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THE STONEWOOD PERSPECTIVE

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Enhancing Board Effectiveness in Hiring Get the Issues Right!

"At its most basic level, the board makes only three types of decisions – to invest, to hire the CEO and to fire the CEO". Russ Siegelman, Kleiner Perkins Caufield & Byers

While governance and fiduciary matters command a bigger share of their time and attention, the hiring of CEOs is among the most important, value-added responsibilities of Boards of Directors. It is also one exercised ever more frequently, with statistics showing that two-thirds of all venture-backed start-up companies replace their founding CEOs and of these replacements, two out of every five fail in the first 18 months.

StoneWood Group has supported many Boards of Directors in their executive recruiting efforts and has observed a range of factors that impact both positively and negatively on the outcomes. None matter more than getting the issues right at the outset, for if a board gets this wrong it will almost always get the search wrong.

When we speak of issues we refer to the people, technology, operational, competitive, market and financial variables which together paint a portrait of the here and now of an organization as well as its opportunity landscape looking forward. Boards must identify, weigh and rank the relative importance of each of these variables in order to understand an organization's current state and to set its short and long term priorities. Getting these issues right is critical as they drive the requirements for finding someone to lead the firm as well as the ensuing selection process to determine the best suited candidate.

Getting the issues right is systems level analysis and can be onerous for boards facing imperfect information, time constraints, quickly changing circumstances and at times divergent interests. But as we hope to show, undertaking the heavy lifting is absolutely crucial for if shortcuts are taken, issues missed, or their importance incorrectly assessed, the results can be disastrous.

Focusing on the future

"Predicting the future is easy. It's trying to figure out what's going on now that's hard"

Among the challenges facing every board of directors is balancing an organization's needs for today with those required to realize its tomorrow. Many boards prefer to dwell on the future, that shining light over the horizon where sales and profits soar, costs shrink, and shareholder value skyrockets. The past, on the other hand is just that, the past, and the present is but a stopping point, an uncomfortable one at times, on the path to the future. But if boards overly focus on the destination without carefully considering the starting point, they run the risk of underestimating the skills required to navigate the journey.

Consider the well-publicized example of Computer Associates. Rife with scandals, it was called "the most dysfunctional big corporation in America". In accepting CEO Sanjay Kumar's resignation in April, 2004, Computer Associates Chairman Lewis Ranieri said, "We will work hard to take the remedial steps necessary to put this entire matter behind us and set the company back on the path to its rightful future."

The strategy to find a replacement CEO was summarized afterwards by Chairman Ranieri, "We knew where we needed to go and I figured that I and my general counsel along with my compliance team could clean whatever needed to be cleaned in the organization before the new CEO arrived. We would do the hard stuff, be the sheriffs while the new CEO could focus on the strategy and software issues needed to get us where we wanted to go". In other words, as far as the Chairman was concerned, whatever plagued the current organization could be rooted out and cleansed before a new CEO arrived. Once 'disinfected' the organization would be a cultural and financial clean slate for the new CEO. With a brighter future fixed in their sights, the board specified the need for a high integrity, technically competent software executive with a track record in strategy and revenue growth.

The Board got what they wanted in Canadian John Swainson, a 26 year veteran of IBM who climbed to the position of Vice-President of Worldwide Sales. Mr. Swainson could even write code, a skill it was assumed would equip him to rejuvenate the company's technological roadmap. In announcing his hiring, the Chairman said, "He has just the right qualities. He knows software, he is credible, he is smart, and he is honest".

Fast forwarding two years, Mr. Swainson's performance was recently described by Fortune Magazine as 'bumbling' and 'lackluster'. While defending his efforts Mr. Swainson admitted, "I sort of perceived, perhaps a little bit naively, that I would spend only a small amount of time cleaning up the problems and a lot of time focused on growth and strategy. What I didn't anticipate at the time was that we hadn't yet done the first part of the job, which is clean up from the past".

While Mr. Swainson has been singularly indicted by the press for Computer Associates' slow turnaround, the board's collective finger prints are also all over the crime scene. By focusing on where they wanted the business to go and minimizing the company's present day 'dysfunctions' (such as a remarkably primitive IT infrastructure, a highly idiosyncratic founder culture and a host of systemic ills cultivated over 20 years under the previous management) the board underestimated the importance of organizational change experience in their evaluation of candidates. They also grossly misguided the CEO's expectations and priorities. Hired for his offensive talents, Mr. Swainson has never left his end of the ice.

