Who's Minding the Store?

By

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Introduction

The terms "leadership" and "management" are commonly alternated as synonyms. However, Peter Drucker observed that leaders do the right things, whereas managers do things the right way. One of the fallacies of the conventional leadership model is that it requires subordinates. On the contrary, some of the most effective leaders have no direct reports yet are often critical change agents as role models. The only real prerequisite to leadership is followers. Absent the latter, there is no leadership. Managers come with subordinates but are not necessarily leaders. Ponder these points to a tree falling in a forest which produces no sound unless there are hearing ears.

The lower middle market is ripe for value-creation, provided the equity partner is poised to address many impediments to robust scalability. In military terms, these issues constitute a target rich environment. Recurringly accretive topics include leaning out processes, upgrading technology, improving organic growth, acquiring complementary businesses, and supplementing leadership skills.

Leaders do the right things; managers do things right.

Some investors may consider that leadership and management expertise are either/or and not both/and propositions. The value-creation play is both/and. However, the mix between both traits varies for individuals and may episodically alter proportions. Even so, professionals may have dominant propensities toward one or the other. Some governance models account for this. For example, the Enterprise Operating System model featured in *Traction: Get a Grip on Your Business* identifies visionaries and integrators relative to leaders and managers, respectively.

One of the more essential traits of effective leaders is when they pivot to followership. One such instance is when a leader—perhaps in a managerial role—defers to a subject matter expert to rationalize the best decision among vying options. This is not a sign of weakness; rather, it is a characteristic of wisdom. Socrates would likely agree as he imparted "the only true wisdom is in knowing we know nothing."

Leadership and management are the primary ingredients in the stewardship recipe for a company. As growth is imperative for lower middle market private equity portfolio companies, this article focuses on the necessary evolution of the entrepreneurial CEO role. Three themes should be kept in mind as points are posited:

- the CEO's ability and/or willingness to scale;
- replacement risk, i.e., unanticipated interruption of CEO participation in forging scalable governance; and
- orderly succession of the CEO as part of the governance transition.

Governance

The default governance mechanism for small companies is commonly control. There is nothing wrong with this, per se, as multitasking is a rational response to budgetary restrictions. Even so, as successful companies grow and attract private equity investors, some entrenched responsibility synaptic circuits may need rewiring. Founding leaders may have hired people to share the workload, but this does not necessarily mean that those supplemental resources are empowered and held accountable. If subordinates are predominantly limited to order taking, an inevitable CEO decision bottleneck looms ominously in the shadows awaiting a time when leadership

Governance should evolve of necessity in deference to reality.

bandwidth is exhausted. The phenomenon may appear with the intensity of a bug meeting the windshield of a speeding car. Bottleneck consequences may be that major decisions are less thoughtful and/or delayed.

The first question which must be answered is whether the incumbent CEO can or will adjust to empowered delegation. The "can" requires a plan. A reliable framing question is whether the CEO could lead the same way tomorrow morning upon walking into a company three times larger. If the answer is "no," then the follow-up question is "Why?" When root causes are plausible, the next question is "What should be done in preventative preparation?", and trailed by "How would you make that happen—and by when?" The outcomes of this exercise should be memorialized. The ability to delegate becomes a byproduct of execution—and is the answer to the "will" question above. In some instances, a CEO may not be able to comfortably let go. This may be a signal for the necessity of orderly succession.

The first question is whether the incumbent CEO can and will scale.

The previous argument commenced with the assumption that the CEO recognized a need for change to effectively lead a much larger enterprise. Suppose the answer to the leadership scenario of the immediately tripled size were "yes," i.e., no leadership style change is required. The inquirer should not capitulate, but rather explore "Why?" questions for reasonable responses. Probing for clarification is appropriate to determine the sturdiness of the incumbent CEO's confidence. Revealed vulnerabilities should be addressed with similar "What?," "How?," and "When?" questions. A codified game plan remains prudent. Successful execution is again the criterion for the "will" answer. As before, the degree of difficulty may be an orderly succession signal.

Two problems accompany the paucity of leadership time. One is immediate: replacement risk, i.e., the "hit by the bus" scenario. This might be observed as a disaster recovery and business continuity phenomenon. Replacement risk possibilities are numerous. One is temporary indisposition by accident or illness. An unrecoverable replacement risk is death.

Less onerous leadership risk is orderly succession. The root issue of requiring a new leader may be the same. However, succession is typically deferred and protracted. The seeming absence of urgency may delude investors into a false sense of complacency. The Center of Executive Succession at the Darla Moore School of Business at the University of South Caroline published the study, "CEO Succession Success: A Board Perspective." Co-authors Patrick M. Wright, Donald J. Schepker, Anthony J. Nyberg, and Michael D. Ulrich corroborate the following succession hazards:

Replacement and succession risk differ primarily by timing.

- Unplanned successions, i.e., replacements, have higher failure rates than planned ones (43% versus 24%, respectively).
- The internal to external succession failure ratio was 4:1.
- