Compensation Advisory Partners

Summary Report // 2020 - 2021

Family Business Executive Compensation Survey

This report is a summary analysis of a joint study by Compensation Advisory Partners, *Family Business* and *Private Company Director* magazines.

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Summary Report

Compensation Advisory Partners (CAP) and MLR Media launched the first-ever *Family Business Executive Compensation Survey* in 2020. CAP, an independent executive compensation consulting firm, and MLR Media, the publisher of *Family Business Magazine*, launched the survey to collect data on the executive compensation levels at family companies and to understand the pay practices unique to these businesses. The survey drew responses from more than 300 family-owned businesses representing a broad range of revenue sizes and industries.

Key survey findings include:

- The top executive positions of Chief Executive Officer (CEO) and President are held predominately by family members. In contrast, specialized functional roles, such as Chief Financial Officer and Chief Legal Officer, tend to be held by non-family members.

- Among the survey respondents, the CEO position is most often held by a family member across all company revenue ranges – even at companies with greater than $500 million in revenue.

- Compensation programs do not vary between family and non-family members at most survey respondents. The majority of companies offer participation in short- and long-term incentive programs to both family and non-family executives. Greater differentiation occurs for long-term incentives because family executives often hold equity ownership in the business, which provides profit-based distributions and dividends.

- Family-owned businesses spend a median of 10 percent of operating income on short-term incentives, which is higher than the spend at other privately held companies. Short-term incentive payments are most often based on company profitability. Beyond profitability, the performance measures used by family companies vary widely. The second most common performance measure is individual performance, indicating that subjectivity plays a role in short-term incentives at many family businesses.

- Long-term incentives are offered by approximately half of the family-owned companies surveyed. The most common long-term incentive vehicles are cash-based performance plans and phantom stock plans.

- The survey asked about dividends to shareholders to understand potential income to family executives who hold equity ownership. Dividends are paid to shareholders at 70 percent of survey respondents. Dividends paid in 2019 were 14.4 percent of net income at median. Given the impact of COVID-19, dividends were estimated to be lower in 2020, at 10 percent of net income at median.

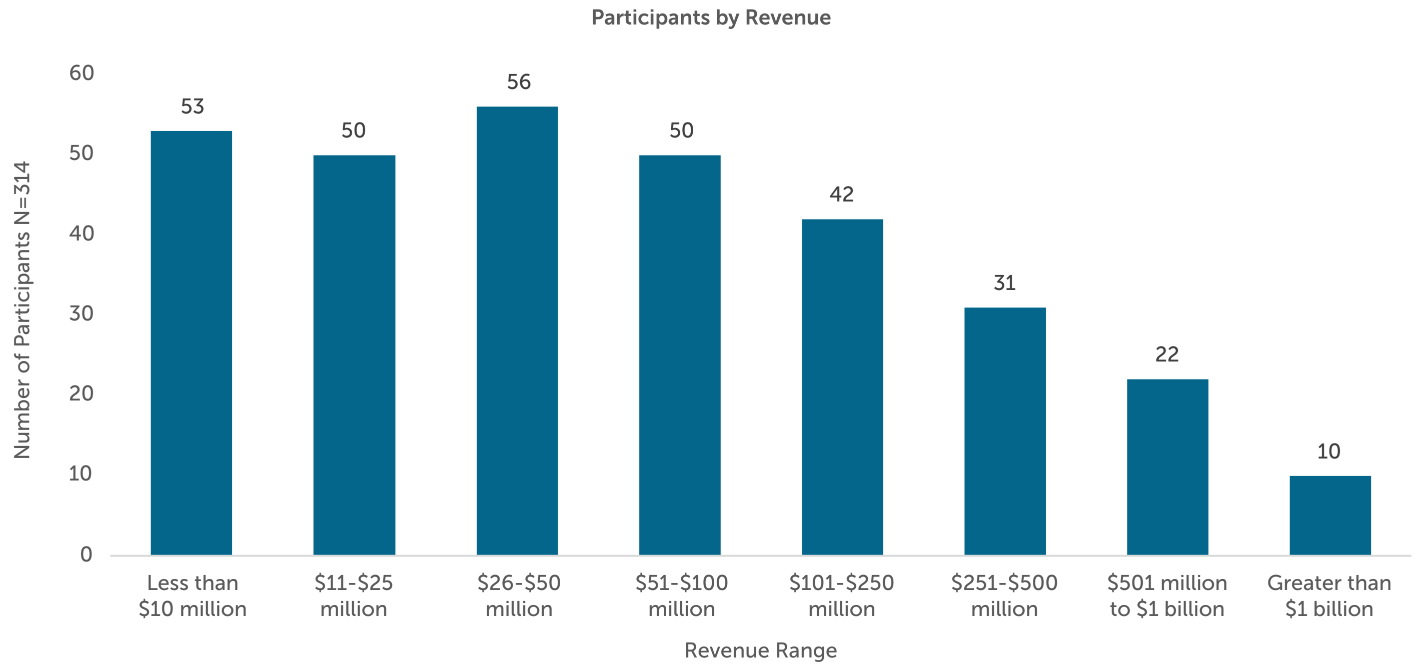
- About one-third of the family businesses surveyed took executive compensation actions in response to COVID-19. The most common action was to suspend salary increases and bonus payouts. Another common human capital action was to reduce the workforce either permanently or through temporary furloughs.

