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Association News

Highlights of the March 14th IVCA Luncheon Event 'Scaling Fast Growth Enterprises: CEO Succession Best Practices' Sponsored by Korn/Ferry International

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CHICAGO – There are many reasons for CEO succession, and many ways it can be done, both on the senior executive, board director and investor level. On March 14th, the IVCA and Korn/Ferry International presented an educational luncheon on the “best practices” for CEO succession and transition, focusing on the particular sensitivities surrounding an officer who also happens to be the founder of the company.

Moderating the event was Bill Westwood, Senior Partner of the Korn/Ferry Leadership and Talent Practice in Chicago. The experts on the dais included: John Aiello, Founder and former CEO of the SAVO Group, and his successor, Mark O’Connell, current CEO and President of SAVO; Jim Heising, President of Red Foundry; and with an investor perspective, Jim Macdonald, Managing Director, First Analysis.

Bill Westwood moderated the program in a Q&A format, both contributing the inquiries and opening the floor for audience questions. The following are the highlights from the event.

QUESTION: There are six traits of a CEO that signal a potentially troublesome situation. One: resistance or rejection of board input. Two: Being off-site or out of touch. Three: Indignation, emotional or combative behavior when questioned or challenged. Four: The silent treatment, cutting off information to the board. Five: Buck passing and finger pointing. Six: Pulling up the drawbridge, directing the management team to stonewall the board.

In terms of your experience, which of these traits would you be most concerned about, or are there other signs that you might look to be concerned about in a CEO self destruction?

Jim Heising: To me, there is one clear indication. As far as I’m concerned, the CEO of a company is responsible for a companies’ culture and inspiration. The first warning sign I would see as a CEO failure is when they are no longer inspiring people in the organization to do better. That can happen quickly, in that they do something really wrong, or it can happen slowly, and atrophy can happen over time. The best litmus test is to see how a CEO is doing is to go directly to people in the company and ask them.

Jim Macdonald: That’s absolutely right, and as an outsider looking in those signs are relevant. As a venture capitalist, you can also listen to what other people in the industry are saying about the company.

Mark O'Connell: I think the signs are really simple. If basic communication is not happening, and the board feels that have to sneak around and use other methods to get information, that's a signal that there's a problem. The board should be structured to be casual – the more casual, the more information they're going to get. Most good CEOs know that. If you can't get that transparency, that's an indication of a problem.

John Aiello: My hunch is that I'm a bit of an anomaly, having run my company for 12 years and six years after we took an investment, so part of that is to be aware of a couple things. A good early sign for investors is a healthy sense of humility from the founder and the CEO, but not passive or insecure.

As much as founders are wired to think, 'this is my baby, this is what I built,' I find problems in the transition linked to shareholder value. Humility, and the understanding that it's not your company anymore, and then understanding with the board, what creates shareholder value? Does a CEO speak of I, speak of me, or speak of we? Ultimately it plays out as to how they handle the board.

Heising: Yes, how do you prevent this from happening in the first place? If it has gone that far – as the traits were described – then something really has been wrong since day one. There are some other issues, first time founders versus people who had been through it before – I've been through a few start-ups, and you have to use humility when doing a start-up, even if they are successful. Secondly, establishing investor conversation early with questions like, if the board doesn't like you as CEO, would you be willing to give up the CEO job? And finally, just setting some goals. It should be no surprise if someone is failing, in my opinion, I find that people typically know if they're screwing up. If goals are set, it's easier to have a conversation if they're not being met.

QUESTION: Do you use social media in any way? Do you look any sources of information about a company that might be on the internet? If so, how do you filter that information or how do you use it?

Heising: This is something new. When I want to hire someone, I will look at their Twitter followers long before I look at their resume. That's a very candid view into who they are, what kind of influence they have and what kind of network they have. Frankly, you can find out a lot about a person or an industry. So I would say, absolutely, use that.

QUESTION: How do you deal with a dominant and brilliant person, who is the inventor and founder, but doesn't take direction well, even in areas they have no experience in like marketing and accounting, to the point where they take offense to credible advice?

