimately, its survival.

Generally it's business founders who have to decide whether or not to employ a family member. If they're determined to establish a corporate dynasty, the decision will not be difficult. But if they place more weight on trying to safeguard the long-term welfare of the enterprise, they may have the dilemma of either employing someone not up to the job or facing opposition from the family if they choose an outsider.

How to cope – an approach to a solution

It's useful first to look at how not to try and cope. Exhibit 1.1 illustrated the powerful but conflicting pressures facing founders trying to contend with people management dilemmas. Many family business leaders, discovering they are trapped in no man's land between the family and business systems, opt for one of two strategies. Either:

1. they try to find a compromise; or
2. they swing indiscriminately between strict adherence to business principles on some occasions, and family principles on others.

But the compromise approach often leads to decisions that are bad for the business, while the second, 'see-saw' strategy produces arbitrary and unpredictable behaviour that's incomprehensible and unsettling for everyone concerned. The two strategies share a common fundamental defect – neither is based on clear and explicit policies.

The most constructive approach for founders, rather than seeking an essentially unobtainable clear-cut solution, is to try to develop procedures that recognise and manage the contradictions. An important first step is to accept that the conflicts are structural, not personal problems – they 'come with the territory'. Secondly, it's helpful to explain and share the problem with family members, the directors and senior management in the business. This shifts the focus of the predicament away from the founder and on to the family business system.

Involving others should help develop procedures to define and separate family and business issues, encouraging collaborative problem solving among all the parties concerned.

Establishing policies

Finally, it's vital to draw up clear and explicit policies to govern personnel issues and family members. Professor Ivan Lansberg, an authority on organisational behaviour, proposes that the contradictory forces are best managed by maintaining a firm distinction between:

- ownership considerations, under which family employees are subject to family norms
- management considerations, under which they are required to submit to the company's principles.

So, in recruitment for example, management principles would demand that relatives should only be accepted into the company if, on business grounds, they possess the skills needed to perform the job effectively. Hence, from a management perspective, they're treated just like anyone else who applies for a position. From an ownership point of view, on the other hand, relatives interested in working in the firm would be given the opportunity to acquire the necessary skills in order to meet the company's standards – eg via work experience in other firms, formal education and training, and so forth – the expenses of which are paid out of family assets, not business assets.

Be explicit

Confusion about who can and who cannot join the company can seriously damage family relationships.

As in so many other aspects of family business life, agreeing clear criteria and guidelines that specify when family principles or business principles are appropriate, will go a long way towards reducing the potential for conflict and promoting effective human resources management in family firms. The family's agreed position and written policy on personnel issues should be included in the family's strategic plan, discussed in another guide in this series entitled **Getting the family to work together.**

The resulting guidelines may not always be followed. Tension between family and business values may not always be resolved. But thinking about what should happen in these situations, and spelling out the policies so they are understood by all, can help minimise the potential for turmoil.

Training and development

Under family principles, family members should be trained according to what's best for them as individuals. Business norms, on the other hand, are less concerned with the flowering of well-rounded individual personalities – they demand that training and development should be based on learning experiences that improve the individual's ability to contribute to the achievement of organisational objectives. What's best for the individual and what's best for the business do not always coincide.

In addition, the business may well suffer when founders spend company money on providing their offspring with an opportunity for promoting their individual well-being and development. Such laudable family projects can range from paying for a training course through to buying a company for the children to run. The exercise may at best be unrelated to promoting business goals, and at worst completely incompatible with them.

Lansberg's approach works here as well. From a management viewpoint it's important that the training and development of relatives should depend on, and fit in with the firm's needs. If a family member's ambitions are inconsistent with the firm's needs, he or she must choose between employment in the family business or following alternative plans using family assets. In other words, from the ownership perspective family members could be entitled to draw on family assets to invest in pursuing their personal business objectives outside the family company.

What to pay relatives who work in the family firm causes a huge variety of problems.

Chapter 3

Remuneration in family companies

Family employees should be rewarded in line with their contribution to the business, and it's important to have a comprehensive remuneration plan that links pay and incentives to the philosophy and goals of the business.

