

# Leadership succession in a private company

by Alan J. Kaplan



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Succession planning is one of the most important responsibilities of a Board of Directors and Chief Executive Officer. Private companies face particular challenges in this arena, given an often complex capital structure, family ownership, or a lack of liquid long-term management incentives. Today's greater emphasis on good governance clearly pertains to private companies, and Boards need to be more attentive and proactive in thinking about leadership succession than ever before.

Management changes often occur after a transition of ownership, particularly in an investor led transaction. While most private investors prefer to maintain management as part of a transaction (management buyout) versus losing much of the executive team (strategic sale or recapitalization), there are inevitably holes to fill on the organization chart at some point. Even if the key senior team remains after a deal is done, savvy investors begin planning early for succession in key roles, first and foremost in the CEO chair. The key to managing this process, and particularly CEO succession, lies in planning for it early, reviewing it often, and following these basic principles:

## 1. Look to the strategic plan first for guidance

Ideally, the firm's strategic goals and objectives are well established and regularly updated, providing a foundation for the kind of new leader best suited to take the organization to the next level. If the company lacks a true plan, the new CEO should drive development of the company's strategic plan in collaboration with the Board of Directors. In this case, it is still crucial for the Board to have some advance discussion around the issues of the strategic direction and potential end game--if one exists.

## 2. Develop a concrete profile of your ideal CEO

It is important to allow each Director to contribute to this effort, and you may want to involve the Human Resources Director at this stage, assuming the company has one. After compiling the "dream criteria" and sharing the conclusions with the full Board, it is imperative to prioritize the top five to seven criteria, in order of importance. It is nearly impossible to come to a timely decision on who to hire if everyone has a different view of what the ideal candidate looks like. Build consensus and stick to it.

## 3. Establish the candidate screening and evaluation process

Remember that candidate confidentiality is paramount. Develop a consistent method by which candidate credentials will be screened; potential candidates contacted; prospects interviewed and evaluated; how reference evaluations will be conducted; who negotiates an offer on behalf of the firm; and who will be the primary contact/liaison throughout the process. Don't limit yourself to prospective candidates who seek you out either. Be proactive in using your network to identify prospects, even if they have not made their interest known.

## 4. Consider using an executive search firm

If the Board or owners lack the time or ability to effectively manage all of these critical steps, it may make sense to invest in a high quality executive search firm. Good recruiters identify unknown candidates; provide counsel to the Board and investors throughout the search; negotiate a fair agreement; and manage the many moving parts of the search process. The best executive search consultants also possess deeper expertise assessing candidates and checking references, and will work with everyone to ensure a smooth transition into the new company.

## 5. Review any qualified internal candidates

This may seem foreign to some who presume that an outsider is the preferred way to go. However, there is mounting evidence that the high profile outside CEO is often less successful than a well-groomed internally developed candidate. (See "The Curse of the Superstar CEO, Harvard Business Review, September, 2002.) Even if you are not convinced that an internal contender is the right solution, the Board owes it to the organization and the individuals involved to seriously consider qualified insiders. This approach reflects positively on key investors as well.

## 6. Plan ahead for the interview

The actual candidate interview can be complex, and even intimidating. Structure the interview process in a way that both maximizes the information gained and entices worthy candidates to remain engaged in the process. This is another area where a good HR Director or consultant can be particularly useful. It is also beneficial to develop a basis for candidate evaluation after each interview. This provides a useful common framework, as well as a foundation for later ranking the contenders. Many private investors view talent assessment as a core competency, but few have developed a formal process for evaluating executives.

## 7. Focus on cultural fit early

Identify someone who is both qualified and who will mesh well with the company's culture. It is easy for Directors or investors to focus solely on candidate credentials and track record, ignoring the "fit" with the organization. But one does no good without the other, and more CEOs fail because of poor fit or integration with their new company than from incompetence. Search Committees often get starry-eyed over a big name or well-credentialed candidate, particularly one with a dynamic personality. What truly differentiates star candidates is the soft stuff: how they lead; their day-to-day management style; communication skills; personality traits; vision; and the like. These are the factors that make or break an executive's success in most cases.

## 8. Review executive compensation programs and alternatives

There are a multitude of private firm compensation programs, and many ways to align investor and executive goals. Cash compensation has become a more significant driver over the past several years, but seasoned executives still want some form of long term incentive as well. Stock options are only one means to this end, not an end in themselves, and there are many ways to skin this cat. Phantom stock plans or performance share units (see General Electric) accomplish many of the same objectives. Whatever your choices, establish compensation parameters up front.

## 9. Check references thoroughly

Make sure to have the proper candidate authorizations before proceeding. Referencing should involve a 360 degree process including not just peers, superiors and subordinates but also customers, advisors, former Directors, and even vendors. The more you learn about how this executive functions, the better able you will be to gauge their fit with the role and organization. Private firms often hire candidates that were known to an investor or Board Member, but such prior knowledge does not absolve Directors from conducting thorough candidate due diligence. Don't forget to verify credentials as well, including academic degrees and professional certifications. You would be amazed at how much exaggeration exists here!

Dealing with executive succession can be a challenge for even the most seasoned private investor, Director or CEO. Developing a practical process and managing it thoughtfully will help ensure the long term success of the company.

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