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GUEST ARTICLE

Be Smart About Hiring Your Next CEO

By Geoff Smart and Randy Street, ghSMART

Buyout investors struggle with hiring CEOs. They make mistakes 50 percent of the time. Making hiring mistakes is every buyout investor's number one problem, due to the high cost of failure and its prevalence. Fortunately, this problem is preventable.

We recently completed the largest study ever done in the buyout industry to identify a better way to hire CEOs. The StreetSmart Hiring Study took two years to complete. We interviewed 20 billionaires, 12 big-company CEOs, and 35 leading buyout investors and their CEOs. We also partnered with a University of Chicago research team to analyze 313 CEO profiles relative to their financial performance. This article provides some advice on how to hire an effective CEO, along with highlights of the study.

Geoff Smart

A Method For Hiring

We packaged the best hiring practices we learned from the study into a proprietary method for hiring. We believe this method can deliver a 90 percent-plus hiring success rate. There are four steps:

1) Scorecard.

The scorecard defines quantitatively what "A" performance means for a role. It is the blueprint for success. First you have to ask, What is the core mission for this role? An example of a mission: "To build the company over the next five years from a $500 million domestic retailer of music equipment to a $2.5 billion global brand that sells through regional distributors."

Next determine the five to seven measurable accountabilities that will define an "A" performance. Examples of accountabilities include, "Grow revenue from $500 million to $2.5 billion over five years (38 percent CAGR)." Others could include, "Increase EBITDA margin from 9 percent to 15 percent by cutting out bloated HQ staff," "Upgrade the talent of the finance organization by replacing the retiring CFO by October 1, 2007," and "Hiring a new VP of corporate development by 12/31/07."

What are the 10 to 20 competencies that are especially important for this deal to be successful? Examples of competencies include "Aggressive but not disrespectful," or "Holds people accountable."

The scorecard can be used not only for hiring CEOs, but for hiring your own colleagues. **Mark Gallogly** and **Jeff Aronson** of **Centerbridge Partners** raised one of the largest debut buyout funds last year at $3.2 billion. They put their team together from scratch with a 94 percent hiring success rate using the method described in this article. Gallogly told us, "It is not by chance. We were clear about what types of people we were looking for." Aronson added, "Part of successful hiring means having the discipline to pass on talented people who are not a fit. One of the toughest decisions we made in our first year was not hiring a talented investor with a challenging personality who could have damaged our firm."

2) Source.

There are two ways that the best deal-makers source CEOs. The first is to build a formal mechanism to pull candidates out of the networks of their colleagues. One of the billionaire deal-makers in our study keeps a personal spreadsheet of talented people he meets whom he may want to hire some day. He requires his managers to do the same, and promotes people and pays them bonus incentives based on their success in sourcing talent.

The second most valuable tactic for sourcing talent is to "deputize" friends of the firm to serve as paid "people sourcers" for you. Several of the deal-makers in our study have a half-dozen recruiters on perpetual retainer. They also build networks of lawyers, bankers, accountants and other service providers whom they pay a recruiting bounty for sourcing talented CEOs.

3) Select.

It is hard to select the right candidate in a pool of similar-looking resumes. Successful deal-maker **Jay Jordan** of **The Jordan Company** told us the story of how he once hired a CEO who looked great on paper, but who failed. The failed CEO requested some feedback upon termination. Jordan, who is an extreme gentleman and somewhat conflict-avoidant, told the CEO, "Look, I hired your resume. But unfortunately, what I got was you!"

Matt Levin, a managing director at **Bain Capital**, has had a lot of hiring success in recent years using these methods, including the new CEO of Toys "R" Us, a portfolio company of Bain Capital, **Kohlberg Kravis Roberts & Co.**, and **Vornado Realty Trust**. The three private equity firms showed discipline in evaluating several candidates who were close to the need, but not quite the right fit for Toys "R" Us, before hiring **Gerald Storch**. "I cannot emphasize enough the importance of taking the time to learn the story of the person, to do a full hiring process," Levin said, speaking about the CEO hiring processes in general. "Everybody has strengths and weaknesses. If you want to enhance your predictive capabilities, you have to really understand the story and the patterns. It also helps you understand how to effectively manage the relationship with the CEO over the long-term."

