

trends Finding the Right CEO: How Hiring Mistakes can Break a Small Cap Startup

a cook associates report

What does it take to be an effective CEO? Quite a bit, according to venture capital firms concerned with the placement of CEOs at small cap startups.

Hiring the right CEO can be vexing, especially considering the amount of compensation required in retaining a top-notch CEO. A study by the American Finance Association in early 2000 found, in a sample of 714 acquisitions during the dot com boom of 1990 to 1998, that 47 percent of CEOs in acquired firms were replaced in 5 years. This included 27 percent who were replaced by internal governance, 16 percent by takeovers, and 4 percent by bankruptcy. This is another indication that CEOs are not infallible in the business arena.

A report from VentureOne, a financial services research firm in San Francisco showed that in 2006, the median salaries of CEOs running venture-backed companies ranged from \$250,000 to \$275,000 annually, and is expected to increase in the next five years. The report indicates that startups are willing to pay the high amount of compensation needed to find the right CEO, and for good reason.

“In today’s competitive environment, it’s extremely important to find CEOs with exceptional leadership traits,” said Seth Harris, Executive Vice President and Practice Leader for the technology practice at Cook Associates Inc., a retained executive search and M&A advisory firm in Chicago. “I like CEOs who are decisive and authentic. They understand the importance of building great teams; having great organizational skills; possessing strong communications skills both internally and externally; a well developed sense of how to motivate people to exceed expectations; and using past failures to develop their instincts and decision making.”

Quite a tall request, but with reports that new businesses fail within the first three years of opening their doors, dynamic CEOs at startups have to wear many hats, this often includes acting in dual capacities as the CTO, CMO and COO.

The business world understands the amount of risk associated with hiring the wrong CEO at an established large public corporation, but they often don’t realize that it is especially important for a startup (which hasn’t proven its viability yet) to hire the right leader to steer the way for future business. However, finding the right CEO often times has everything to do with extensive background information, and often this information is deficient.

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“We have found that there is not enough due diligence when it comes to understanding the background of the candidate,” said Greg Hulecki, managing partner for Boston-based FA Technology Ventures, an early stage investment group that specializes in emerging growth sectors of the Information and Energy Technology industry.

“There is often not enough detailed data about the CEO’s responsibilities and what they truly accomplished during their tenure, to make an accurate decision,” he added.

The challenge facing venture capital groups is having a thorough process in place that begins with identifying what kind of fit a CEO candidate was at their former organization, and if they have what it takes to fit in with the current situation at a startup. Hulecki stated that culture should never be overlooked when trying to determine the best candidate for the job.

“It makes such a difference. Details on their past performance should always include an assessment on the candidate’s ability to make a successful transition from a large company to a smaller one,” he admitted. “I can’t emphasize how often we’ve seen someone who looks terrific on paper, but the fit was completely off because the culture was never taken into consideration.”



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Rod Randall is senior managing director for Vesbridge Partners, an investment firm based in Westboro, Mass. The firm has managed \$1.7 billion in capital in the high-technology sector since the firm’s inception in 1988, and has played a strong role in determining CEOs for small cap startups. Randall has been in the venture capital industry since 2004, and makes it a point to be actively involved in the candidate screening process. He noted that although it is important to look at a CEO’s track record, it is equally important to consider their adaptability during the various stages of a startup.

“We look for someone with a strong sense of leadership, and the only way to measure that is to look at their former company, and evaluate if it was a successful player under the candidate’s tenure,” said Randall. “Experience has shown that it is more important to match the CEO to the stage of the company rather than the industry. Considering the amount of money that is invested in a CEO through bonuses and high-compensation rates, a CEO should never be considered replaceable. We look for someone who will work out in the long-term.”

Randall added that a CEO should know how to manage the dynamics of a new company by recognizing the market, and in the case of technology companies, there often isn’t the luxury of being able to surround him or herself with knowledgeable technology people to determine the market for them. When it comes to technology startups, CEOs must already have an understanding of technology and the market without having to reference others on the matter.

“I think the biggest characteristic we look for in a CEO is if they are an active copier,” explained Randall. “Lacking in active coping abilities became a warning bell for us as we became more involved in our searches for CEOs.”

Randall went on to explain that CEO candidates also need to have to an effective strategy in mind long before they take over the helm of a new company.

“I can’t stress this enough. We had one CEO who came from a large public company and when the first version of the acquisition strategy didn’t take, he became completely lost in finding a solution. He couldn’t understand the organization dynamics and came back to us and said: ‘Now what?’ This was a classic example of a large company executive who had been President or Vice President of a large company’s division, who had gotten used to having an endless amount of resources at his disposal and people who provided the research, and was used to having strategy dictated to him from higher up. He couldn’t find the initiative that is a ‘must have’ in all CEOs.”

