Fundamentals of CEO Selection Beyond the History

When you hire a CEO, it's wise to consider looking beyond his or her performance history. A strong track record is wonderful, but past success before doesn't mean future success for you, because circumstances may differ. You might also care about **how** candidates achieve results: are they likely just to hit the targets or hit them in a way that leaves the company more (or less) attractive to prospective buyers? Is being on their Board likely to be a pleasant three to five years for you or a medium-term penal sentence? You may put up with a jerk to succeed but it might be worth considering if you have any more attractive options.

Less than the bare minimum

When you pick a CEO, the bare minimum is someone who can execute your investment thesis. You check track records to see that they've done the needed tasks before. But that's not enough. For example, Toys R Us' board of directors chose Dave Brandon to be CEO in June 2015 based on his track record of leading Domino's Pizza and Valassis Communications to IPO's. They thought he had the skills for the challenge – stimulating unprecedented growth and gaining digital experience at Domino's suggested that he could get Toys R Us ready to compete with Amazon. David Brophy, director of the Center for Venture Capital and Private Equity at the University of Michigan's Ross School of Business stated, "He's experienced. He's done it before. He's a known quantity to them." They hired him, and in September 2017, Toys R Us filed for Chapter 11 bankruptcy. Past is not necessarily prologue. Maybe you know some other stories like this, perhaps some uncomfortably close to home.

The bare minimum

In fast-moving or uncertain markets, expecting the unexpected makes sense. You need to know how candidates will cope with what none of you had imagined. Executives need technical skills and industry knowledge and also the ability and willingness to deal with whatever obstacles and opportunities they will face. Understanding candidates' underlying motivations and coping capabilities is key: how willing and able they will be to learn and to shift strategies in accordance with the opportunities and risks.

One way to learn how candidate will likely act in unknown circumstances is to assess them psychologically. There are clues to be detected by the appropriately trained eye and brain. For example, a founder and CEO of a foreign language school kept the curriculum she thought best for education rather than modify the offering to drive profitable growth, even during a recession. Educating others was her major motivation. She didn't want to get aggressive; she didn't want to become like "a work machine" and wanted to be "more personable and patient." These attitudes could be detected by a psychological assessment, and their implications understood. Eventually, her private equity investors disagreed with her unwillingness to change and replaced her as CEO. Unfortunately, the company still went out of business.

Another founder and CEO of a food company also sought growth equity. His life history had given him a powerful self-confidence that he could help others and a deep interest in health. His mission was to bring food to people that would keep them healthy. When he sought outside funding, investors were concerned that he would not delegate and that he not kill an unprofitable brand he had launched. But a psychological assessment suggested that he was in fact a flexible good coper. And it turned out that when he needed to delegate and coach, he did. And he stopped subsidizing the unprofitable brand. He could transcend himself in order to grow the business. His investors exited in less than 18 months at 5x invested capital, selling the business to a large food conglomerate.

The good news is that you can tell who is built to change and cope (and who is not) but you have to do the work to do it.

More than the minimum – some considerations

Exiting the food company was bittersweet for investors because working with the CEO as he tackled emerging unknown unknowns was so thrilling. Not only were the goals met; getting there was fun for the investors. Do you care much if your Board service is enjoyable or painful? You can know whether your relationship with the CEO is likely to be enjoyable or not, and how you can work with him or her to make it as productive and as enjoyable a relationship as is possible. Your relationship and enjoyment is beyond the bare minimum but is also obtainable.

Or you may know the exit you want, and so have preferences for how the financial goals are met. Besides hitting financial goals, the CEO is going to do something to the organizational capabilities of the organization and to its strategic position: he or she may move it forwards, may move it backwards, may not move it at all. Some future conditions of the organization may be better or worse for you when you plan to sell it. If you know what those better future conditions are, then picking a CEO who can send you in that direction would be better.

What's desirable for the future depends in part on your exit plans. If you are likely to do an IPO for exit, then creating or sustaining a strong culture would probably be a good idea. But if you are more likely to sell to a larger firm that would combine the organizations and smash your culture into theirs, then maybe having a strong culture is of no value or even a negative. Developing organizational capabilities is almost always a plus. If you buy a manufacturing organization and train people in the Toyota Production System, three years from now, few would say this additional organizational capability has no value.

Doing the bare minimum or more

Detailed analysis of a candidate's business track record is necessary but not all you can reasonably consider doing. Psychological assessment is another tool. It raises the odds of successfully hitting your financial targets, and greatly enhances your chances to hit non-financial goals and to make the experience more enjoyable for all.

A range of people provide this kind of service to companies. A smaller group have deep experience in psychology, leadership, and the private equity business and its unique features. For a private equity firm, doing more than the bare minimum – or at least experimenting with it – will be a good investment with high returns.