Succession Planning in Private Companies

Slow-Motion Train Wreck

By Jim Johnston

I've chosen succession planning and hiring as a topic. It's certainly a topic CFOs and HR execs care about, and one that they cannot afford to ignore. What I've found is that CFOs are actually in a good position to observe the slow-motion train wreck caused by poor succession management and bad hiring. Some of the train wrecks I have seen arose:

- From delay in replacing an ineffective key executive, sometimes a delay of years.
- From hiring an executive who fit the past needs of the business, not the future, or who fit the wrong future.
- From selecting from a tiny pool of candidates. Usually it was tiny because it was limited to people who were loyal and familiar, or who just happened to be on the radar at the moment.
- Or, from launching a person into a key job without a clear understanding of what he or she had to deliver.

These are mistakes you've also probably seen over, and over, and over. These mistakes in succession and hiring *predictably* trap a business below its potential. Sometimes these mistakes are disastrous. This article is designed to prepare you to recognize these problems and do something about them.

Let's begin to do this by recognizing that each time your company fills a spot on the senior team, it is a moment of creation, a moment for *creating* the future of your company. If the moment is wasted, it's like wasting a move in a chess game. That's a big deal.

When I was a kid I knew a man who was a very good chess player. I asked him, "So, how good are you?" "Well, Jim," he said, "there are people in the world who can beat me, but I can beat absolutely anyone who puts two moves to waste."

From your CFO vantage point, do you see your company wasting its moves when it comes to designing the senior roles and filling them? This is worth pondering, I promise you. I encourage you to take an interest and be involved in succession and hiring across the company. I want you to have a broad impact.

Last year in my talk at the CFO Playbook conference, I said the CFO is the executive who can look across all aspects of the business in an integrated way. The other executives—finance, marketing, operations, sales, and engineering—are in functional silos. We owe it to our companies to think broadly. We owe it to ourselves.

Sum of the Hires

If you think broadly about your business and its future, you might see it through several lenses: as the sum of your products now and in the future, or as a function of your customers and markets, or your production capacity, or your intellectual property. All these are useful, broadening views. But today I want you to look at your business through a different lens. I want you to see it as the sum of the choices made in filling the senior leadership team: the CEO, the CFO, the VPs of marketing, operations, sales, engineering, and so forth.

The mantra today is this: "My company is the sum of the senior executives we have chosen. Our future depends on these executives and their successors."

The impact these people make drives all else—the products, the customers, the technology, everything. So then let's ask, where do senior executives come from? What is the process that leads to having the senior executives you have? It comes down to a five-step process: "Diagnose, Design, Search, Select, and Launch."

First we **Diagnose** the need, or the opportunity, to make a hire. This could arise from a retirement, a resignation, or a firing. More likely, though, it arises from changes in the business itself.

Then, we **Design** the role we're going to fill. We ask, "What must the person in this role deliver in order to take the business into the future?"

First, of course, decide what that future is. By working this question, you are beginning to create that future, even before you hire anyone.

Years ago I had an experience that taught me this. I was hired to do a CFO search for a company that didn't exist yet—it was to be a roll up of five independent mattress manufacturers.

Fortunately, I decided to talk to each of the five presidents carefully about their combined future. I also talked with the investment banker who was orchestrating this deal. I found they actually had many different views of what path the rolled-up company would follow. They didn't agree on centralized vs. decentralized [a] purchasing, [b] or accounting, or [c] production scheduling, for instance. They didn't agree on financing strategy or exit. So they also, necessarily, had many different and conflicting ideas of the CFO role. If I had begun by talking to candidates, it would have been a big mistake. Each different future path required a different kind of CFO.

This isn't unique to brand-new companies. I've come to think that all companies, not just a newly created one, face forks in the road and several possible paths to the future. **I think of every senior hire as a strategic moment to choose a future and <u>then</u> do the right search.**

Search: In an already-established company, that search can be among candidates from inside the company *and* outside the company.

Select: Selection is about narrowing the pool several times, and choosing a final candidate.

Launch: Finally, the new executive launches into the work.