What to pay relatives who work in the family firm causes a huge variety of problems. In the family system, the guiding norms are that family wealth should either be distributed according to need or according to principles that are transparently fair. In the case of siblings, for example, fairness is generally taken to mean that resources be allocated equally. But, in the business, remuneration should be based on the individual's contribution.

Discussion of 'remuneration' in this chapter centres on the difficulties family companies often encounter when deciding basic pay levels for family members. Chapter 6 ('Employee motivation'), on the other hand, looks in broader terms at overall reward packages for both family and non-family employees, concentrating on motivation and the various types of incentive schemes.

Family business pay problems

Some people are not comfortable discussing money generally, and personal salary or wage levels in particular. It can be difficult for founders and senior generation members required to talk about remuneration terms with their relatives (especially their children).

As a result, what relatives should be paid is generally decided on the basis of an ambiguous combination of principles, which generates all sorts of tensions and inefficiency in the company. Some companies pay family members significantly more than the market rate; others pay less than the market rate on the principle that family members have an obligation 'to help out'; other firms pay all family members at the same rate, regardless of their contribution, with the likely result that incompetent relatives stay and competent ones leave the company to earn a fairer salary elsewhere.

Other common causes of pay problems include:

- The 'financial carrot': using pay to lure family members into working for the family firm.
- Extracting funds: confusing business and personal funds and using pay or perks as a means of transferring money from the business to the family.
- Mixing up motives: confusion about whether payouts to family members are in return for the job or as recognition of their status as family or their role as owners.
- Pay substitutes: relying on perks to 'top up' family members' pay – either all the time, or as a means of placating family members who feel they are not being paid enough.

The problem-solving approach based on the separation of management and ownership would entail rewarding relatives strictly on the basis of business principles. If desired, ownership liquidity strategies can be used to boost family members' earnings independent of their role within the company – for example, by way of share dividends rather than a higher salary. Such an arrangement acknowledges the privileges of ownership but preserves a merit-based reward system in the business.

Whatever the final policy, the details should be clearly spelled out so that they are understood by all family members inside the business, as well as by those who might be contemplating joining.

In larger family companies it's advisable to establish a remuneration committee of the board. If the committee deals with all salaries, this encourages the feeling that remuneration is being approached in a systematic, even-handed way – a feeling that will be reinforced if the committee includes some non-executive directors among its members.

Setting up a remuneration plan

Piecemeal alterations to a family firm's remuneration policies often stir up more problems than the changes were designed to resolve. This is because remuneration planning touches on a range of very sensitive issues relating to family involvement in the business. Little is likely to be achieved unless these issues are addressed, articulated and a consensus approach is worked out. Tinkering with an inadequate family business pay system is generally not the answer. What tends to be needed is a detailed evaluation of current policies followed by the development of a comprehensive plan that links pay to the agreed philosophy and goals of the business. The other key steps in developing a systematic approach to remuneration planning are:

- establishing a framework for base pay and incentives
- communicating details of the plan to everyone concerned
- setting up procedures to review the plan and, if necessary, amend it.

The market value of jobs

The problem-solving approach based on the separation of management and ownership rewards relatives strictly on the basis of business principles. It is important to pay family members a market rate, rather than a family rate, for the job. It's possible to establish the market rate by 'unpicking' a job to establish what it comprises, then to carry out an evaluation exercise involving checking what rates are paid for such a job in the wider market-place. Questions to be asked when deciding a job's market value include:

- What industry is the company operating in?
- How big is the company?
- What are other people in similar jobs paid?
- How many people does the individual oversee?
- What is the person's influence over business strategy and performance, including profitability?
- What is the cost of living in the location concerned?

This can be a lengthy analytical process that many large companies (let alone smaller family concerns) are reluctant to pursue.

A more practical approach may be to establish an internal set of comparative measures for each part of a job's responsibilities. For example, firms with a stable management who want to bring in a family member can assess the situation internally and assign relative values to particular responsibilities. So, say a family member is recruited to head up marketing: the person running finance could be rated at a total of 135 for all his or her responsibilities, while the person heading up sales could be rated at 125, and it might well be decided that marketing is a similar function and should also rank at 125 in the pay scale. While still open to interpretation, at least the process has been carried out in a structured manner. Similarly, set principles can be established to determine the basis for calculating bonus schemes offered to incentivise family and non-family managers over and above their fixed salary.

