SpencerStuart

Transitioning from Founder-Led to Founder-Inspired

Best Practices for the Board

Where do we go from here?

The company launched with tremendous excitement, with clear promise and a highly focused vision. Now, as the company nears a potential IPO, excitement is dwindling as the organization's performance has decelerated and the prospects of growth are less clear. Could it be that the person who conceived the company, whose determination gave it life and sustained it when few others believed may be unable to take the business to the next level? Have the requirements for the job outgrown the founder's capabilities or motivations?

Our decades of research on CEO performance, most recently our work on performance decline and the CEO Life Cycle, demonstrate the risk of board complacency. The longer the board waits to act when a CEO is struggling, the greater the risk that the organization will be unable to recover. Moving quickly to assess the challenges, align with the CEO on the vision and time frame, and reduce the risks of the CEO's limitations can be the solution in many cases. Interventions can include enhancing board and top team effectiveness, providing coaching or other leadership advisers to the CEO, and/or augmenting the top team to address experience or skill gaps.

A board may conclude that the limitations of the founder/CEO are too great, and a new CEO is needed to take the company to the next level. The decision to replace the founder/CEO must be made well before the need becomes grossly apparent. "The point at which a founder/CEO actually volunteers to step down is almost always six months after the optimal time for replacement," says a prominent investor. Research of public companies shows that when performance is declining steeply,[1] boards that move faster to replace the CEO greatly improve the chances for positive recovery.

[1] Steep decline defined as companies performing on average at -20% to -100% BHAR.

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There are three common scenarios we see in early-stage companies:

- **The engineering standout.** The technical founder has skillfully transformed the back-of-an-envelope concept into successful alpha beta prototype. But when it's time to turn an R&D outfit, even one with early customer momentum, into a real, product-producing company that can generate repeatable revenue, the founder/CEO's limited skill set and commensurately narrow focus become more and more apparent. At this point, the company may need a market-oriented CEO to take the business to the next level.

- **The charismatic charmer.** The founder/CEO's charismatic personality lured investors to support the venture. But, as the founder confronts the mundane tasks and details required to scale and sustain the business, the beacon that once illuminated and energized begins to look more like a laser that blinded everyone. Investors see that the founder's interests and capabilities were focused on the pitch — on the deal, but not on the details.

- **The breakout.** Founded by a single entrepreneur or, in many cases, a pair of entrepreneurs with complementary skills, the company appears to be stalling out. The growth curve has flattened, and the founders seem unable to redirect the trajectory. Despite some talent in functional areas, the issue is not individual functional leaders but the core metronome or rhythm of management — from developing people to getting the top team in sync.

Of course, there are many other scenarios and early warning signs that the founder/CEO may be in a situation beyond his or her ability or desire to lead and manage. Sometimes, the founding CEO is simply burnt out, has vested majority of stock and wants to transition to a more balanced lifestyle. Warning signs include:

- Lack of financial discipline and an inability to get the burn rate under control; financial surprises are routine
- Nonexistent planning, policies and procedures even as the company scales
- Regularly missed projections
- Lack of a strong, scalable team — a team with either too little relevant experience or without the ability to downshift for the company's needs and scale
- Friction among executives, lack of productive executive meetings, executives being sidelined in decisions and key executives departing or considering new roles regularly; two-tier leadership teams
- Unwillingness to dive into detailed metrics and data

The executive leadership team often has early insights into a founder/CEO's struggles. They may be frustrated by silos, lack of acceptance of new ideas, willingness to adopt all new ideas, or operating problems that reflect difficulty scaling. Executives may lament an important leadership decision being changed without explanation after a weekend where the founder is hanging out with an adviser or a friend on the leadership team in a social setting or paging through the latest business book.