Today I want to hit all five of these steps, but especially the first two: Diagnosing and Designing. These are generally neglected. I want to open your eyes to how much difference they make. I'm opinionated on this. You may not agree with what I'm going to say, but I promise to give you a lot to think about and remember.

Change and Growth

Diagnosis and Design happen in a context of *change* and *growth*. Businesses change and grow. People change and grow. Sometimes the business takes the lead, and the business requirements stretch the people. You've had these stretching experiences. I know I have.

There was the time in my mid 20s when my boss asked me, late one afternoon, to convert a five-year financial projection from constant dollars to inflated dollars, and to add leverage, and then recalculate the cash flows.

I said, "OK, I'll do that." What else was I going to say? After all, I was a University of Chicago MBA. I was in a silent panic. I had never done this before. I watched everyone else go home for the night and then I was alone. I stayed late into the night and I figured out how to do it, deriving it from first principles. That experience stretched me.

Other times, though, the stretching goes the other way: *people* take the lead, and make the *business* stretch. At the senior executive level, this is really the way we *must* think about it—the *people* do the driving and the business gets stretched. The leaders create. The leaders drive. The leaders lead. Bill Gates did that at Microsoft. For 30 years, the man pulled the business into its future. At each stage, Gates was out in front of his business enough that he could lead the business to the next level.

But having decades of such a close match between leader and the needs of the business is rare, especially in an industry with a lot of change. Usually, in CEO and VP roles, either the person outgrows the business or the business outgrows the person, and a mismatch develops.

If you see where I'm headed with this, your thoughts right now are going to your own business and the mismatches in the management team. In a minute we'll dig into this more, and we'll develop a diagnostic tool.

I learned a great lesson on change and growth from Len Halio—he founded and led a venture-backed software company in Massachusetts. He told me of the day when he sat down with his initial team around a table. He said to them, "We're starting a business. We want it to grow and grow some more. In time it will likely *out*grow each one of us in the roles we have at the start. Let's not be surprised or flustered when this happens. After all, a business that outgrows us is what we want, isn't it?"

So you have the Bill Gates scenario on the one hand, and the Len Halio scenario on the other. In one, the person and the business just keep rising, in sync. In the other, the business keeps arcing upward, but the person plateaus. A replacement person must come in who can keep leading the business upward.

Len found that indeed, his business outgrew the starting team, each role in turn. As that happened, Len brought in new people. Sometimes the incumbent stayed and reported to the new person, sometimes the incumbent left. Finally, the business was acquired and Len himself was outgrown, and he left. He saw this as a great success. Len is a wise man.

Introspection

Now, let's do some introspection. Please think back to the day when you started in your current job. On that day, how was the match between you and the role?

Scenario A: you were bigger than the job at the start. Since that day, you've driven and dragged your company to new heights. This means you were a *very good hire* for your company. You've had an impact.

Scenario B: you started off being smaller than the job, but you've grown into it. This means taking the job was a *good move* for your career growth.

Scenario C is a problem: you were smaller than the job and you still are. The gap is substantial. Maybe you're growing, but the gap remains.

Scenario D: you were a close fit when you started, but a gap has opened up since. Now, you're bigger than your job. Maybe you've grown faster than the job, or maybe the company is decaying. If this scenario describes you, you are probably wanting to bail out.

Does one of these fit you? Or, maybe there's a variation on these that fits you better.

Let's look at Scenario C again. If this does describe you, you are in trouble. If this describes your company's whole senior team, the *company* is in trouble, big trouble—especially if it describes you, the CEO. **If most of the key people have plateaued, it is impossible for the company's arc to keep rising.**

In senior roles, merely keeping up with the business *is not enough.* Bill Gates didn't just keep up with Microsoft for 30 years—he led the company into its future every step of the way. Your team has to do the same, and it probably won't be the same people for 30 years!

Rick Walters

Rick Walters made this come alive for me recently. Rick is an entrepreneurial CEO who built a prepared chilled food company from $1M in revenue to $45M, in seven years, with strong profitability. I recruited Rick recently to the board of directors of a food company I advise, where we want him to help us have similar success.