About The Survey Participants

More than 300 companies responded to the survey, representing a broad range of industries and revenue sizes. Manufacturing is the most prevalent industry in the survey (one-third of respondents), followed by real estate and rental and leasing; agriculture, forestry, fishing, and hunting; construction; wholesale trade; and retail trade.

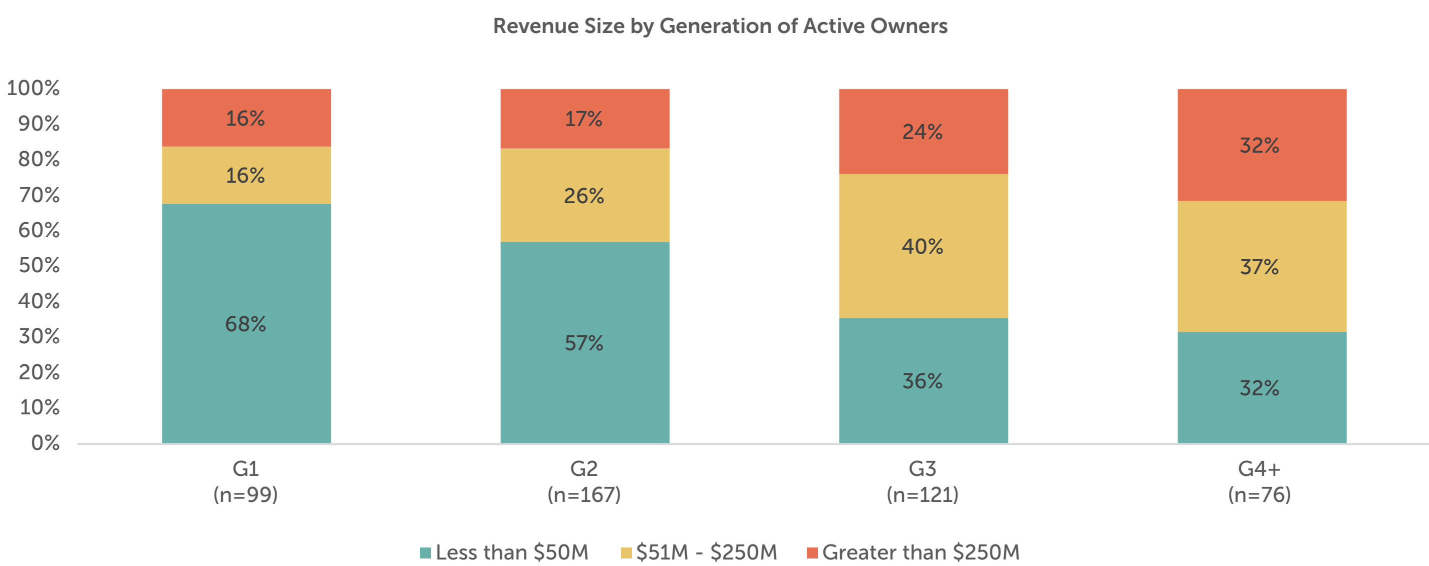
Participating companies span all different sizes. Exhibit 1 shows the distribution of responses across different revenue ranges.

EXHIBIT 1



The survey drew participation from companies with one to more than six generations of active family ownership. Exhibit 2 shows the distribution of revenue across generations. (Generations 4, 5 and 6+ are aggregated in the exhibit.) Not surprisingly, mature family businesses that have been in operation for many generations tend to have higher revenue, as Exhibit 2 illustrates.

EXHIBIT 2



Approximately 75 percent of participating companies are S or C corporations. Ninety-five percent of participating companies are based in the United States and Canada. All survey results are denominated in U.S. dollars.

Compensation Practices

The survey asked participants to provide compensation data (salary, short-term incentives, and long-term incentives) for 10 executive positions. Median compensation data for the total sample are shown in Exhibit 3. (The detailed report for survey participants includes data for each component of compensation, and also shows compensation data by revenue range).