As mentioned earlier, the ownership route can be used to boost family members' earnings, independent of their role within the company, by way of share dividends rather than a higher salary. Such an arrangement acknowledges ownership privileges but preserves a merit-based reward system in the business. Although this is better than the family member receiving the total sum involved in the form of salary, it does not necessarily resolve possible problems from the standpoint of a non-family employee who feels poorly rewarded: both are receiving, say, £75,000 a year in salary but the family member gets an extra £150,000 in dividends. Possible solutions are share incentives such as an employee share ownership trust (ESOT), or a cash bonus scheme tied to increases in the value of the company.

Case Note

At a family-owned investment company, payments were being made to senior family and non-family executives for all sorts of haphazard reasons. The directors wanted to rationalise and restructure the situation. As a result, the company's share capital was increased and reclassified into two different classes of shares – class 'A', carrying the main voting and dividend rights, went to the family members, and class 'B' went to the senior executives (also including one or two family members). Class 'B' shares carried a 'ratcheting' entitlement whereby if the holders' performance reached predetermined levels then, as a group, they received an increasing participation in the capital growth of the company.

As regards the 'A' shares, there was a policy that dividends would only be paid at fairly conservative levels (in this case, half the post-tax profits). So, family members might end up being paid high dividends, but this would be based on an objective criterion and demonstrably within what the company could afford. The 'B' class shares were not entitled to dividends but included the ratcheting element mentioned above: under this, if the executives with 'B' shares grew the net asset value of the company by more than specified amounts, then their jointly held equity interest in the business could increase from 10 per cent, up to a potential maximum of 20 per cent. In addition, all senior posts were re-evaluated in order to arrive at objectively assessed remuneration levels.

Family members were not deprived of the financial benefits of ownership, while non-family employees seeing family members receiving salary and dividends on their 'A' shares at least had the incentive that their own participation (via the 'B' shares) was also increasing in line with the company's growth.

Although quantitative market value criteria are crucial in evaluating a job, qualitative criteria are also often taken into account. These indicate that certain positions command extra remuneration because they require more of the individual. Qualitative criteria in evaluating managerial jobs include, for example:

- Leadership qualities: to what extent is the manager required to create, communicate and carry out corporate strategy, while fostering teamwork and enthusiasm among others working in the firm.
- Ambassadorial qualities: the extent to which a manager is required to represent the business to the outside world, and at what level.
- Strategic grasp: the ability to clearly define, implement and follow through strategies that meet the company's goals.
- Contacts: the number and calibre of contacts the manager is required to work with, both inside and outside the company.

Communicating the plan

Once a remuneration plan is established, family business owners must set about building confidence in it. Details of the plan need to be communicated to everyone concerned, perhaps via individual meetings or through group sessions with management, the workforce and so on. The priorities at such meetings should be to stress:

1. That the plan is not an exercise in bureaucracy, but has been drawn up to address a number of specific remuneration and motivation issues that can affect family firms.

2. That the plan is linked in with broader corporate objectives, plus the details of this relationship.
3. That the plan is based on clear and explicit policies, and aims to establish an approach to remuneration and motivation that is systematic, even-handed and objective.

Regular meetings should also be scheduled at which any shortcomings or unforeseen effects of the plan can be assessed, and procedures should be set up to modify it if required.

Chapter 4

Performance appraisal and promotion

Family employees should be promoted in line with their contribution to the business, and their performance should be evaluated regularly and objectively within a system that applies to all staff.

A psychological quagmire

Most employees want to know what's expected of them and want feedback on how they are doing. If this is carried out constructively, areas that need improvement can be identified and areas of good performance can be reinforced. Indeed, this is the rationale for appraisal in business activity, where individuals are judged on their ability to contribute to the achievement of organisational goals. But it is often against family principles to apply an objectively derived set of criteria in order to evaluate the worth of family members.

It's hardly surprising, therefore, that founders or senior generation members, facing the unenviable task of having to assess the managerial competence of their offspring or other relatives, suffer psychological stress. It's simply not possible for them to do justice to the requirements and norms of both the family and the business.

