

**Attracting, Retaining and Motivating
Key Executives in a Family
Owned and Operated Business**

Presented by:

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**Subject Usually Arises in the Context
Of Succession Planning at the Top**

Or

Finding Talent to Bring Organization to a New Level

Has Many More Implications

- Change in company from one business level to the next
- Need for Professional Management vs. Founder Management
- Need for additional Technical Expertise,
 - increased marketing expertise
 - greater financial expertise
 - advanced marketing know-how
- Need to Change the Culture of the Organization
- Need to Change the Strategy of the Organization

Cases:

- 1. Polaroid: Founder insisted on building company. Took it to enormous success, but never had replacement people or products in mind. Company is long term failure.**
- 2. Cheese Company...private...\$100MM in sales...10 family members in top 12 employees. Many unqualified for their jobs. Couldn't agree on next President. Had to sell company.**
- 3. Ad agency: private, \$150MM in revenues, founded and operated for 25 years successfully. Outsider was strong # 2 in industry knowledge. 23 year old son in the business. Sudden death of founder...wife inherits business...asks for help...we suggest outsider to take the helm...she feels he is not "right representative of family"...places son (and herself) to run business. Company collapses within 1 year**

- 4. Technical Manufacturer and Designer...Inventor/founder brings 45 year old son into business...son is lawyer, photographer, musician...he tries to walk in father's shoes. While father is there, son has "air cover."...once father retires, there are no new products and no new customers...company falters for failure to have good concepts of product and people growth.**

- 5. Family owned fabric manufacturer- 2 brothers divide total company operationally. Both have intense "despise" for each other. Hardly talk. They keep business alive barely, but can't attract outsider to take any key role in company.**

- 6. Musical Instrument Parts Manufacturer...Family passed from one generation to next. Current President has 23 year old son currently living as recent college grad on tropical island. Only key advisor is accountant...friend since college. No plan for back-up, even at suggestion.**

**The Family is not the Enemy...There are many Successful
Companies and People in Family Owned Businesses**

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Succession Planning, Attracting and Retaining

Is Same in Any Company

But has Additional Factors for Family Businesses

Decisions to be Made by Founder and Family

- Will I accept this person as a Key Member of Management?
- Will the business allow the key executive into private family financial and other matters?
- Can the business make the outsider feel like an insider?
- How much information are you willing to share?
- How much of the profit are you willing to share with non-family members?
- How much equity will you allow to outsiders?

I. Attracting Requires:

- The Right Definition of the Job to be done
- Assessment of the candidate's ability to perform the defined job
- Selection of the candidate who can fit into the culture and purpose of the organization
- Preparation of Family Management to accept the new employee as a Key Contributor
 - real equity, or
 - interest in a percent of profits only?

II. Retaining The Key Employee

- Must be a Cultural Fit
- Family Must be willing to Share and Accept
- Family Must be Willing to Communicate
- Behavior of Top Management if Key
- Perception that the Company is Serious About Real Growth and Change
- **Compensation is Not the only Factor that Retains Key Employees**

**“Retaining is Significantly More Effective and Cost
Efficient Than Recruiting”**

There are some Timeless Principles of Compensation

- There is no one best way. The best solutions come from Understanding of the Underlying Business Issues
- “Don’t take another patient’s medicine”
- Companies differ from each other by:
 - Management Style
 - Stage of Business Development
 - Internal Economics
- The Life Cycle of the Business Plays a Key Role in Compensation Planning
 - Start Up
 - Growth
 - Mature
 - Stable or Harvesting

(Most issues of absorbing outsiders are in the first two stages)

How the Market Stage of Your Company Influences Compensation Strategy

Compensation Elements	<u>Emphasis by Market Stage</u>			
	Start up	Growth	Mature	Harvesting
Base Salary	Low	Moderate	High	High
Short Term Incentives	Low	Moderate	High	Moderate
Long Term Incentives	High	High	Moderate	Low
Retirement Benefits	Low	Moderate	High	High
Health and Welfare Benefits	Moderate	Moderate	High	High
Perquisites	None	Low	Moderate	High

A company must consider its internal economics when designing a plan

There are seven core components of compensation:

- 1. Base salary programs, including salaries and salary increases**
- 2. Short Term Incentives, including annual, gainsharing and spot awards**
- 3. Long Term Incentives, including actual stock or simulated equity**
- 4. Health and Welfare Benefits, including health, life and disability plans**
- 5. Retirement and Capital Accumulation Benefits, including defined benefit and defined contribution plans and supplemental plans**
- 6. Perquisites, including financial planning and security measures**
- 7. Alternative*** non-monetary reward systems such as telecommuting**

In Designing Compensation Plans “Consider Everything as an Alternative”

- **Use Cash Depending on What You Can Afford Combined with the Competitive Market Place for People**
- **Place a High Value On Performance**
- **Use Annual Incentives for Achievement of Operating Results**
 - if you lack cash, consider deferral plans
- **Use Long Term Plans for the Achievement of Strategic Objectives**
 - there are many forms of private company stock
 - award stock based on actual realized growth in company**
 - measure success on increase in value
 - avoid budget achievement plans
- Use “success based” Non-Qualified supplemental plans to increase overall value of capital building programs

Pay Key Executives Both as Owners and Key Functional Managers

- **Don't pay only on company performance**
- **Avoid having managers ride the "company success" Coat-tail**
- **Be sure to measure success in key employees major functional area**
- **All Research indicates that there is a high correlation Between Increase in Company Value When Management Pay is Tied to Performance**