Rick told me that during those 7 years he changed out his management team 3 times. He had to do it to keep stretching the business to its potential. At the beginning he had no way to attract the people he ultimately would need, so he had to go in stages, and watch for symptoms of mismatch.

Diagnose Symptoms

Let's think about the symptoms of a mismatch, or gap, like Scenario C.

Avoidance, Denial, Delay. The top symptom of a gap is avoidance. Practicing avoidance is a coping strategy for staying inside your comfort zone while your world is crashing down all around you.

Here's an illustration. I worked with a Sales VP who managed a sales force of 8. He knew his people were inadequate and unskilled—he said so himself during his first month in the VP job. But over time he got sucked in, and eventually decided we couldn't do any better. He adapted to the status quo. This guy wanted to be liked. He delayed confronting people. He would deny any and all evidence in order to escape having to fire someone. This avoidance got painful. In every board meeting for a couple of years, we discussed our underperforming sales force and our paralyzed Sales VP.

That VP never did face the problem. The CEO, who had some avoidance issues himself, and had originally hired the sales force, finally faced the problem for him and revamped the sales force. He also demoted the VP to national accounts manager. Then, instead of a sales VP in denial, we had a very good national accounts sales manager. That role suited him. The company surged ahead, no longer limited by the VP.

The next symptom of a gap is failure to delegate. Building a team and delegating to them is crucial. Watch out for the executive who's always overworked, always has his head down, and is lost in the weeds. Among CEOs, this is probably the most common symptom of being in over our heads.

Once a CEO engaged me to assess the performance of his CFO. This CEO was frustrated with the CFO, and at the same time the CFO was insisting on a big pay increase. What I found was this: that CFO was completely buried all the time in controller work. It was by design. He intentionally had a weak team, the highest paid of whom earned 1/3 the CFO's pay. This CFO was candid with me: he explained that he was afraid a more competent staff would make him redundant. Meanwhile, month after month, year after year, this CFO neglected the crucial issues that were his true province—issues his boss was desperate to address.

The next symptom is being always reactive, never proactive. In senior positions, it's not enough just to react to what lands on your desk—after all, that stuff comes from the past and present of the business. To build a future, an executive must go actively looking for it. This is true in every senior role.

What's perhaps the most obvious symptom is the executive who has just checked out—is not there. Perhaps was very capable, but has become non-responsive, absent physically or mentally, or is distracted, disabled, or in decline.

When these symptoms are cropping up in one, or several, of your company's key roles, you are going to see *consequences* in the business as a whole. Competitors will pass you by. You'll fail to enter growing markets and ride shrinking markets downward. While technology and methods move on, you'll remain stuck. Your best people at all levels will start to bail out. They know the score. Ouch.

Ignoring these symptoms is disastrous. Are they debits and credits? No. Are they balance sheet ratios or profit margins? No.

Think about it: these symptoms *are* about facing reality, asking tough questions, assessing performance, considering alternatives, and coming to objective conclusions. In other words, they require exactly the strengths a CEO has in more abundance than any other executive.

Let's begin facing some of your reality right now. Consider each senior exec in your organization, including yourself. For each symptom, give a letter grade, as I have illustrated here for the Sales exec. Then sum it up with an assessment of the overall gap for each exec, from minus 3 to plus 3, between the person and the requirements of the role. "Plus" means the person is bigger than the job. "Minus" means the person is outgrown.

Design

If you do this exercise and see severe symptoms piling up, it's time to act, and time for you to get your colleagues to act. **If you diagnose a mismatch, and then stop, you trap the business in a box the size of your current team's talent.**

I want to make an important point: confronting mismatches is very important, but it's *not always* about getting rid of people. Confronting people with requirements they are not meeting, and asking them to grow and change, can work wonderfully well. And in reality, I think developing people in this way is the higher calling. But today I'm focusing on succession and hiring.

I've been living with this term "succession planning" for months as I've prepared this talk, and I am a little uncomfortable with the term. It implies that you have an organized approach, and great foresight, well-groomed internal candidates, and a timeline, like General Electric does for its high-profile CEO succession.