Aiello: When you put customers and shareholders – and their success – at the center of every conversation, it strips away a lot of the roles we play and equates everyone on the board. Even for the most obstinate, brilliant, I'm-not-going-to-listen-to-your-advice type of person, I think it negates a lot of that emotion from the conversation.

By the way, the definition of shareholder value is worthy of conversation. If the board members think the company will create shareholder value one way, and the CEO another way, that's where the healthy conflict should happen. Once there is unified understanding of how to create shareholder value, and that founder CEO understands that they are a shareholder as well, I think it tends to unify people. It's hard to disagree with creating both shareholder or customer value.

O'Connell: Another approach I would take is to suggest to any new CEO, they should go find some friends. People who walk in their shoes, who have no vested interest in that CEO's success, you can set up a formal mentoring program. Get someone who can coach him in a casual environment, and you also can coach the coaches.

Macdonald: As a venture capitalist, the first thing I hope going forward is that I never invest in that company. That is a situation that could end up with an ambush change.

Heising: From my point of view, you're not in the business of training people, you're in the business of making money. If I was investor in that situation, it wouldn't be someone I'd invest in, if it were clear the person was the way as described.

O'Connell: To that end, you could get some of your VC friends to have a conversation with that CEO, with the reasons why they wouldn't invest in that company. That's hitting him on the head with a baseball bat, not being able to raise money. It's a much stronger dose of reality. Without him being open to feedback at this stage in the game, there would be little hope of monetizing the company for him and his investors.

Heising: As we all know in this room, the idea is nothing, it's the execution. It's emotional, we're not selling to computers, we're selling to people. If that person walks into a room and doesn't listen to anything, it's a clear sign that even if he has the idea that will change the world, it's highly unlikely to succeed.

QUESTION: In the same vein, what about younger CEOs? How do you deal with thirtysomething people who are often victims of their own success?

Aiello: I think the first question to ask them is, 'do you want to be CEO?' In a lot of cases they feel like they have to, for retaining a vision of the company, and they don't necessarily realize that they don't have to be CEO to maintain that vision. If they really take a hard look at the requirements of being the CEO, including all the stuff they don't want to do, it might be a really easy conversation to say, let's find them someone to work on the operations side.

Heising: I will give you a very tangible example. I was 36 years old when Sterling invested in Savo. I'd never raised money before, never started a company before. But you have to remember that founders are wired to think they can do it, they can figure it out and I was going to do it. I will tell you to not sell them on the outcome, founders don't want someone else deciding the outcome. Sell them on the process, and let them arrive at the outcome.

Here's a specific example. One of the first things we talked about after closing our first round of capital was bringing in a VP of finance. I was strongly against it at the time, but we collaborated and did it, and it turned out to be the wrong thing to do. So three years later, when it came up again, I had built up these layers of resistance on the topic. What we agreed on was for me to chart my time on a monthly basis, and see how much time I spend on financial issues. I came to the conclusion after one month that I was spending 60% of my time being a CFO, and at the next board meeting we decided to hire one. Agreeing on a process was the best way, the most intelligent way, to deal with those types of problems.

O'Connell: You need to look at a gap. There is the CEO behavior and leadership on one side, versus what the board and investors want the CEO to do – that is the gap. The question then becomes, is there anything that CEO is going to be able to do to help close that gap? They're not going to change overnight, no matter how smart or flexible they are, so you have to decide what you have the stomach for in closing the gap, and what becomes most important. If the board, investors and CEO are not talking this way, then they talk around each other, and that is when the relationships break down, like all relationships in life.

Bill Westwood: It strikes me that the underlying theme is around self reflection and self awareness. When you have CEO situations like what had been described, somebody has to put a mirror in front of that person, judging whether or not their capabilities and aspirations are in line for what the company wants from their CEO. Then there can be a gap analysis and an honest determination on whether that's the role the CEO wants to play, and how they want to play it.

QUESTION: From what I've been hearing, you've been breaking down performance determination in a two by two matrix – the horizontal axis is a good or bad business result and the vertical axis is whether you like them or not. That results in four possible boxes for that CEO and the decision to replace them is a function of those four outcomes in each of those boxes. But aren't there only two boxes, good performance and bad performance?