Once again, the effects of this awkward situation can at least be minimised by clearly distinguishing family (ownership) and business (management) principles. The separation implies that family members working in the business must be subject to evaluation on professional grounds like all other employees.

The evaluation process

Modern management techniques emphasise the value of self-assessment – individuals evaluating themselves against their own predetermined performance targets and discussing the results with employers and colleagues. The performance appraisal process should obtain the views of other employees (peers, superiors and subordinates) in order to reduce the potential for family bias and to encourage objectivity. Canvassing opinion in this way is probably best achieved by providing for anonymous responses, perhaps to a regular, standardised questionnaire. Otherwise there is the risk of non-family employees 'covering' for incompetent family members.

Performance appraisal and promotion

Questionnaires often include measurement scales where a number between one (representing performance far in excess of expectations) and seven (performance far below expectations) is ringed relative to each criterion being evaluated. For a son or daughter who is a divisional manager in the family company, their performance evaluation criteria in the questionnaire might include, for example, their abilities at:

- developing a clear strategic plan and goals for the division
- communicating the division's plan and goals both upwards and downwards within the company, and externally to the company's advisers and customers
- showing effective decision-making and delegation skills
- demonstrating sound financial management skills.

If family members are being 'groomed' to assume senior posts in a family business, it's important their performance is evaluated not just in relation to the job they have at the moment, but also against the standards of their target job. In addition, family members aspiring to leadership positions within the company usually need to demonstrate competence as regards family and ownership factors as well as in relation to their job. A rising family member may be an excellent performer within the company, but the family may reasonably expect to see evidence that he or she can also deal effectively with family relationship problems, complex financial planning issues (requiring a thorough grasp of shareholder trusts, estate planning, dividend policy and so on) and with governance-related responsibilities (serving as a board director).

Promotion

A similar approach should apply to a formal policy on job promotion. Decisions on promotion can be entrusted to a special group composed either exclusively of non-family directors and senior managers or of both family and non-family members where neither side has a majority vote. This group procedure can even be extended to promotion at director level. An objective evaluation and promotion policy brings with it three principal advantages:

1. Appraisals are clearly not based on favouritism.
2. The potential for rivalry and jealousy between both family and non-family employees is reduced.
3. It encourages the development of a much more professionalised managerial culture.

The freedom of non-family employees to leave, taking specialist knowledge with them, becomes a major worry for some owners.

Chapter 5

Non-family employees

Family businesses must work in order to attract and motivate high quality non-family employees, and must openly recognise and reward their contribution.

Relations with the family

Being a non-family employee in a family business doesn't suit everybody, and there are many instances of talented managers who have resigned because they have run out of opportunities, or because the politics and emotional cross-currents in family-owned companies have become too much of an interference in their work. But managers who are able to cope with such factors are often very good indeed.

Many non-family employees who fit in well at family firms enjoy the informality of working in a closely knit team, as well as the personal relationship with the family and its leader that may be unobtainable in large, public companies. Employees derive a feeling of confidence knowing they are not simply part of a faceless institution. They are happy as long as they are fairly remunerated, treated with respect and given the opportunity to fulfil their career aspirations.

Exhibit 5.1 - Non-family employee anxieties about family involvement in the business

- They worry that the autocratic management style of the owner will inhibit their personal development and prospects.
- They are concerned about the effect of family tensions on the business and on their ability to get on with their job properly.
- They fear becoming drawn into some dreadful family power struggle.
- They are unsure of their job security in circumstances where the owner is not planning management succession. The owner's children are perhaps not qualified to run the business, and a likely outcome is that the company may have to be sold.

Non-family employees

Family members may be suspicious about the loyalty of non-family employees who, as a result, find themselves excluded from key planning or operational information. The freedom of non-family employees to leave, taking specialist knowledge with them, becomes a major worry for some owners.

On occasions a loyal, trusted employee can become a counsellor and mentor to the next generation and could be appointed to run the company, either indefinitely or for an interim period, bridging the gap pending a new family member being ready to take over leadership.

Reliance can also come to be placed on non-family managers for more structural reasons. As a family business matures it tends to acquire its own identity, distinct from that of the founder. At the same time, management by consensus will have become a problem because there are so many family members, all of whom have a stake in the business. This combination of factors often leads to greater dependence on non-family managers as the best means of maintaining the continuity of the business.

