*Case Study*

# ConnectedHome, Inc. (B)

As an additional consideration for investing in ConnectedHome, Black Oak Partners has notified the CEO that they would require that the firm hire an individual who has established expertise in developing web sites for marketing to consumers. The person they have in mind was involved with a moderately successful venture. Following a private acquisition of the venture, she resigned to join a large consulting firm that is developing its own expertise in web site development.

The CEO recognizes that to induce the individual to leave her current position, ConnectedHome would need to offer an attractive package of cash compensation and equity. To satisfy Black Oak without engaging in further negotiation, the management team members would have to cover the cash component of the compensation package by reducing their own compensation. Any shares awarded to the new team member would have to reduce the fraction of equity retained by the existing team members without reducing Black Oak's equity share.

The CEO understands that structuring a deal that can satisfy all parties will be complicated. It is likely that each team member would be committing at least the next two years to the venture and that, even with an IPO in two years, it would be about three years before they could harvest their equity investments. All members of the team are sacrificing current income compared to what they could achieve if they were to abandon the venture and all concerned about the risk of the venture. Because of their different ages, opportunities for alternative employment, and wealth levels, each member of the team is likely to value the opportunity differently.

In an effort to gain perspective on the problem, the CEO has prepared a summary table for the four individuals who would be affected by the negotiation (Exhibit 1). He believes that an annual salary of $60,000 would be sufficient to attract the new team member, provided that the stock ownership allocation is sufficient. However, making the offer attractive enough will not be easy. If the individual joined the ConnectedHome Group and the venture failed, she would be unlikely to find new employment except at a significantly lower compensation level than she currently is earning. The alternative earnings potential of the other team members, as shown in Exhibit 1, assumes abandonment or failure of the ConnectedHome venture.

In light of the information in Exhibit 1, the CEO wonders what total compensation package should be offered for the next two years and how existing team members should share the cost of providing the compensation. He also wondered about the interplay between the choice of strategic direction for the venture and the compensation packages that would be needed. Could it be that everyone, including Black Oak, would be better off if ConnectedHome were to stay with the management team's less risky strategy of diversifying between the Internet and mail order?

Exhibit 1

**Team Member Financial Information**

| Position | Current Salary | Alternate Salary | Current Ownership of ConnectedHome | Approximate Other Wealth[1] | Age |
|---|---|---|---|---|---|
| CEO | $90,000 | $140,000 | 20,000,000 shares | $1,600,000 | 58 |
| CFO | $75,000 | $170,000 | 10,000,000 shares | $3,000,000 | 42 |
| CIO | $75,000 | $120,000 | 5,000,000 shares | $500,000 | 35 |
| New Internet Marketing Director | $200,000[2] | $175,000[3] | | $2,000,000 | 37 |

[1]Predominantly invested in marketable securities.
[2]Estimated annual salary and bonus in current position.
[3]Estimated salary in alterative employment if venture fails.