Succession planning is a very big-company concept. It brings to mind the image of a cruise ship going back and forth year after year, seamlessly, smoothly, replacing the executive chef from time to time, or the captain, on a schedule.

But I doubt that's how it works in your business. My guess is that the ship that is *your* business frequently morphs—from rowboat to canoe to ferry to hydrofoil, to aircraft carrier, and perhaps reverts back again. And I imagine your world feels more like wartime than a pleasure cruise. And sometimes, in the ship that is *your* business, you have to break up the furniture and burn it for fuel in order to make port.

Whatever type of ship image fits your business, I think you'll find, in nearly all cases, that when these symptoms arise, it's going to be unexpected in some way, and your company has to scramble. When this time comes, it's time to move from diagnosing to designing.

Design has four steps. It's common to jump to the last step, but I want to show you a better way. Step A is to see and describe the company as it is today. What markets are we in, what products do we make, what's our ownership structure, our org chart, our locations, our business model? What is our history? What values and culture do we have?

It's important to understand all this because we have to hire people who can function in the company as it is today. But, if dealing with today were all you needed, you could probably limp along without doing the hire at all.

Step B. It's the desired *future* that will really determine which candidates you should search for. This is asking the question, "Where is the business going?" Actually, that is a trick question. Your company is going *nowhere* under its own power. The right way to put this question is, **"Where are we going to *take* our business?"**

Asking it this way is a different mindset that recognizes that individual people's choices have crucial impact. Some people think the trajectories of companies—and countries—are determined only by large forces, not by the impact of individuals.

I live in Lexington, Massachusetts. My house is three tenths of a mile from the Lexington Green. This is where the American Revolutionary War began on April 19, 1775. Each year in our town we re-enact the Battle of Lexington.

Yes, there were geopolitical forces at work at the birth of our country. But reading David Hackett Fischer's wonderful book, *Paul Revere's Ride,* convinces me that the story of April 19th was contingent, not determined. It depended on individual people's actions. If Paul Revere hadn't ridden out from Boston, the Lexington Minute Company would not have lined up on the Green. The shot heard round the world would not have been fired.

In our businesses, yes big forces are at work, but the crucial turning points are contingent. We must hire people who will make a difference, the right difference. They and no one else will create the future. **If we don't hire for the future, our ship will just keep sailing back and forth, back and forth, with a gradually aging and shrinking complement of passengers.** What the role has to deliver, in order to create the future company.

There is a link that gets us from today to the future. I call this link "What's It Going to Take?" Before we start writing job postings or interviewing candidates, we want to figure out what the business requires from the role we're filling. Really, we're talking about what *two different* businesses require: the business of today, and the business of the future.

The usual approach is to define what it's going to take in terms of tasks to be performed. It's shallow and backward-looking to think in terms of tasks. It's powerful to think in terms of *results*.

Here's an example of a task-oriented quote from a Sales VP job description: "Conduct annual sales meetings of the sales force." This is a task. Here's a better quote, more of a result: "Evangelize the indirect channels so they will accept new product launches enthusiastically." This is not very measurable—a bit squishy. Here's a measurable result: "By 2015, the Sales VP will grow the sales force headcount by 25% and the sales per person by 20%."

Here's another one: "During 2013, the Sales VP will reduce our average payments to brokers from 4.5% of sales to 3.8%, in line with the average of our peers." These are results, measurable ones.

Why is a results orientation best? It's an efficient way to help candidates self-select in or out of your pool. Many who are scared of the results you require will stay away. The ones who can deliver will be drawn to you.

Later, as you assess the pool, as you study the resumes, you can ask yourself whether they actually have delivered similar results in the past.

Later still, when you get to interviews, you can ask candidates to tell you stories about delivering results like you need. **If you've described the results, and *they* know they can deliver those results, they'll figure out a way to tell you so.**

Skills, Accomplishments, and Traits

Now we come to the last step of design: choosing the skills, accomplishments, and traits we seek. It's so tempting to do this too soon, before you get clarity on today's situation, the future situation, and the needed results. Resist that temptation!! All of us have read bland, interchangeable, generic job postings that result from jumping directly to this last step.