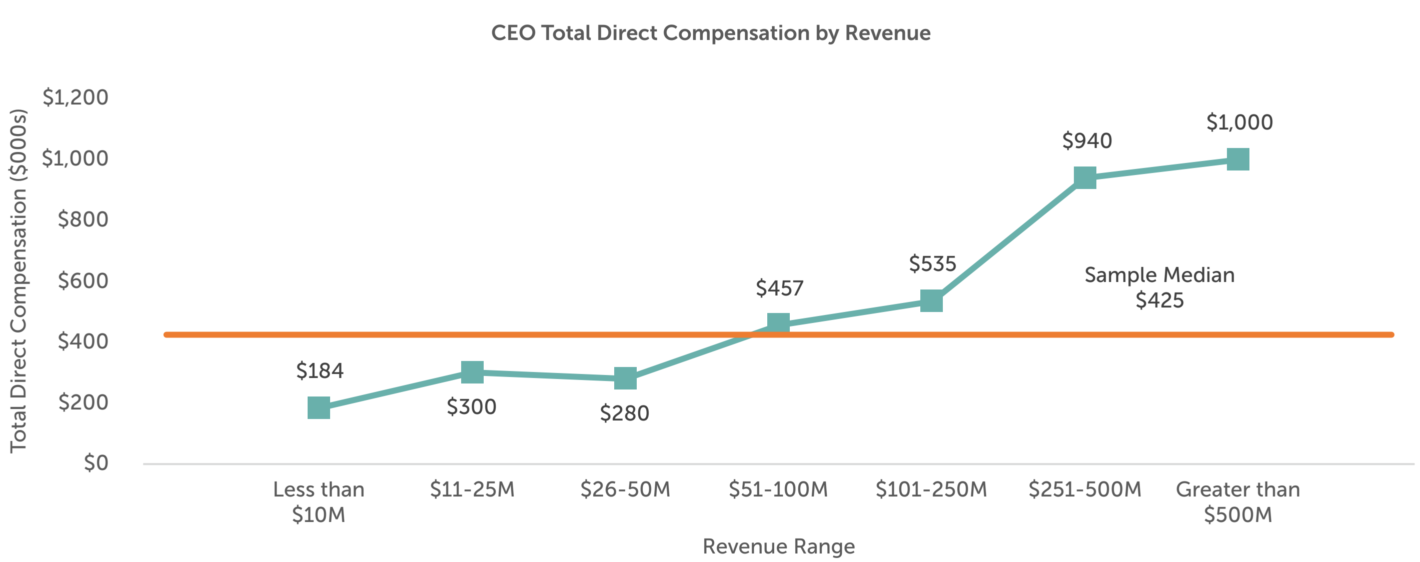
EXHIBIT 3

Median Compensation Data for All Companies	
Position	**Total Direct Compensation**
Chief Executive Officer	$425,000
President	$350,000
Chief Legal Officer	$300,000
Chief Operating Officer	$270,000
Chief Financial Officer	$250,000
Chief Sales Officer	$239,572
Business Unit (or Sector) Head	$170,000
Chief Human Resource Officer	$169,842
Chief Information Technology Officer	$156,506

Note: Insufficient data were available to report Chief Investment Officer compensation levels.

Company size is correlated with the level of executive pay at family businesses, as shown in Exhibit 4. As a company's revenue increases, the complexity of operations and the responsibilities of the executives also increase, necessitating higher pay to attract and retain executive talent.

EXHIBIT 4



Family and Non-Family Executives

The survey asked respondents to indicate whether a position was held by a family member or not when providing compensation information. As shown in Exhibit 5, the two executive positions of CEO and President tend to be held by family members. In contrast, specialized functional roles tend to be held by non-family members. In addition, as shown in Exhibit 5, smaller companies have greater family representation in the executive ranks than larger companies. The results are not surprising: Smaller companies tend to rely on family member "sweat equity." As companies grow, they hire talent from outside the family, particularly to gain specialized functional expertise. One surprising result is that the CEO position is held by a family member across all revenue ranges – even at companies with greater than $500 million in revenue.

EXHIBIT 5

Percent of Positions Held by Family Members by Revenue

Position	Less than $50M	$51M to $250M	$251M to $500M	Greater than $500M
Chief Executive Officer or President	86%	76%	69%	62%
Functional Heads	29%	12%	4%	5%
Average of All Positions	57%	33%	23%	20%

Note: Functional Heads reflect the following positions: Chief Financial Officer, Chief Sales Officer, Chief Legal Officer, Chief Information Technology Officer, and Chief Human Resources Officer.