Macdonald: That's the wrong matrix. Good and bad performance, definitely, but whether I like the guy or not I think is the wrong axis. From a venture capital point of view, successful entrepreneurs are very driven, sometimes hard to like. I want him to do his job and fill in the gaps, and if he's not – then it can be determined. It may be only a two box matrix.

Heising: I think only two as well, and the answer comes from how change comes about within those boxes over time. You will look at how this CEO is inspiring people – do they share a vision and is that becoming important? Eventually the CEO doesn't fight battles, they lead people into battles. But when they start to lose those battles, that's when people around the situation start to talk.

Aiello: I might approach the question differently. There is an assumption that the board is doing this analysis independent of the CEO. In my case, the board and I together decided on a CEO search and transition process. But the economy changed, and we decided together it wasn't the right time. When the topic came up a couple years later, the matrix included a factor of fatigue. Where would fatigue fit in on that two-box matrix? The human element of the founder's DNA is woven in to the company. If as investors you only look at it in a cold, sterile way, you will miss the 3D nature of that matrix. Over time, you have to build those types of relationships and see those types of emotional elements.

QUESTION: Once a board makes a decision to replace a CEO, what is the best way to handle the transition between the incoming executive and the outgoing one? Do you keep the other person around or do you just hand the keys over to the new leadership?

Macdonald: That depends on all the things we've been talking about before. The best scenario is when it's all agreed upon with the outgoing chief, and he stays with the board. Some incoming CEOs don't like that, but if it's a friendly transition and everyone knows that the founder is good at some things, and will continue to do those things, plus if the incoming CEO is not threatened by having the founder around, that is the best result. The opposite of course is the 'murder,' where you oust the person and just bring in a new CEO. It goes across that spectrum.

Heising: When it gets to that replacement point, the decision is usually already made. Either the outgoing person is mad, and they are going to be a cancer on the company if they remain on the board or it was a mutual decision and there is a good reason for the outgoing chief to stay around. The other question might be, how do you prevent the cancerous situation if the outgoing person is bitter? How the transition is handled will determine the answer to the question of whether they remain on the board or not.

QUESTION: From an investor's perspective, is it ever too early to bring up the topic of a CEO change?

Macdonald: No, it's never too early. One way to keep the conversation going is to talk succession planning, and what kind of talent are you developing in a successful company. It's never too early.

Heising: Investors don't like surprises. When the question was asked of me, I answered whatever was right for the company. And it should also be constantly brought up, a CEO that is being replaced should know it's coming up.

QUESTION: Mark, did you specifically have a voice in whether or not John remained on the board of SAVO when you took over as CEO?

O'Connell: When SAVO came along, and John will laugh, because I made him interview my wife. Because I had been through two wild CEO transitions, it takes the life out of the incoming leadership, depending on the environment you walk into. John is a really gracious guy, and I still thought, 'will this environment be all that it's cracked up to be?' It was a gracious transition, John was a very big guy to do it the way that he did it, and he helped me in every possible way. Did we want him on the board? Sure, because he's a very influential leader in our industry and our company. I even wanted John to be the Chairman of the Board the first year of my transition, because I didn't want disruption for the customers. Our customers also described it as a smooth and graceful transition.

Aiello: It goes both ways. Here's a heads up – not all founders are obstinate human beings. It doesn't take a rocket scientist to know that you don't bring in a highly regarded CEO candidate and then look over his shoulder and second guess him. I knew I had to get out of there and make it Mark's company. We were intentional about the transition. I personally called and met with each of our customers, and introduced Mark. It was intentional, thoughtful and the customers were involved. Again it comes down to the human element, it was the emotional quotient, what is inside the heart. Meeting with Mark's wife was a very big part of the evaluation process as well. I wanted to know what makes him tick.

Heising: At the end of the day, if you're going to have a good relationship, you have to be somewhat friends, you need to emotionally get along with each other. If it can be a peaceful transition, it's because you allowed it to happen, and let the outgoing CEO to be a part of that process.

Another factor is the staff behind the outgoing CEO. If they are loyal to them, an ambush-type firing can make it ten times worse. The company is the employees, not the CEO. It is important to explain to employees why it's happening, and in our case we were able to have the candidate meet the employees, to at least feel like they had some ownership in the situation. Transparency is important, because losing morale in a change makes a bad situation worse.