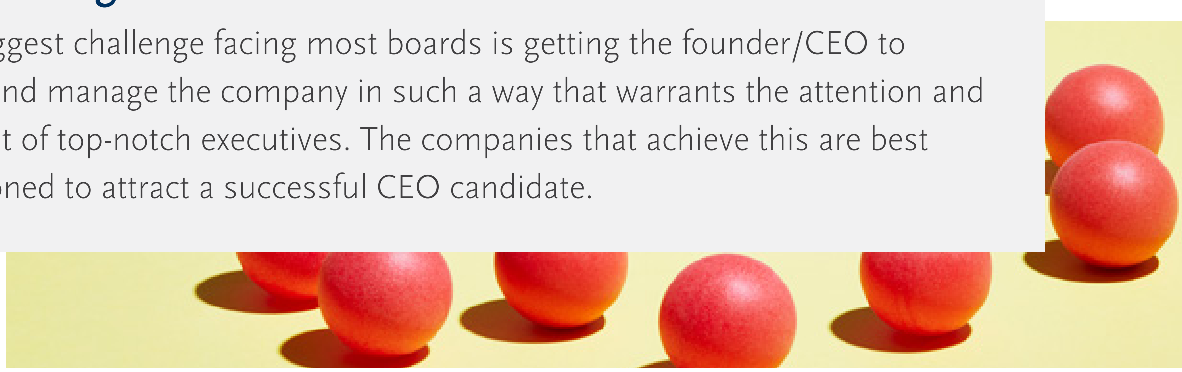
The board can spot these early warning signs by staying close to management through committee work, by mentoring key executives and by asking questions during board dinners and social events. One best practice is board-directed CEO 360s, where board members play a role interviewing direct reports. This helps directors gain a more holistic picture of performance and gaps. Seasoned directors also meet with investors (non-board involved) for their unfiltered views and ensure the board has aligned on what constitutes good performance versus poor performance. Getting access to employee engagement surveys and diagnostic material directly versus a synthesis by management can also provide a window into the company.

Just because a company manifests some of these characteristics does not necessarily mean the responsibility falls solely on the founder/CEO or that changing leaders is the only answer. In some cases, it may be extremely difficult to ascertain the root cause. However, if the company presents the symptoms noted and the CEO possesses some of traits listed below, it is possible that the founder/CEO may need an intervention. These include founder/CEOs who:

- Have never had to scale their leadership
- Cannot balance process and content
- Do not value specific experience in areas like marketing, finance or HR
- Are unable or unwilling to make difficult decisions or change decisions frequently
- Have poorly developed financial skills; dislike discussing operating data versus vision
- Cannot let go of early strategies that seem to be failing
- Are not hungry to be better at leading; don't seek to develop their own management skills
- Are unwilling to invest time in leadership development, including their own succession planning
- Make "lone ranger" or one-off influenced decisions, usually without team buy-in
- Seem to recast or ignore signals that call into question their plans; disinterested in management and focus entirely on PR and external issues

The timing conundrum

The biggest challenge facing most boards is getting the founder/CEO to grow and manage the company in such a way that warrants the attention and interest of top-notch executives. The companies that achieve this are best positioned to attract a successful CEO candidate.



There are examples of successful founder/CEOs who exhibit most or all of these traits, and the context matters. People do change and grow, and interventions — from coaching to augmenting the team — can resolve the issues. Some boards may suggest a CEO coach to work with the founding CEO to help build capabilities and overcome blindspots. But founders with many of these traits may suffer from what we call "founderitis." The symptoms of founderitis differ depending on the company's stage of development, but left untreated, founderitis can be disastrous. As a partner of one venture firm advised, "In some cases, a founder's negative impact can outweigh the good. It's the board's job to determine that pivotal point." As another investor shared, "Most startups still fail and many of the founders who are successful in some previous company have never failed before."

Gaining the founder's support with transparency, gratitude

From the investors' point of view, the primary cure for founderitis is to recruit a successor to the founder as CEO who is capable of leading the venture to the next level — someone who knows the industry and understands the market potential. Delivering the board's decision to the founder/CEO is certainly one of the most difficult aspects of a transition and must be handled with the greatest care. The director closest to the founder/CEO, often someone viewed as a mentor, ideally will deliver the news, preceded by generous acknowledgement for all that the founder has achieved to get the company to this point. Hearing the news from a trusted ally can make the message more palatable and can create the conditions in which the founder can then be enlisted to assist in the transition.

"The biggest risk is time — the time it takes to recruit a new CEO and team while also working with and coaching the existing team."

This non-confrontational, transparent approach does not mean the board should take a leisurely approach to the actual transition. "The biggest risk is time — the time it takes to recruit a new CEO and team while also working with and coaching the existing team," advises the general partner of one venture firm. But the open, upfront approach makes it possible to keep the founder/CEO and his or her team in place while the search is conducted. Assuming the founder is "coachable" (and that there is someone on the board with the time and relevant experience to the task), this option creates an opportunity to halt the downward spiral and improve performance, while a longer-term CEO succession solution can be considered.

Some boards may be tempted to cloak the replacement process in secrecy. Confidential searches that take place behind the founder's back usually backfire. The founder will inevitably learn about the plan and is likely to be angry at the betrayal and, potentially, openly hostile. This environment will negatively impact the quality of chief executive candidate pool: Who would want the job under such circumstances?