Given the predominance of either family or non-family members holding a specific role, differences in total compensation for family and non-family executives cannot be meaningfully measured, except for select positions.

The President position and Chief Operating Officer (COO) position have more even distributions of family and non-family incumbents in the roles than other survey positions. To help control for company size, the two positions were analyzed by looking at pay for the President and COO roles as a percentage of CEO compensation in the same company.

- President: Base salaries for both family and non-family Presidents are about 95 percent of the CEO's salary at median. The family President earns up to 15% less in total compensation than the non-family President. In fact, a non-family President's total compensation exceeds that of the CEO at several family-owned companies responding to the survey. These findings indicate that family businesses that hire non-family Presidents view these incumbents as similar in value to the CEO. One explanation is that family businesses hire Presidents for succession-planning purposes to prepare a non-family member to eventually take over the top position.

- Chief Operating Officer: In contrast to the President position, family members in the COO role typically earn up to 15% more in base salary and total compensation than non-family members in the same role. A potential explanation is that families strive for greater pay equity between family members on the executive team.

The survey asked respondents whether family and non-family members were treated the same when receiving short- and long-term incentives. The majority of companies offer participation in short- and long-term incentive programs to both family and non-family executives.

There is more differentiation in participation for long-term incentives for family member executives, which is not surprising since family members are more likely to be shareholders and, therefore, be eligible for dividends or profit distributions. Long-term incentives are more likely used for non-family members to attract and retain talent, and to align the executives with company and shareholder objectives.

Short-Term Incentives

Short-term incentives are an important tool for rewarding performance and focusing executives on the near-term objectives of the business. The respondents provided their companies' approximate budgets for short-term incentives as a percentage of operating income. At median, short-term incentive spending was 10 percent of operating income.

CAP has assessed short-term incentive spending as a percentage of operating income at privately held companies over the past decade. Privately held companies have historically spent 6 percent to 6.5 percent of operating income on short-term incentives at median. With a higher spend relative to other private companies, family companies emphasize short-term incentives as an important way to motivate and reward executives and employees.

The survey respondents report using a broad array of performance measures to determine payouts. More than half of the respondents use a profitability measure in determining short-term incentive payouts. Beyond profitability, no other performance measure stands out as a prevalent practice. Exhibit 6 below shows the top five most prevalent performance metrics at family businesses.

EXHIBIT 6

Most Common Short-Term Incentive Performance Metrics
Ranked by prevalence
1. Profitability Measure (net income, operating income, etc.)
2. Individual performance
3. Operational objective(s)
4. Revenue
5. Strategic objectives(s)

After profitability, individual performance is the next most common performance factor, which indicates that subjectivity plays a role in short-term incentive decisions. Other common metrics are operational objectives, revenue, and strategic objectives. The broad array of performance measures favored by family businesses indicate that they assess their performance more holistically than privately held and publicly traded peers, which strongly emphasize profitability and financial performance in their short-term incentive programs.

Long-Term Incentives

Long-term incentives are granted to attract and retain executives and focus them on sustainable value creation and maintenance of the long-term health of the business. Long-term incentives, such as restricted stock, stock options and long-term cash incentive plans, are widely known because of their use at public companies and the significant values they can deliver.

At publicly traded companies, long-term incentives are almost universally offered to top executives. In contrast, privately held companies do not have liquid stock with daily valuations that they can use as executive incentives. Given this limitation, the prevalence of long-term incentives is approximately 60 percent in privately held companies. In addition to the long-term incentives mentioned above, privately held companies offer phantom equity, stock appreciation rights (i.e., phantom stock options), profit interests and deferred compensation.

The prevalence of long-term incentives at family-owned companies is less than that of other privately held companies. Only half of the family businesses surveyed offer long-term incentives to executives (see Exhibit 7). The prevalence is lower than at other privately held companies because family businesses are often reluctant to share real ownership or economic value with executives outside the family.

EXHIBIT 7

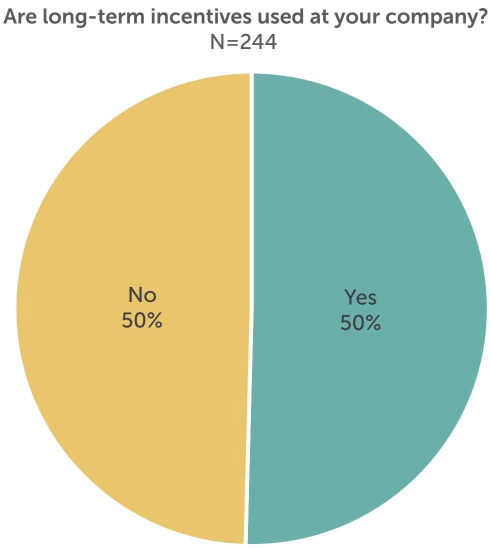


Exhibit 8 below shows the top 3 most prevalent long-term incentive vehicles at family-owned companies. These companies predominately favor cash-based vehicles.