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Randall pointed out that all CEO candidates should have fundraising experience, not in the literal sense (although that helps), but in theory.

“They have to look at what they do as fundraising from the start,” said Randall. “The CEOs job is to keep the company funded, and they have to understand that this is a primary focus, and every decision the CEO makes has to meet that end.”

Randall also suggested that there are many characteristics that are expected of a CEO interviewing for a position with a startup, including familiarity with the venture capital community and an understanding of how it works. They must also be compelling and have an articulate vision for the future, not just from a technology standpoint, but also from a business standpoint. Randall added that in addition to being energetic, they must have the guts to lead a startup by having a thorough understanding of what is expected of them, and possess the ability to deliver results very quickly without being prompted.

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“We like to determine if a CEO has domain experience and can help with active strategy. Ideally, this is someone that has dealt with selling to the target customer and they know the competition and market dynamics from within, as well as being comfortable with working with advisors. It also helps if they have lots of customers to bring to the table. This is where a rich rolodex comes into play,” Randall said.

When asked what characteristic would keep a venture capital firm from hiring a CEO candidate, Randall said arrogance and an individual who is stupidly tyrannical in the way they interact with their management team.



“Some candidates think they need to be a tyrant to create something new,” said Randall. “This should never be the case, and this style of management has been proven not to work over and over again. No one respects a tyrant and no one wants to work for one.”

When a company endeavors to acquire a CEO for an entrepreneurial startup, having the right IQ is no longer the only requirement to becoming successful. There are more factors than meets the eye, and a great deal of that has to do with character. It can be the one determining factor between longevity, and adding another number to a cluttered list of failed startups.

About Cook Associates, Inc.

Cook Associates, Inc. is a retained executive search and M&A advisory services firm. Our core business is creating value at the intersection where talent and opportunity connect, and we are uniquely positioned to help our clients capitalize on the brightest talent and best performing companies in the marketplace. Our client base ranges from multinational corporations to early stage entrepreneurial companies, private equity and venture capital firms. Brand name clients include American Express, The Blackstone Group, Canon, Dover Corporation, GTCR, Heinz, Johnson & Johnson, Juniper Networks, Levi Strauss & Co., Pitney Bowes, and Sirius Satellite Radio. www.cookassociates.com

Seth Harris is an Executive Vice President with Cook Associates, Inc. and a search consultant within the firm's executive search division. With nearly 15 years of experience delivering exceptional search services in technology related markets, Seth is well-positioned to comment on industry trends. He can be reached at 781.565.1146 or via email at sharris@cookassociates.com.

According to Seth Harris of Cook Associates, Inc., these are five major mistakes made by venture firms when hiring a CEO:

1. **Not considering the growth stage of the company**
The skills required of a CEO will differ depending on whether the company is pre-product/pre-revenue, product launch with initial customers, growth, hyper-growth, plateau, decline, re-birth. You must understand expectations for the next two years to properly match CEO skills with your company's current stage of growth.
2. **Forgetting to sell**
The CEO candidate you want must be wooed! Too often, much time is spent on assessing prospective candidates with little attention given to *why* the candidate should join the company. A candidate needs to hear, see, and feel the passion of the Board and executive team. They must be given an opportunity to see themselves as part of the “dream” and the exciting possibilities that your company holds out. Spending as much time as possible engaging and continuing engage your best candidate during the process is crucial to landing the CEO you want.
3. **Relying on “gut feel”**
The degree of thoroughness in understanding key CEO competencies needed for your company, and rigorously testing these in the course of candidate evaluation, greatly diminishes your risks in hiring the wrong candidate. It is particularly important that key competencies and behaviors for the ideal candidate are documented, and qualities “assigned” to key members of the interviewing team so each competency/behavior can be explored thoroughly.
4. **Holding out for the “rock star”**
Maintaining a sense of realism in understanding who you can recruit to your company is vitally important if you wish to finish the search in a timely fashion and not lose market momentum or first mover advantages. Understanding key behaviors necessary for your CEO to succeed will help you select the best fit versus the press release.
5. **Not selecting and empowering a CEO search committee**
Many times due to the importance of the search, all Board members try to play a part in the ongoing selection process – and it is no secret what happens when there are too many hands in the cookie jar. An empowered search committee helps maintain focus on a positive result while ensuring an adherence to a process that maintains accountabilities and proper delegation.