This step has three very carefully chosen words:

Skills are typically the most open to expansion as we go through life. Missing skills can often be learned. Written responses and work samples are good indicators of skills.

Accomplishments (or experience) take more time to obtain. Stories are the best way to discover candidates' true accomplishments.

And finally, **T**raits. Personality traits very seldom change. The best way to discover them is in face-to-face interviews, and through reference checking. Really, we should not select people for senior positions based primarily on skills. In a CFO Playbook conference survey, the #1 leading source of hiring failure, mentioned by 60% of respondents was, "The winning candidate turned out to have different skills and traits than was thought at the time of selection."

When it comes to both skills and traits, it's fairly easy to be deceived. How many people have you seen hired whose main skill was interviewing well? Besides, we don't *care* primarily about traits, and even less about skills. We care about results.

If we've truly identified the results we want, and the candidate can deliver those results in a setting like ours, almost by definition he or she has the skills and traits we want.

Search

OK, we've diagnosed and we've designed. We're ready to search. You'll notice I'm most of the way through writing this, and I'm only now looking for candidates. I can just hear you thinking, "Slow! Wasteful! Overcomplicated!" It's true, we have put a lot of effort into figuring out what we're want *before* we start to look.

It turns out there are two approaches: there's Searching and there's Browsing.

<u>Search</u> is when you actually know what you are looking for and why, and you've decided how you'll recognize it when you see it. This is what you are ready to do if you have diagnosed and designed carefully.

Browse is when you just start looking, without knowing what you want. You look at many kinds of candidates, you learn and change your mind as you go, you are opportunistic.

I saw this up close up when I tried to advise a food company that was doing a search. Well, we called it a search, but it was really more of a "browse." The board and the founder/CEO just started talking with candidates. They thought they might hire a CFO, or a COO, or a president. And for *each* of those three titles, they had several possible profiles in mind.

They talked with candidates making salaries from $100,000 to $400,000. Some had CFO backgrounds in food companies about our size, but one was the COO of a non-food company and it was 50 times our size. There were many other candidates scattered in between.

Why was this? The board and the CEO couldn't decide what they wanted, actually, they couldn't agree with each other, and so they browsed, hoping that seeing the candidates would somehow unify them around a single direction for the company and the job. That search took a year and was very distracting and contentious.

In another case I participated in, initial discord between the CEO and the board was entirely healed, and this healing and consensus occurred precisely during the *design* phase of hiring a new CFO, before we ever talked with a candidate. Consensus about the company's future and the search came not just *during* the design phase, but *because* of the design phase.

You are looking at the bison and wondering, "What does the bison have to do with it? I'm getting to that. Think of search and browse being like hunting and gathering. Hunting and browsing were primitive roles, when hunters worked purposefully over a big area to hunt down a large animal, while gatherers stayed close to home and gathered what presented itself.

For finding senior executives, the Search method is preferable *if you can figure out beforehand what you want*. It lowers risk. It leads the board and management to reach consensus and clarity ahead of time and do the search in a targeted way.

The Browse method is preferable if you find it necessary to be open to the stimulation of the browsing process to suggest a direction.

Whether searching or browsing, it's always better to consider lots of candidates than to take the first one who seems plausible. If you were buying a house, the small funnel approach would be to talk with a few friends, or drive up and down your own street watching for "for sale" signs. The large-funnel approach would be to filter *all* the available houses using your chosen criteria, and then narrow to the best possible matches.

There's an especially dangerous case, and that is hiring from a pool of one, a single candidate. **Of all the ways to improve your chances of success in hiring, my very favorite is to develop two or three very good candidates from a large pool.**

How do you get a large pool? You need a candidate magnet. Remember, we've done a lot of work to figure out what the business is today, where we want to take it, and what the executive we are hiring must contribute. So, in your job posting, disclose all this. I've been known to circulate a four or five-page article laying out the whole story of today, tomorrow, and the needed contribution and results—the sort of article you'd read in a business school case study or an equity analyst's research.