Role in management

If it's clear that family members, even after training, are not sufficiently competent to become managers, then the firm ought to recruit outsiders. Both the firm and the family will be better off when only the most qualified people get management positions.

Family companies may have a problem finding talented outsiders willing to work for them. Once found, the firm could also could have a problem in motivating them. For family businesses in which business and family principles have not been separated, these problems can be very serious. Qualified outsiders expect to find that nepotism prevails in family companies, and that it will prevent them being given a fair chance. Many have doubts about whether the firm is being run professionally by the family – if it is, why should they be bringing someone in? They will usually be unable to aspire to ownership, or even leadership. Their salary will possibly lag behind levels obtainable in non-family firms. Their decisions may be overruled by family members. Worse still, they risk becoming a pawn in some endless family battle.

However, if the company is professionally run and the business–family (management–ownership) separation is achieved, these problems can disappear, or at least are minimised. Managerial positions cease to be the exclusive preserve of relatives. Remuneration and assessment are more objective. The overall result can even make the family business more attractive to capable outsiders than working for a non-family public company.

The reasons for this include:

- Managers can expect quicker exposure to a wide variety of decision-making situations.
- They often find it much easier to get things done than in a large, dispersed-ownership company.
- They enjoy the more personal and satisfying working environment to be found in family firms.
- They value the opportunity to interact with the owner and key decision maker.

Exhibit 5.2 – Family businesses with dedicated and motivated non-family employees - some common features:

- Family and non-family members are recruited and evaluated according to merit – identical, objective standards apply.
- Career development opportunities are provided for non-family employees, and remuneration is related to economic principles.
- If there are any conflicts between family members, these are not allowed to affect the business.
- A management succession plan has been put in place by the owner, and has been explained to all key employees – family and non-family.
- The valuable role played by non-family employees in fostering the success of the business is openly acknowledged and rewarded.

There are many strategies and plans that can help create and support the vital ingredient of motivation in the workplace.

Chapter 6

Employee motivation

Recognition and reward of both family and non-family employees can take many forms, ranging from a simple 'pat on the back' (vertical encouragement) through to elaborate performance-linked incentive schemes. They are all aspects of employee motivation that can provide family businesses with superior performance and a competitive edge.

There is a common misconception that the best way to motivate employees is with the 'carrot' of financial incentives and the 'stick' of penalising failure. This does have the advantage of simplicity, but ask highly motivated employees to explain their motivation and the likely response will be 'Because I love my job'.

Pay and benefits are often even less likely to represent key motivating factors for family managers, who sometimes tend to describe their motivation in terms of duty, either to their parents or to other family members. They see their role as a custodial one of preserving the firm for the next generation and, as a result, are often not good managers.

Giving the best performance

The value of a highly motivated workforce (at all levels) is incalculable, and the carrot and stick method will never achieve the desired result because it's based on a misunderstanding of what it is that stimulates employees to superior performance. Enjoying the carrot and fearing the stick may well ensure that people work hard enough to keep their salary cheques coming, but fear rarely drives people to perform at the limits of their capabilities.

The approach relies exclusively on external influences and ignores the crucial fact that motivation must come from within – in other words, there must be self-motivation. The important areas of concern therefore revolve around personal factors like achievement, recognition, how satisfying is the job itself, the need for responsibility and personal development. These are true motivating forces, whereas external matters such as company policy, organisational structure, salary levels and incentive schemes do not in themselves motivate, although they are important in helping to kindle self-motivation and to encourage it.

Exhibit 6.1 - Practical steps to foster motivation

- Encourage employees to use their own judgement and to improvise. For example, establish work groups in which employees decide on the details of how a job should be done.
- As well as authority, give employees responsibility for results. For example, structure tasks so that employees can follow them through in a logical sequence from beginning to end, and so that they assume complete responsibility.
- Communicate goals clearly and make it understood that the employee is accountable. Keeping people informed helps them to feel respected and also helps them to solve problems.
- Make work rules flexible so that individuals fit them to their own needs. This reduces the emphasis on less important factors (for example, when a particular job is done), and helps to focus on the central issue of results.