Forms of Executive Payout

Component of Compensation

1. Base Salary
2. Annual Incentives
3. Stock/Long Term Incentives
4. Health and Welfare Benefits
5. Retirement/401(k) Plans
6. Perquisites
7. Alternative Arrangements

Principal Purpose/Goal

1. Cash flow and competitive
2. Reward Short Term Results
eg.. operating objectives
3. Reward Long Term Results
eg.. strategic objectives
4. Pay for Security Protection
5. Capital and wealth building
6. Were luxury perks: condos,
cars
Now: security, tax planning
7. Be flexible

Changes in Compensation Climate:

- 1. Expectations of the Dot.Com era...disappointments in stock shift emphasis from stock to cash**
- 2. Economy...makes labor market softer, Easier to Recruit. Do not use this approach when addressing high potential employees**
- 3. 9.11...a tragic attack with little effect on the attraction and retention of top key management and specialist employees**
- 4. Arthur Anderson/Enron...Easier to be a private company in the coming years. Less public scrutiny. However, may have most significant effect on philosophy change in reporting and communicating with employees in general.**

The Role of the Labor Market

- **For the attracting and retaining the “average” employee, the labor market plays a significant role. In a tight labor market, employees are more difficult to attract and retain, especially in short skill and technology skill areas. Employees have the advantage in a tight labor market.**
- **In a loose labor market the employer gains the advantage. However, even in a loose labor market there are always short supply skills, for example the labor supply issue in technology.**
- For key executives who are your “future”, your “keepers” and your next generation of “management leadership” always respond with compensation and other programs as if it were a tight labor market.
- **No one should ever lose a high potential employee**

The Use and Issues in Executive Contracts

- 1. Almost always benefit the company more than the employee**
- 2. Get your lawyer to prepare-be prepared to face employee's lawyer**
- 3. Never design or sign without your lawyer's review**
- 4. The contract determines the deal:**
 - a) pay**
 - b) job, duties, title, reporting relationship**
 - c) goals**
 - d) extra pay for what?**
 - e) stock, when and why?**
 - f) benefits**
 - g) retirement**
 - h) relocation**
 - i) sign on incentives, cash or stock or both**
 - j) terms and conditions of exit strategies**

Employment Contracts (Continued)

**The contract must specify the exit strategy for the company
(most contracts fail here)**

- a) if the deal is not working well for the company**
- b) if the deal is not working well for the executive**
- c) change of control**
- d) death, disability, retirement**

Issues:

- a) relocation back (for the individual)**
- b) severance**
- c) salary continuation**
- d) counseling, outplacement, tax and financial advice**
- e) partial payment for achievements already earned**

Greatest failures in executive contracts are in failure to cover exit strategies.

Issues in Executive Contracts-Non-Compete Clauses

[Warning: If you believe that Non-Compete Clauses are unenforceable, your notion may be hazardous to your wallet, your mental health, your health and perhaps your livelihood]

- . Always written to protect employer**
- . Designed originally to protect employees from cashing in knowledge, customer list, etc, opportunities**
- . Although non-compete clauses protect employers there are very few real actual remedies**
 - that is reason for full blown court level actions**
 - remedies can be monetary**
 - remedies can be injunctive relief**

Non-Competes (Continued)

- . **Decisions made by courts are based on the law, and on public policy**
 - **common wisdom is that you can't keep a person from his livelihood**
- . **Executive Contracts with Non-Compete Clauses usually voided if employee is downsized or released (not for cause)**
- . **Executive Contracts with Non-Compete Clauses more enforceable if employee resigns voluntarily or is dismissed for cause**
- . **Executive Contracts very enforceable if issued for "considerable" consideration...e.g. stock options, big bonuses, sign on bonuses, etc.**
 - **That causes court to look more closely**
- . **Most common non-compete clauses:**
 - **do no harm**
 - **do not steal employee trade secrets, client lists**
 - **do not poach employees of former company**
 - **confidentiality**
- . **More restrictive clauses such as "never work again in any company which".... Is harder to get past court...but there are still cases which disprove that**
- . **Less restrictive clauses, eg.. within 6 months, or within 50 mile radius are seen as more reasonable and more enforceable.**

Newest issue in employee contract non-compete clauses:

EMPLOYER TURNABOUT

- . In a tight labor market, many employers (even those which have non-compete clauses for their own employees) want to hire hard to find employees who are still under non-compete clauses from their old companies.**
- . This creates tremendous conflict for the hiring company regarding its potential for conflict.**
- . Both employee and hiring employer knowingly breaking a covenant can be sued and restrained if they lose the action**
- . May lead to a new view of the role of Non-Compete Clauses**
- . Latest surveys show there are more enforceable non-compete clauses than previously**

Role Of External Advisors

- 1. Accountants...need to establish financial health, investment capabilities and the measurement of achievements for the payout of annual and long term incentives**
- 2. Consultants...have the broad picture of the competitive practices in compensation, benefits, management style issues and labor market conditions.**
- 3. Assessment/Coaching Consultants...Can be helpful in assessing key candidate qualification and in mentoring**
- 4. Lawyers...Can memorialize in required language the intent of executive contracts, stock option plans, supplemental plans, etc.**
- 5. Benefit Plan Designers (Consultants)...can show picture of best practices and prevalent practices in health and welfare and retirement benefits.**

- 6. Insurance Brokers...can implement company plan desires by securing desired insurances. (we like to separate the consulting about benefits process from the product sales process)**
- 7. Investment advisors...can assist with proper investment options for retirement plans, deferral plans, etc. once plans are designed. Again, try to separate design from product purchase.**

Finally:

Never criticize a man until you have walked a mile in his shoes. First, you will be a mile away when you criticize, and second, you will also have his shoes.