To get the fullest picture of a candidate, ask them the following five questions about every job they have had:

1. What were you hired to do in that job?
2. What accomplishments were you most proud of in that job?
3. What were some low points during that job?
4. Let's talk about the people:

i) What was your boss's name? What will he/she say were your biggest strengths and areas for improvement?

Randy Street

ii) Please tell me about the team you inherited. Did you hire anybody? Fire anybody? What was your hiring success rate?

5. Why did you leave that job?

Buyout investors who attend our training workshops ask us all the time, "What types of CEOs make money for investors?" Buyout investors mistakenly like to back a profile of CEO we termed the "Lamb." Lamb CEOs rate very high in the areas of being open to feedback, listening, and treating people with an unusually high level of respect. But preliminary research suggests that Lambs were only deemed successful by their buyout investors in just over half of the deals in our study.

In contrast, buyout investors are less excited than they should be to back an alternative profile of CEO, which we termed the "Cheetah." Cheetah CEOs move fast, act aggressively, are extremely persistent, work hard, and have very high standards. They make bold, sweeping strokes at an aggressive pace. Again, according to preliminary research, Cheetahs were successful in 100 percent of the deals in our study.

What does a Cheetah CEO look like? **Selim Bassoul** is a Cheetah. Five years ago, **American Capital Strategies** was considering an investment in Middleby Corporation, a manufacturer of restaurant cooking equipment. Bassoul took the helm and immediately killed unprofitable product lines, boldly changed the work week to Wednesday to Sunday to be open during the peak customer weekend hours, and hired similar-minded, hard–charging leaders. The result? Bassoul proudly told us, "We grew the stock price from $4 to $142 (35x growth) over the last five years. It has been fabulous growth!"

Finally, choose CEOs who are not afraid to surround themselves with talented people. Eighteen months ago, representatives of **The Blackstone Group** and **Apollo Advisors** made a bold move to replace the CEO of an underperforming portfolio company. That company's value had been flat for five years. With prodding from its two largest investors, the board selected a new CEO using the method described in this article. The new CEO, **John Zillmer**, used this method to hire or promote 27 new superstars into the management ranks over 18 months with a 90 percent-plus hiring success rate. The result? The value of the company is up 56 percent over two years. **J. Tomilson Hill**, vice chairman of Blackstone, told us, "We wanted a CEO confident enough to have "A" Players, and John Zillmer was the perfect fit for what we needed."

4) Sell.

Successful deal-makers sell candidates by keeping in mind the 5 Fs of selling a CEO: Fit, Family, Freedom, Fortune and Fun, in order of decreasing importance. Fit means showing the candidate, "Here is how your talents and interests fit into this business strategy." Family means finding out, "Is your spouse and are your kids OK making this move?" Freedom means emphasizing, "I will let you make decisions and I will not micromanage you." Fortune means showing the candidate, "If you are successful, you will make $X million." Finally, Fun means showing the candidate, "We will have a working relationship I think you will enjoy."

Billionaire deal-maker John Malone described how he recruited away Microsoft's CFO **Greg Maffei** by focusing like a laser on convincing Maffei's family to move from Seattle to Liberty Media's headquarters in Denver. It was the biggest sticking point, but Malone convinced Maffei to join by convincing his family.

Close your CEOs with higher success rates by concentrating on the 5 Fs.❖

Hiring Don'ts

1. **Evaluate a CEO without identifying the core business drivers first**
2. **Use "all gut feel" and little data**
3. **Ask CEOs hypothetical questions. These are too easy to fake**
4. **Forget to seal the deal once you have identified a desirable CEO to hire**
5. **Favor the "Lamb" profile vs. the "Cheetah" profile of CEO**

Hiring Do's

1. **Use a scorecard to identify what "A" performance means for a given deal**
2. **Source candidates by pulling leads out of the networks of your colleagues and by deputizing friends**
3. **Select the right CEO by conducting chronological interviews and spotting red flags**
4. **Sell your CEO by emphasizing the 5Fs: Fit, Family, Freedom, Fortune and Fun**

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