QUESTION: You've talked a lot about the importance of the CEO and board dynamic, and having the board be a place where relaxed, open dialogue can happen. Do you have any thoughts on how you create that atmosphere or some of the things people can think about to have those types of conversations?

O'Connell: One of the simple things I do is the same thing you do when you have friends – you spend time with them. You have a beer with them, you break bread with them. We have very casual dinners the night before board meetings and strategy sessions. I also do my best to have one-on-ones between myself and the directors, and we have observers in on that. And if I feel if I'm not speaking to my board on a pretty regular basis, every six weeks or so, I feel like I'm out of sync with them. I feel that it's part of my job and their job – and they need to play that role. Then we're not afraid to take each on, and they know I can take a punch. You need to have a relationship with the directors and the board. The more we know about each other, the more helpful they are to me.

Macdonald: I really like to make sure there is plenty of time for questions and answers at board meetings. One of the early warnings against a CEO is when they monopolize time at a meeting with a presentation, and then they run for a flight. I think that's because they don't want questions thrown at them. It's critical also to have a Chairman apart from the CEO, so they can control the board agenda and keep it more open for Q&A.

Aiello: I've learned a lot about board governance and management from Mark, but I want to go on record by saying that the 'board meeting' is the most outdated and irrelevant entity that exists in today's world. I think things just move too fast. To me, the most effective thing in creating a good, healthy board dynamic is informal conversations. Is there just talking and becoming real with one another? I think informally a board can be more valuable than being formal.

What we're interested in is discussing strategy as an organization, as in pairing the board up with an executive team, taking on a specific area of expertise and working on their part of the overall strategy. That has been extremely valuable, because they become part of the ownership of the strategy.

QUESTION: What are the lessons that you have learned in an ambush replacement, and the subsequent reluctant CEO that takes over in that situation?

O'Connell: The most most important thing I would encourage board directors to play attention to, is that their responsibility doesn't end with the 'murder.' After the body is out of the boardroom, you really need to take time with the transition and spend time with the new CEO, as in what the board can do to help them. There must be physical involvement to show support, and there must be an investment of your time.

Also asking yourself as a company, what will the first hundred days, or even the first week, need to look like? And how will the mixed reaction of the employees play out, because they will be in mourning. Know that your responsibility is to help carry the water.

Heising: Clearly, a 'murder' takes place when there is a total relationship breakdown. It's going to be up to the outgoing CEO to recognize, if they're going to be practicing the negative traits mentioned before, that they are looking to get 'shot.'

O'Connell: If the board is feeling there is something wrong, there is a good chance that the employees are feeling it as well. The life of the employee – their aspirations and financial well being – are tied to the company as well, and they can recognize how a CEO is doing. It's not always a big surprise, but long overdue.

QUESTION: What do you do when an founding CEO is on their way out, but are still a majority stockholder, and wants a non-executive or board role?

Aiello: I purposely didn't want to over-think my role in the SAVO transition, Mark and I worked together to put that into the future. It's important that the incoming CEO take over the company without a pre-defined role for the outgoing person. What evolved for me was that I always had a good relationship with our customers, and when there was renewals, or difficult renewals, Mark employed me in this regard. Not surprisingly, we were intentional about that evolution, because it was his company to lead. We morphed into over time, it has to happen organically and collaboratively. The best practice is to wait and see after a six month period or so.

Heising: For the first month or so, it naturally becomes a 'co-CEO' situation, because the incoming CEO knows he's not going to know everything, and needed me to be his right hand throughout that process, to get the most out of the company.

Aiello: To be clear, it wasn't a 'co-CEO' in our case, it was Mark's company from day one, but it was important to understand what I was NOT to be doing, and that is what an incoming CEO can express on day one. It wasn't perfect, it was hard, and I'd give myself a 95 out of a 100 in the actual practice, but it had to be done.

QUESTION: Jim Macdonald, as a seasoned investor, any final remarks on this topic?

Macdonald: We've covered a lot of ground here, this is a key to a good investment and it is also a key to limiting the downside of a bad investment. It's a critical topic for everyone involved.

The next event will be the annual IVCA/NVCA Luncheon on May 2nd, 2012. Click here for more information.