A similar scenario plays out frequently in the start-up sector when boards skew the search criteria towards where they want the firm to be taken and ignore or diminish the issues that will need to be overcome for the firm to get there. It is assumed that a 'competent' executive will overcome whatever organizational, technical or financial problems are inherited, if any exist, en route to the more important task of propelling the organization forward. But surprises ambush and occasionally kill new hires, and by limiting the dialogue on the characteristics of the organization today, boards unwittingly set up incoming CEOs for nasty surprises which they may not be equipped to manage.

Recently I spoke to a candidate about a CEO search we were conducting. Our firm had been involved in his hiring several years ago into a troubled company seeking to be repositioned and sold. Having succeeded in this task he was looking for his next assignment. As we spoke about our current search, I noted that unlike our last involvement, this opportunity was a more attractive growth story unfettered by major turnaround concerns. Before I could finish the sentence however the candidate quipped, "Bob, if there is one thing I have learned in this game, it is that they are all turnarounds. You better expect that or you are dead".

An understanding of the present state is also critical for the many boards considering recruiting executives who will reside remote from head office. It has become a national obsession in Canada to lament the shortage of start-up CEOs, and to look longingly to the larger, more mature pool of US talent. But only some companies can tolerate a remote CEO and only certain CEOs can effectively manage a remote company. There are rules of thumb written with the blood of the many companies past and present who have gone down this path. They are all predicated on a deep understanding of the organization which a new CEO will inherit.

It should be acknowledged that the struggle which some boards have with the here and now of their organizations is perfectly understandable. The exiting CEO may have had a vested interest in distorting the current reality and may even have shielded the board from issues, people or inconvenient facts. Boards comprised largely of investors are often compromised by limited operational experience from which to assess the strengths and weaknesses of their organizations. Busy and frequently with the benefit of only quarterly board binders, many lack visibility and depth of understanding of the companies under their care.

Nonetheless, recruiting to a desired future state is a treacherous pursuit unless accompanied by a map of how one plans to get there. Such a map must start with a well marked, well-understood, "You Are Here".

The Quick Fix

"We've had the past, we may not have the future. Just worry about today."

Sometimes boards respond too much to the specific issues or problems of today at the expense of broader or longer term concerns. Consider the examples of the GAP and Home Depot. Under the leadership of brilliant entrepreneurial founders both organizations have grown to become global household brands. But as the two retailers expanded, issues of coordination, efficiency, process and managerial discipline increased in importance and for a period, both firms wavered. Facing impatient shareholders with short memories, the boards of both firms elected to replace their founders with leaders better schooled in managing complex multinational corporations.

When Paul Pressler was hired to manage the GAP retail chain in 2002 one article gushed, "The polished, good looking Disney veteran is a hard-nosed operations wizard, not a dreamy fashion junkie. He is just the man to restore discipline to the company". Meanwhile over at Home Depot, one business writer commented, "finally… folksy Home Depot desperately needs the no-nonsense, data-driven Bob Nardelli to whip it into shape."

As everyone by now knows, both executives were recently released from their respective firms. In reporting on Mr. Pressler's departure, BusinessWeek stated, "In the end, he was a numbers guy who didn't understand the longer-term drivers of the fashion business". Among the many post-mortems on Mr. Nardelli, one observer stated, "Nardelli gave the board what they wanted. He turned the faltering retail giant into an earnings juggernaut. But this is a retail operation not the military, and he never really understood the difference". Stated differently, Mr. Pressler created a highly efficient chain of stores filled with clothes no one wanted to buy while Mr. Nardelli had employee-less stores tuned like Swiss watches that no one enjoyed shopping in. Ultimately, neither executive balanced their obsession with process and efficiency with an understanding of the more nuanced art of long-term retailing excellence.

Start-up boards are also frequently obsessed with the present. Often dominated by investors driven by exit considerations, boards talk long term but think and act short term. If a firm is viewed to need sales they hire a sales-oriented CEO. If the products are stalled, they hire a technologist. And on and on it goes. But in the world of early stage companies success is a witch's brew of variables and boards err if they overly focus on the challenges of here and now.

Over a coffee recently, a respected investor recounted one such lesson he had learned over the past year. One of his investee companies had gone through an uneventful process of moving its technology from the lab through early market validation. The firm was ready to commercialize, and the Board made the decision to replace the highly technical entrepreneurial founder with a sales savvy CEO. They recruited an executive who had been the VP Sales and then COO of a company whose revenues had rapidly grown from $1mm to $20mm. Though the executive did not come from the same industry and had no previous CEO experience, he knew how to sell to similar markets, had early stage experience, had proven he could scale, was credible to potential investors, and seemed ready for the next step in his career.

