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Family offices come in different shapes and sizes – they can be quite varied in their purpose, and may include functions spanning investment management, accounting / tax planning, philanthropy, and general personal finance advisory for family members. Given the complexity and uniqueness of these organizations, it can be challenging to define “what does success look like”.

The overarching purpose of the family office and the scope of activities undertaken sets the context for

structuring compensation for the management team, which should be “fit for purpose” to align pay with the desired outcomes.

In the article below, we offer key questions to help family offices establish a philosophy for management compensation. The focus is on family offices where the primary objective is investment management, standalone investment management entities that service family offices, or investment professionals within a family office organization.

## *Q1: What is management's role in developing and executing the investment strategy?*

Generating long-term returns on capital and meeting short term funding needs are some of the key investment objectives for family offices. The role and responsibilities of the management team within the investment decision-making framework is an important input to defining the appropriate accountability to performance and how incentives should be structured.

In certain situations, management may be provided a particular investment mandate by the family. There may also be limitations on management's scope of responsibility (e.g., significant business interest that is critical to the family). Furthermore, if there are different pools of capital, it will be important to delineate and clarify the responsibilities of the management team.

Family offices can then execute on the overall investment mandate in the most appropriate approach (e.g., Asset Allocation vs. Manager selection vs. Security selection; active vs. passive). Depending on the approach taken by management, it will necessitate certain skillsets / expertise and have associated impacts on performance assessment for compensation purposes.

Assessing management's performance needs to be tailored to the specific investment approach adopted. Performance can be measured across a number of dimensions and may include absolute and / or relative performance indicators. Selecting the most appropriate investment benchmarks is a critical aspect of defining success and rewarding for it.



## *Q2: What is the expected time horizon for the family office's investments?*

Different investment strategies and asset classes will have varied investment horizons. For example, more liquid investment strategies may have performance measured on a shorter basis versus investments in alternative assets which are typically illiquid and might be measured on a longer basis.

If the family office also invests third party capital in a more typical private equity / venture capital investments (i.e., typical GP / LP relationships), this may have a shorter performance period relative to permanent capital (i.e., long-term business ownership interests).

## *Q3: What is the competitive market for talent?*

To ensure competitive and appropriate levels of pay, family offices need to determine the market for talent and this is based on the skills and experiences required to execute on the investment strategy. Depending on the sophistication of investment activities the family office is seeking to undertake, the relevant market pay levels will differ.

While other family office comparators may represent direct “peers”, the market for talent often includes a broader set of asset management or even financial services firms, depending on the specific role being benchmarked.

In certain situations, a family office may want to recruit a specific individual who has been a long-term trusted advisor of the family. Using market benchmarks in these circumstances may be more challenging and a greater emphasis may be placed on the opportunity cost of the individual in moving to the family office.

## *Q4: How should the total compensation package be delivered?*

Compensation for senior investment professionals should be aligned with success and the experience of the family. At the same time, it should reflect the individual performance and contributions of the employee.

A family office with a stronger pay for performance orientation should provide a substantial portion of total compensation in the form of incentive pay, particularly for the senior leaders. Furthermore, the type of investments managed by investment professionals may also influence the balance of fixed vs. variable pay.

Consider the pay design and how it reflects the overall risk appetite of the family office. This can include factors such as (i) mix between fixed / base salary and variable pay and (ii) mix of short- and long-term incentives.

Overall, the performance management framework needs to be reflective of the family office's governance programs and practicality of administering compensation programs.

## *Application of Philosophy to Family Employees*

Family offices that employ family members in the organization will need to consider whether and how the pay philosophy may differ based on a few factors.

An initial consideration is the level of involvement by the family employee (e.g., full-time employment vs. part-time). A "market driven" approach to compensating family employees could be perceived to be a fair outcome when there are also family members not directly involved in the business.

When comparing family vs. non-family employees, a common and straight forward perspective may be to apply the same philosophy to all employees. However, some firms may contemplate paying family members less than market for an equivalent role if there are other factors or related benefits such as tax efficiency.

Family offices should consider the various trade offs and internal / external pressures impacting this decision.

The compensation philosophy of a family office underpins and anchors all compensation decisions. It also supports the organizations' strategic plan to ensure compensation programs are aligned with the needs and objectives of the family office. Over time, the philosophy should be reviewed occasionally to ensure it continues to be appropriate given the evolving internal and external context.

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*If you have questions about this article or are interested in how Hugessen can support compensation the needs at your family office, please contact Richard Liu ([rliu@hugessen.com](mailto:rliu@hugessen.com)) and Kevin Zhu ([kzhu@hugessen.com](mailto:kzhu@hugessen.com))*

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