Pearl Meyer

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The Five Pillars of Tailored Executive Compensation

David Seitz
MANAGING DIRECTOR

Family businesses are built on legacy, trust and long-term commitment, but even the most well-run companies have to evolve to survive and thrive across generations. One of the greatest risks to the continuity of a successful family enterprise is the failure to attract, retain and inspire executive leaders who can help the business flourish.

While family culture can be a powerful competitive advantage, relying solely on internal loyalty or legacy is simply not enough. Executive compensation is a vital, strategic tool to align executive leadership with family shareholders, yet it can be underdeveloped or misaligned in many family-controlled firms. We'll explore five foundational "pillars" that can help family businesses design and manage compensation in ways that are both competitive and customized to their values and long-term vision.

Pillar 1: Close the market information gap—understand market pay practices

Family companies often have a blind spot and do not realize they lack information about how their executive compensation levels and plan structures align with external market standards. Without the external benchmarks or specialized advisory input that are standard in public companies, a "market information gap" develops, where family business decision-makers don't have sufficient data or context to fully understand how compensation levels and structures compare to those offered by similar organizations.

This knowledge shortfall on pay practices matters. Without visibility into how the market compensates leadership talent, family firms risk falling behind in attracting and retaining the executives they need. Further, they miss an opportunity to align executive leadership with the business and drive long-term shareholder value.

Key questions for the market analysis include:

- What is the labor market for executive talent?
- What levels of compensation are appropriate given our size and industry?

- How should our family values and legacy influence pay design?

Pillar 2: Establish strong executive pay governance

It is important to establish a strong governance and decision-making process around executive pay. Unlike public companies, family firms are not required to maintain independent compensation committees or disclose pay practices in proxy statements. The absence of a compensation committee, or designated board members who focus on compensation, can lead to the absence of a thoughtful, integrated compensation strategy and plan designs that are inconsistent with market practices.

Good pay governance includes:

- Assigning executive pay oversight to designated board members or establishing a compensation committee of the board.
- Scheduling regular reviews of compensation market practices.
- Establishing a calendar of executive pay decisions with clearly defined roles between management and the committee.
- Leveraging independent outside experts to provide objective input and reduce potential internal bias.

The appropriate governance process should reflect the evolution of the entire board. Family firms will benefit from formalizing how executive pay decisions are made. This can avoid misunderstandings, and it also demonstrates to executives, whether they are family or not, that compensation is managed with fairness and integrity.

Pillar 3: Design a realistic compensation philosophy

Once your family company has established a better understanding of the external landscape and has a governance process in place, the next step is to define a clear compensation philosophy. This compensation philosophy serves as a strategic compass, and should reflect both the realities as well as the aspirations of the business.

The right compensation philosophy guides decisions around compensation levels, pay mix and incentive plan design. Importantly, it also helps reconcile sometimes conflicting goals, like offering attractive incentives to outside executives while preserving family ownership control.

For example, a company may decide that, while it will not match public company levels of long-term equity-based pay, it will compensate by offering higher-than-market retirement contributions or above-market annual salary and annual incentives. The key is not to copy the market, but to respond to it intentionally and in alignment with your company’s ownership, culture and business goals.

Too often, family companies continue pay structures based on legacy, rather than strategy. A customized pay philosophy helps shift the conversation from “how we’ve always done it” to “what makes sense for who we are and where we’re going.”

Pillar 4: Address the long-term incentive gap

Long-term incentives are critical because they provide alignment between an executive’s financial interests and long-term shareholder value. One of the most striking differences between public and family-owned companies is how long-term incentives are treated. In large public firms, long-term incentives represent the majority of a senior executive’s compensation, aligning leadership rewards with sustained business performance. By contrast, in many family companies, long-term incentives are sometimes limited or altogether absent.

A family company must explore the full range of long-term incentives including real equity, phantom equity, stock appreciation rights and long-term cash. A well-designed long-term incentive plan can align the financial interests of executive leadership with family shareholders, and it can be a key component to attract and engage leadership talent.

Pillar 5: Communicate the total compensation package effectively

Family companies often pride themselves on loyalty, mission-driven culture and strong personal relationships. These are very valuable assets, but they don’t replace the need to clearly communicate the economic value of compensation.

Executives need to understand how the total compensation package works. This includes all elements of total compensation: base salary, annual incentives, long-term incentives and employee benefits. Too often, unique or generous components of a pay plan may go unrecognized or underappreciated because they’re not clearly explained. In the case of incentives, communication is important to ensure that leadership focuses on the key business goals and priorities.

Transparency and clarity in communication are vital:

- Use plain language to describe how programs and performance drive pay.
- Reinforce how the company’s pay strategy reflects its values and long-term commitments.
- Provide progress reports and results.

When leaders understand how they're being rewarded—and how their performance shapes future opportunities—they're more engaged, aligned and motivated to stay.

Compensation as a bridge between legacy and future

When compared to public and non-family companies, family businesses have many inherent competitive advantages, such as culture, loyalty and freedom. The best compensation programs in family firms don't copy what others do. Instead, they deploy tailored strategies that honor the family ownership of the business and ensure it can attract and reward the executive leadership necessary for the business to thrive.
Anchoring compensation in these five executive compensation pillars allows family companies to invest in leadership that is capable of carrying their legacy well into the future.

About the Author

David brings 30+ years of executive compensation experience, specializing in long-term incentives, pay strategy, performance metrics, and executive retirement/global programs, including support for IPO and M&A transitions.

About Pearl Meyer