Other boards attempt to dodge the issue of removing the founder by launching a search for a chief operating officer. Many of these are CEO searches in disguise. Top candidates may be given the confidential message, "Come aboard as COO, and we'll make you CEO within six months." There are many problems with this approach. First, no one is fooled, least of all the sitting CEO. Second, the vast majority of executives who do come aboard as CEOs-in-waiting never move into the top spot because board members soon recognize that the heir apparent (hamstrung and unable to lead) isn't the CEO material they were looking for. And third, candidates who agree to go along with the CEO-in-waiting plan almost certainly have less potential. Great CEO candidates only consider great CEO positions.

Finally, the CEO search should be launched before any major overhaul of the senior management team. Experienced investors advise never to build a world-class team around a weak founder/CEO.

Launching the search: six best practices

Once the decision has been made to go forward with a post-founder CEO search, our best practice model suggests the following approach.

1. Develop the right CEO profile

In the case of a founder/CEO transition, it is especially critical to define upfront the type of leader needed. It's completely inadequate for a board to say, as some do, "We'll know it when we see it." For boards that have built discussions about CEO succession into their regular agenda, this step is easier.

Board members should build consensus on a CEO profile through iterative rounds of discussion about the company's current and future needs. As they do this, the priority skill sets, leadership characteristics and requisite credentials for the next CEO will become self-evident. This process should consider strategic issues, such as whether the board wants the next CEO to recruit a new senior management team or work with the team in place, and whether the culture needs to shift. Ideally, directors define the leadership mix that will serve the company for the next five-plus years. Great boards treat this as a living document and revise the profile as they meet candidates and learn about the market.

Some important requirements include the ability to recruit, motivate and retain key senior executives, a track record building performance-oriented cultures and experience with planning, budgeting and financial management. Research has shown that the critical leadership capabilities are strategic thinking, driving results, leading change, leading people, collaborating and influencing, and building people capability. The most successful founder/CEO successors also are outstanding judges of character, have a strong personal drive and are highly credible with customers, investors, employees and management. Beware the common biases. While some directors look for a new CEO who embodies everything the founder was not; others may be biased in favor of profiles that are nearly identical to the founder out of an underlying fear of too much change. Others have a bias in favor of previous CEO experience — something which is rarely a sure-fire path to success.

Keep in mind that the founder/CEO may have already hired an executive as a possible or promised successor. The board should determine early how to handle internal succession candidates and manage executive team dynamics. This may include assessing the top team to get a sense of their individual capabilities and potential, which can be done as a development exercise rather than a succession initiative. Assessments also reveal unique and complementary capabilities of team members, as well as the team's internal dynamics, all of which provide important context for future succession decisions.

2. Enlist support

A smooth transition requires the support of the board, founder, members of the management team and the company's employees — ideally in that order. Open and sensitive, yet diplomatic communication and consensus-building are vital for enlisting support, particularly of the founder. Some steps to take:

- Select a board member highly trusted by the founder to highlight the founder's tremendous strengths and contributions to date.
- Emphasize the company's needs for a different kind of leadership.
- Make it clear that strong internal teaming is needed to achieve the company's next milestone and keep it growing — even if changes are needed.

Gaining the support of the founder/CEO on the need for new leadership — while not an absolute prerequisite — is enormously beneficial. The transition will be less disruptive, and senior management will be more likely to accept the new CEO and stay put. Many venture capitalists argue that the relationship between the founder and the new CEO is the critical success factor. "The ideal scenario is to recruit a professional CEO with the intelligence, confidence and interpersonal skills to work alongside a founder — minimizing the negative and extracting the positive," one VC tells us.

3. Help the founder find a new role

Once a commitment is made to hire a new CEO, establishing a clear-cut role for the founder is vital. That role will, of course, depend on the founder/CEO's core strengths. A technical founder may be a natural chief technology officer. A sales and marketing star can be tapped to pursue strategic deals as head of business development. A highly intellectual founder, someone long on vision but short on management skills, could make an ideal head of strategy. Another option is to ask the founder to serve as chair and use his or her reputation to the company's benefit without having to fulfill an operating role. Sometimes a founder's new role is outside the company pursuing personal or philanthropic goals or establishing a new startup. A healthy relationship between the founder and successor CEO is especially critical if the founder is moving into the role of executive chairman. Data shows that founder executive chairs stand a better chance than non-founder executive chairs at success in the role (when done correctly).