There are many strategies and plans that can help create and support the vital ingredient of motivation in the workplace. Throughout it is important to have a clear set of objectives to help select the most appropriate strategy.

For example, consideration must be given to the form in which any such incentive arrangement will be paid. Both cash and non-cash incentives (such as employee share schemes or other types of equity arrangement) could be used. Any form of incentive will have the common aim of providing additional remuneration, either currently (eg annually) or on a deferred basis (eg in three to five years time, or on an 'exit').

Incentive design

The design of an incentive plan can be split into seven constituent stages (see Exhibit 6.2, the details on which have been contributed by David Ellis, Director, Employment Solutions Group, BDO Stoy Hayward LLP). Stage one involves consideration of what business need an incentive plan would be seeking to address. Once this has been established, it should be possible to formulate the series of objectives that the incentive arrangement must satisfy if it is to meet that business need (Stage two). For example, if a company needs to integrate a newly acquired business there could be cost saving or integration targets to meet. If the company needs to increase turnover, some form of sales incentive would be appropriate. Profit targets could point to both increased turnover and/or cost saving measures. There is no 'one size fits all' answer.

Exhibit 6.2 - Incentive design plan changes

Stage	Comment
1. Plan introduction	Is there a need?
2. Identify your objectives	What are you hoping to achieve?
3. Select the participants	Who do you need to provide with incentive?
4. Choose the performance measure	Does the measure match the plan objectives?
5. Plan design	What are the practical implications?
6. Launch	How is the plan communicated?
7. Post-launch	How will the plan be monitored?

Stage three involves selecting who is to participate in the incentive. This is crucial. Only those individuals who can really make a difference should participate. There needs to be 'line of sight' between the participants and the performance measures – can they really make a difference in achieving the targets? Care must be taken to ensure the incentive arrangement differentiates between those who work hard and those who are just along for the ride.

Stage four is about designing the performance targets. Over what period is performance being measured? Is it an 'all or nothing' measure, or will amounts be paid out in stages? Assuming the latter, what is the entry-level payout and what is the maximum? How would payments be graduated in between?

Then come the practical questions. What form should the incentive be paid out in? What happens if a participant leaves? How much is the company prepared to spend? These details should be drawn up in Stage five.

Stages six and seven are the most important, but often the most overlooked. An incentive plan will fail if it is not understood by participants. There is no point striving to introduce a tax-efficient plan, if there is no clarity around what needs to be achieved in order to trigger a benefit. Communication is key. Post-launch, the monitoring process must be implemented and the communication process built upon. Participants needs to be told how they are performing against their targets.

In summary, incentive plans do not need to be complex but they do need to be well considered.

Chapter 7

Conclusions

An unstructured approach to managing employee resources can work in very small family firms where the owner can be involved personally in all aspects of the business. But, for larger companies (and indeed smaller ones that wish to grow), more organised methods with structured policies are essential.

Inventiveness and flexibility – hallmarks of the best family businesses – need not be sacrificed by the introduction of a more structured approach to people management. Implemented carefully, a people management and motivation programme helps family firms make the most of these strengths.

The key suggestions made in this guide are:

- clear and explicit management criteria must be drawn up on personnel policies relating to family members
- the contradictory family versus business forces are best managed by maintaining a firm distinction between ownership considerations (under which family employees are subject to family norms) and management considerations (under which they are required to submit to the company's principles)
- family employees should be rewarded and promoted in line with their contribution to the business, and their performance should be evaluated regularly and objectively within a system that applies to all staff
- family companies must attract and motivate high quality non-family employees, and openly recognise and reward their contribution
- motivation comes from within individuals. Encourage employees to use their own judgement and give them responsibility for results. Communicate goals clearly and make it understood that each employee is accountable
- before adopting a particular type of incentive scheme, define carefully what you wish to achieve, and make sure the scheme will operate effectively in your organisation.

Perhaps the overriding conclusion concerns the vital importance of establishing clear-cut, objective criteria for recruitment, remuneration, promotion and training, as well as for the other people management issues examined in this guide. The resulting guidelines may not always be followed, but thinking about what should happen in these situations, and spelling out the policies so that they are understood by all, will minimise the potential for problems.

