

Source: Family Business — Spring 2001 issue

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When compensation divides siblings

The most effective sibling partnerships don't merely acknowledge their differences; they actually celebrate them.

By Ivan Lansberg

Two brothers, ages 55 and 47, and their 51-year-old sister own and manage a large retail enterprise that they inherited years ago from their parents. For the most part they function well together, with one exception. Disputes over each other's compensation—and, more recently, their retirement packages as well—have repeatedly strained their relationship. And yet over the years they have learned through painful trial and error some of the better ways of addressing this thorny subject.

The trouble started on the first day the sister and younger brother formally joined the company. At that point the older brother had been in management for more than six years and had already advanced to the company's upper-middle management ranks. Nevertheless, their father insisted that the sister and younger brother be paid the same salary as the oldest brother. His rationale was simple: "You're all equal siblings, and in order to avoid rivalries among you, I will treat you all the same"—a principle with which the mother wholly concurred.

This philosophy, however well-intended, ultimately backfired. While the sister and younger brother seemed content to be treated equally, the older brother objected to applying the principle of equality when the differences in experience and seniority among the three seemed so evident to him. But the father stuck to his guns. And much to the older brother's dismay, the compensation among the siblings remained equal even after the father retired and turned operational control of the company over to his oldest son. (In theory the three siblings functioned as a leadership team, but in practice the oldest brother was recognized as "first among equals.")

Upon the parents' death, ownership of the company was divided equally among the three siblings. At this time the oldest brother became chairman and CEO, the sister became head buyer and the youngest brother became the president of the real estate division, which managed shopping malls and other properties. But the retailing operation generated most of the profits and accounted for more than 80% of the family's total

wealth. The oldest son—while respectful of his parents’ wishes and grateful for the opportunities the family company had brought him—deeply resented his siblings’ failure to formally acknowledge what he viewed as his significantly greater contribution to the business. “I’ve made them all rich,” he would say, “and yet, they treat me as their professional peer. How can *that* be fair?”

Whenever he complained, his siblings would invoke their parents’ egalitarian philosophy and remind the older brother that they too had contributed to the enterprise. Then one day the older brother had to intervene in a major real estate venture that had gone sour. This venture, which had been an important initiative of the younger brother, was losing serious quantities of money and threatening the profitability and credit standing of the entire enterprise. Before the older brother went off to meet with creditors, he huddled with his siblings.

“You’ve asked me to take on the management of this real estate financial crisis we find ourselves in,” he told them. “And I will do so, provided the two of you are willing to work with me in establishing a compensation package that rewards me fairly for my work as chairman and CEO of our family enterprise.”

The siblings reluctantly acquiesced. Within a few months of his direct involvement, the real estate crisis was resolved in ways that far exceeded everyone’s expectations. Under the initiative of the younger brother and the sister, the siblings hired a compensation consultant, who helped to design a remuneration package for the older brother that was in line with industry standards for a company of their size and profitability. By helping to define a financial “ball park,” this process helped the siblings to establish what professionals in the compensation field refer to as “external equity.”

This was important to the older brother because, like many senior executives in family enterprises, he felt underpaid relative to his peers in the marketplace. His suspicions were in fact corroborated by the consultant’s analysis. But the thornier problems emerged when the siblings focused their attention on “*internal* equity”—that is to say, the value of the older brother’s total compensation package relative to that of his siblings and other senior executives in the company.

At this point, much of the discussion focused on a classical definition of justice that dates back to the Greeks: “Justice is the equal treatment of equals.” It quickly became evident that while the siblings were indeed “equals” as owners, their accomplishments in management were undeniably unequal—as the older brother’s contribution to resolving the recent real estate crisis showed.

The fundamental issue here was the difference between ownership rights on the one hand and managerial compensation on the other. The more the siblings discussed these issues, the more they realized that being equals as owners didn’t mean that they were also equally entitled to the same compensation as managers. The fact that in this family company—as in many others—there had never been a formal dividend distribution to shareholders (because of the burdens of double taxation) further blurred the lines between

ownership and management and exacerbated the confusion about who was entitled to receive what kind of compensation. This was particularly important in light of the sister and younger brother's argument that they were entitled to inflated salaries as executives precisely because they received no compensation as owners.

Once the siblings understood this basic issue, they developed a compensation system that differentiated what they were entitled to receive as owners from their compensation as executives in the business.

At first they established a bonus based on the company's overall performance that served the function of a dividend allocation without incurring the tax liabilities. (This, in turn, established a platform for the development of a formal dividend policy that will become increasingly important as the company begins the transition to the cousins stage.) But the most important psychological step involved recognizing that even though they were equal shareholder partners, they needed to accept differentials in managerial compensation based on each one's proportional contribution to the business. Naturally, this meant agreeing on performance criteria to define each sibling's contribution and establishing control systems that would measure results on the relevant variables.

It's often a challenge for siblings in these situations to accept that they don't all possess comparable leadership and management skills. The most effective sibling partnerships, however, don't merely acknowledge these differences; they actually celebrate them—precisely because it's in everyone's interest that those with the most talent for leading and managing the enterprise are assigned to positions of responsibility that further its growth.

Naturally, this also means learning to tolerate differentials in income (and lifestyle) that may inevitably result. Developing such tolerance for inequality is never easy among siblings. It certainly can't be imposed or decided upon arbitrarily. Quite the contrary: Tolerance for inequality can be achieved only through the consensus of the parties involved. As the story of these siblings suggests, despite all their squabbles about compensation, they never wavered on their commitment to each other and to doing what was right for the enterprise they inherited.

Philosophers since Aristotle have understood the important relationship between *procedural* and *distributive* justice—that is, the process that's used to arrive at allocation decisions will influence how people feel about the fairness of the distribution that's ultimately adopted. People's capacity to accept unequal allocations invariably is enhanced if they feel they understand the issues and have participated in determining the distribution of rewards.

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