EXHIBIT 8

Top 3 Long-Term Incentive Vehicles	
Vehicle	**Prevalence**
Performance cash plan	41%
Phantom stock (long-term performance cash tied to company value)	25%
Restricted stock or restricted stock unit (actual ownership)	16%

In the family businesses that have long-term incentive programs, the most common practices are to grant awards annually, and to have vesting or performance periods spanning three or five years.

Without a public market to provide liquidity or a valuation for equity, private companies must decide on how to provide these features in their plans. To value equity, family businesses typically use an established formula or an outside, independent appraisal. These companies typically provide liquidity upon an executive's termination or upon vesting of the award.

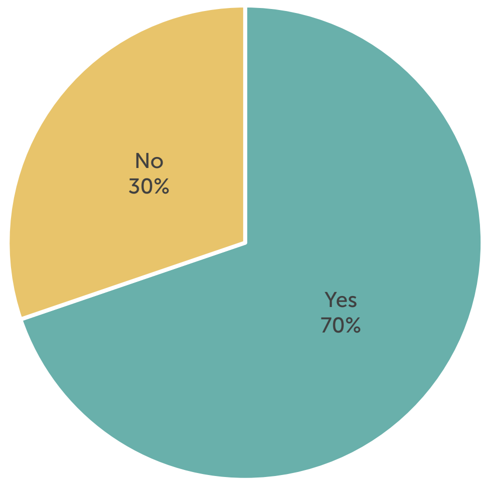
The companies surveyed report modest pools for the sharing of value creation relative to publicly traded peers. More than half of the respondents with equity-based long-term incentive plans report pools of 10 percent or less of total shares outstanding.

Dividend Practices

The survey asked family businesses about their dividend payment practices to understand the income potential for executive shareholders. Of the survey respondents, 70 percent pay dividends to shareholders (see Exhibit 9).

EXHIBIT 9

Does your company pay dividends?
N=248



In 2019, companies paid out 14.4 percent of net income at median to shareholders. Given the impact of the COVID-19 pandemic, companies anticipate paying smaller dividends in 2020.

Larger Family Businesses (Greater than $500 Million in Revenue)

Competing with publicly traded companies for executive talent is a particular concern for large family businesses. In reviewing the survey responses of companies with greater than $500 million in revenue, a few distinctive compensation practices emerge:

- Higher pay positioning – Larger businesses tend to have an above-median pay positioning for base salary and total compensation compared to smaller counterparts. This higher positioning for total compensation is achieved, in part, by short-term and long-term incentives.

- Short-term incentives - Larger businesses provide higher maximum short-term incentive opportunities (150 percent to 200 percent of target) and budget a higher percentage of operating income for short-term incentives.

- Long-term incentives – Over three-quarters of larger family businesses offer long-term incentives to their executives. Long-term incentives are typically granted annually, and the grants are limited to the senior executive group.

- Budgeted salary increases – While smaller organizations tend to have a wider range of annual budgeted salary increases, larger companies' budgeted increases center around three percent.

The Impact of COVID-19

Participants were asked to provide information about any actions taken in response to COVID-19. Approximately one-third of the respondents indicated that they took executive compensation actions because of the pandemic. Of the respondents that reported broader COVID-related actions, the most common were:

- Suspended pay raises or bonus payouts (46%)
- Reduction in workforce (40%)
- Furlough of employees (32%)
- Reduced base salary (30%)
- Suspended or reduced dividend payments (24%)

The most common durations of the COVID-related actions are indefinite/to be determined (31% of companies), the duration of the pandemic (22%) and through the end of 2020 (21%).

Looking Ahead

COVID-19 made 2020 a challenging and unprecedented year. As a result of the pandemic, companies had to modify their business strategies to meet an array of challenges: ensuring employee safety or managing a remote workforce, managing disrupted supply chains, and responding to the ongoing economic uncertainty. In turn, compensation strategies were also modified.

Given COVID-19, 2020 was not an ideal year to launch a new compensation survey. The compensation data presented in this report may have been impacted by these challenges. As a result, CAP and MLR Media plan to conduct the second iteration of the *Family Business Executive Compensation Survey* in summer and fall of 2021. In this next iteration, we will be able to evaluate trends in compensation practices and continue to provide executive compensation benchmarking data to family businesses as they transition to normalcy.

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