Provided this is achieved, and given the personal atmosphere and sense of belonging and common purpose that predominate in successful family businesses, such firms are in a better position to manage their human resources and to get the most out of them.

Implemented carefully, a people management and motivation programme helps family firms make the most of these strengths.

The business school view by Professor Nigel Nicholson, London Business School*

Motivation and reward in the family firm

It is generally believed that rewards are the main motivational tool in business. That is true on a broad definition of the term – valued outcomes bring more success than fear as a motivator, and the most motivated workers are those who find the work itself rewarding rather than any payment system. This does not mean such happy souls will work for nothing; pay is something everyone expects but it is a fickle friend as a motivator, being both unreliable and sometimes paradoxical in its effects. This makes reward systems probably the biggest headache in management. You can't do without them, but they are just about impossible to get right, for every system has some unwanted side effect. Implication: pick the system that has the side effects you can live with! Two themes need to be considered:

- the type of people you are employing
- the kinds of systems available to you.

The first theme addresses the awkward fact that every individual is uniquely motivated, and any reward system presses different buttons. Some people really care about money, while others want recognition and reputation. Power and position are most important to some people, while others are looking for challenge, freedom and opportunities to learn. At the same time there are some features that are universally important. Everyone wants enough money to satisfy their essential interests – to maintain their family and standard of living, and people also want rewards that are timely and show they are valued. But many firms make a mistake in assuming that, because material rewards are an essential prerequisite, they are also a universal motivator. Often they can be a prime demotivator.

The most common problem comes from the universal concern that rewards be fair and sufficient for one's efforts. Individuals and groups compare themselves to others to make this judgement, and this is often a point of tension in family firms, where one party looks over their shoulders at another and makes an invidious comparison. This occurs between family who are in and out of the management of the firm, and between family and non-family executives. Everyone is liable to think (falsely, often) that some other group is getting the better deal. The management of motivation and reward has a lot to do with effective communication, as this guide amply demonstrates.

The second theme – the kinds of systems available – follows from the first. Companies worry about the size of monetary rewards and how they should be delivered, without thinking enough about alternative motivators, such as fringe benefits, recognition symbols, status signifiers, career opportunities and other ways of enhancing a person's experience. And even if one just considers pay systems, they can be delivered in ways that have very different effects. Flat pay systems have the effect of signalling equality within some groups, while underlining class distinction between strata. Payments by results methods tend to lose their incentive value above certain levels, and achieve their main utility by penalising performance that falls below acceptable thresholds. Gain sharing methods – systems where employees get to keep a proportion of what they achieve on a specific assignment – are very useful for delivering short-term results, but work less well over longer periods. Group incentives enhance the sense of a common interest among a group, but create the 'free-rider' problem by breaking the link between individual effort and business success.

The most important thing to remember with incentives is their symbolic value. A small difference between values can be a chasm if the two individuals consider themselves equal, or if they see themselves as hugely different. Every reward system is a signalling system. So there are some lessons to be drawn from this:

1. Think very carefully about the systems you implement and the unwanted side effects they may produce. What looks like a motivator can turn out to be a demotivator.
2. Don't expect any system to do too much: keep systems simple and transparent and don't rely on them to do your motivating for you. The real job of motivating lies in the hands of people who manage people.

3. When it comes to incentives, decide whether you want to bind people together in a sense of collective teamwork (group rewards); to symbolise equality or difference (flat rates, strata); to stimulate peopleto work harder (targeted bonuses); or to prevent effort from falling below a threshold (piecework and merit rating systems).
4. Also remember that different factors motivate people to join, to perform and to stay in an organisation. This explains why many firms have packages that are great attractors but turn out to be very bad motivators, why others are able to encourage people to stay but not to join, and why some are great at energising people but no good at retaining them.
5. Remember that culture is the most important and inimitable motivator of all, in each of these areas. People will join, give their best and stay in firms that have dynamic, open and achieving cultures.

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The continued success of the family business sector is critical to the UK economy. Yet, surprisingly, little guidance is available on these unique and complex issues that family businesses face. One organisation, however, makes available the guidance and help family businesses need.

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