In contrast, the typical job posting is just about skills and accomplishments, and maybe traits. The skills and accomplishments are important, to be sure. In a full-disclosure job posting, the skills and accomplishments become the natural end result in a unique context, instead being generic and indistinguishable from the postings of every other company.

Once I did a search for a COO, and I wrote the kind of full-disclosure article I've described to you. I circulated the article widely. Within days, a retired CEO got a hold of it and wrote me about an executive who had once worked for him who would be the perfect match. I called up this CEO and wow—I could hear the excitement in his voice—it was thrilling. His candidate was very strong indeed, and emerged as the best in a field of finalists, and we hired him.

If I had circulated just a traditional posting, I never would have awakened that excitement and I never would have known of that candidate.

Select

Your candidate magnet will attract…lots of candidates. How do you narrow the pool?

Make a first cut by eyeballing resumes and vetting them against your objective criteria. You might spend two minutes per resume to make this cut. The next cut is harder, but I have a little secret: Get the candidates to help you. You've disclosed a lot to the candidates about today's business, tomorrow's business, and the needed contribution. So now, say to them: **"You've made the first cut."** (It's important to say this, so each candidate knows this is worth investing in.)

Then say, **"Now I need your help. Please draw on all I've disclosed about our business and our needs, and write me an essay. Persuade me you are very close match."**

Candidates who know they are a very close match will spend many hours composing their replies to you. When you read the replies, it will feel miraculous. From the best replies, you can select a small number of finalist candidates to invest more time in. From these finalists, you are very likely to make a brilliant selection.

Launch

That brings us to the launch. In the survey responses, the #3 cause of failure was "The early on-boarding process was weak." But if you've done this right, I predict a smooth launch. Why smooth? Let's think about it.

A, The candidate won't be flummoxed by conditions on day one—you disclosed a lot about today's business and you considered the match carefully.

B, there's good clarity on the direction of the business and the candidate's department—you've built the whole search and selection process around that future vision.

C, most importantly, there is no question about the needed results. In fact, if you wrote that job posting with a results orientation, the posting itself is the basis for a performance review at 6 months—at 12 twelve months.

Once, sad to say, two years after a CFO started work, the CEO reviewed the original job posting and terminated the CFO for failing to deliver the needed results. It could have been a bad design, or a bad selection, or a bad launch.

Hiring is Transformative

That story reminds me that *nothing* can ever reduce risk in hiring to zero. Train wrecks will still happen.

I began today by saying that CFOs have a good view of train wrecks in succession and hiring, and that they happen more than they should. They are predictably caused by common mistakes. I mentioned four of these destructive mistakes. You'll find these mistakes happening whether you use contingent search firms, retained search firms, or no search firm at all.

Mistake One. Delaying for years replacing an ineffective key executive—being stuck.
To counter this, we talked about seeing symptoms of mismatch and moving to free a company from a box that's the size of its current management team.

Mistake Two. Looking for executives who fit the past needs of the business, not the future, or who fit the wrong future.
The cure for this is to get clear on the future we want, and do a targeted search for the right candidates, rather than a "browse" where the candidates we happen to meet will overly influence us

Third is selecting from a tiny pool of candidates whose main qualification is that they are loyal—or close at hand, not that they are competent.
The solution here is to consider many candidates, disclose a lot to them, and then get them to help you narrow the pool.

And fourth is to launch people into new roles with little agreement on what they are to deliver. *For this, we want to put huge emphasis on needed results, beginning with when we design the job and write the job posting, and continuing right through the final interviews and the first months on the job.*

A strong results orientation is not for every company. In some company cultures, perhaps yours, loyalty trumps performance. This is especially true in family companies, young companies, and some very founder-centric companies. But every company that continues to grow will have to make a transition from a loyalty culture to a performance culture to at least some degree.

I'm a CEO advisor. You are a CFO. You have an inherent results orientation. I wish you well in helping your management team diagnose mismatches and then move purposefully to make the hiring choices that will take your company to its highest potential.

Nothing can be so transforming in business as effective succession and hiring. It's worth doing it well.