When deciding on a new role for the founder, keep in mind that the data shows that companies have poorer performance (three-year post-transition TSR) when founders depart and return to the CEO role compared to those who permanently transition out of the role. Directors should ensure that the founder is prepared to commit fully to his or her new role to avoid a situation in which the founder has hopes (no matter how slight) of eventually returning to center stage.

In some situations, the founder/CEO's title should be replaced before commencing the search. This will help potential CEO candidates visualize themselves in the job, because filling an open position is far more comfortable and attractive than actively dislodging someone else. If this is not possible, then placing the word "acting" in front of the incumbent's title may serve the same purpose and prevent confusion about whether the CEO's chair is vacant or not.

4. Make the search priority-one

Board members need to organize for and prioritize the CEO search. Be clear about which directors or standby committee will take the lead.

The search will be more efficient if one board member is assigned to lead the search. This board member must make time for interviews, travel to meet candidates, calibrate and refine the search requirements, and maintain clear and constant communication with the search consultant, candidates and other board members.

Typically, the board will consider any internal succession candidates at the same time as external options. This approach enables the board to make a decision with more information and increases the odds of retaining the internal candidate as a key executive if desired.

5. Choose a closer

Reaching consensus, selecting the finalist and closing the deal with that individual may not be easy. Since most prime candidates require some eleventh-hour persuasion, it's important to prepare a contingency plan. Know which board member has the most industry clout or name recognition that will help excite a candidate about the opportunity.

Identify your best "closer" — someone who can convince a dream candidate to accept the position. Once the best candidate has been identified, have your closer on alert, ready to seal the deal.

6. Monitor the transition period. And stay close to the new CEO

A smooth handover improves the new executive's likelihood of success, which can influence the company's performance for years to come. The board can support the transition in several ways.

First, everyone will want to know how the new CEO will be different from the founder. The board should communicate the new CEO's style, strengths and relevant experience to all stakeholders. Tell them why this person was chosen and do so with passion and conviction.

The board also needs to give the new CEO explicit permission to move slowly, focusing first on executing the current strategy and building relationships at all levels of the organization. Otherwise, CEOs may feel pressure to differentiate themselves out of the gate, rather than spending the necessary time understanding the culture and assessing legacy talent. The transition plan should focus on shifting the company culture from founder-led to founder-inspired to preserve what is best about the company while preparing for new growth and scale.

The new CEO's transition also should include real mentoring. The board must encourage two-way, honest communication between the founder and the incoming CEO on all relevant business issues. Appointing a lead independent director or external adviser who can act as a "referee" between the new CEO and founder can be one useful tactic. The board also should make it crystal clear that the new CEO has its full support and that all decision-making authority has passed from the founder to the new CEO.

Finally, the board also plays an important role in helping the new CEO deal with "surprises," which are inevitable. These may include a less-than-stellar balance sheet, the imminent departure of key senior team members or significant delays in product development.

Conclusion

When the performance of a founder-led company begins to decline, boards need to act. Assessing the challenges, aligning with the founder/CEO on the vision for the business and the timeline, and supporting the founder/CEO through interventions such as board and top team effectiveness work can help change the trajectory. For some companies, boards may need to replace the founder/CEO with an executive able to lead the company to its next phase. This process should be handled sensitively and diplomatically, engaging the founder in building the right leadership team for the future of the business. Lastly, it is worth noting that much of this advice holds true when things are going well for an organization and/or when a founder is making the choice themselves that it is time to move on.

About Spencer Stuart

At Spencer Stuart, we know that leadership has never mattered more. We are trusted by organizations around the world to help them make the senior-level leadership decisions that have a lasting impact on their enterprises, on their stakeholders and the world around them. Through our executive search, board and leadership advisory services, we help build and enhance high-performing teams for select clients ranging from major multinationals to emerging companies to nonprofit institutions.

Privately held since 1956, we focus on delivering knowledge, insight and results through the collaborative efforts of a team of experts — now spanning more than 70 offices, over 30 countries and more than 50 practice specialties. Boards and leaders consistently turn to Spencer Stuart to help address their evolving leadership needs in areas such as senior-level executive search, board recruitment, board effectiveness, succession planning, in-depth senior management assessment, employee engagement and many other facets of culture and organizational effectiveness, particularly in the context of the changing stakeholder expectations of business today. For more information on Spencer Stuart, please visit **www.spencerstuart.com**.

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