On joining the firm, the new CEO pushed hard to take the company to the next level. He did what he did best, setting up direct and indirect sales channels. He handled large accounts personally and was extremely 'hands-on'. But the company stalled. When the board probed to understand the situation, the CEO indicated that the market was simply not responding to the firm's solutions. Though he continued to press, after a year of no progress the board grew frustrated and released the CEO.

Reflecting on the experience, the investor acknowledged that the board had erred in simplifying the leadership issues to executing revenue growth. The CEO's failure was not his inability to sell but rather his inability to re-vector the organization when signs of market rejection became clear. The investor now realized that the failed CEO had in his previous company been the execution-oriented COO under a highly entrepreneurial CEO. It was the CEO, not the COO, who had the ability to see opportunities that others could not and could move the business to those intersections. The board had not contemplated the portfolio of skills required of the CEO if sales failed to materialize and thus had not selected for those adaptive skills.

This scenario happens frequently when boards fire an existing CEO. In constructing their 'straw man' they often pick and choose attributes which eerily resemble the mirror opposite of the outgoing CEO. They focus on eliminating the flaws of the previous CEO without contemplating the full complement of attributes that will be needed for the organization's mid to long term success, including some of the more positive qualities of the departing CEO. Alleviating today's pain overwhelms and obscures the requirements for tomorrow's gain.

Struggling with the Issues

Hiring effectiveness is most compromised when start-up boards lose or lack visibility into the issues altogether.

We once did work for a well-known entrepreneur who leveraged a prior success into a large round of funding for his new semiconductor company. With considerable promise the firm embarked on an aggressive growth plan. But over the next 18 months leapfrogging technologies, unexpected product development hurdles and changing economics in the semiconductor sector conspired against the firm and left it floundering. Unable to secure additional financial support for his original vision, the founder shifted the firm into a subsystems company, anchored by its core technology. The firm then furiously pursued a myriad of horizontal and vertical markets, partnerships, and channel strategies. But with only modest traction to show for their efforts, and an increasingly frustrated founder, the board agreed that a change of leadership was in order. With funds depleting, the board agreed it needed 'a proven executive with domain expertise who can get up-to-speed quickly'.

Entrusted with the search, we struggled to understand the specifications. From which domain did the board want expertise, and what kind of experience did they seek? What issues did they perceive to be underlying the lack of traction? Did they want an individual skilled in building subsystems companies, someone deep in one of the more promising verticals targeted by the firm or a turnaround expert? While the board of directors had devoted considerable time to understanding the dynamics of the semiconductor market initially targeted by the firm, it struggled to keep abreast as the firm wandered from those roots. The board simply did not know what would be needed to make the firm successful.

This situation is not uncommon in entrepreneurial companies that float successive market or technological trial balloons in search of favorable trade winds or in firms whose exiting CEO has systematically shielded the board from important issues. But board uncertainty begets trouble such as when boards interpret poor revenue growth to issues of sales and marketing competence only to learn from the incoming CEO that he or she has, in fact, inherited major product issues.

Uncertainty robs the board of the ability to make informed decisions on the leadership attributes required to take the firm forward. It forces them to turn to 'rationalized myths' or assumptions about what to do, such as 'Fire the founder, hire an American'. These assumptions, and there are many, often share an underlying disconnect between perception and reality. Boards resort to casting a wide net for the prototypical 'savior' or the always popular 'good guy' and gamble that they will somehow know and agree upon the right candidate when they see him or her. Invariably the best looking candidate rather than the best candidate wins the contest.

Conclusion

"It's the hardest work we do, and people don't jump at the opportunity to do it." Heidi Roizen, Mobius Ventures

The pursuit of organizational success is a steep, treacherous climb up rugged terrain. Leadership is critical and there is no more important role for a board of directors than the selection and support of those leaders. But different terrains call for different leaders, and boards must know the topography and conditions they are dealing with when appointing leadership. Such knowledge goes beyond where the firm is today or the peak it strives to conquer. Instead, a board must strive for a "god's eye view" of the entire landscape and journey being taken.

There are no shortcuts in gaining such perspective. It takes work looking at the issues, the challenges, patterns, and tradeoffs in a complex system. While the board will never predict the unpredictable or 'plan out' the role that serendipity plays, it can develop an understanding of the forces that affect the firm today and shape its future. It can get the issues and themes right and in the process make far better hiring decisions.

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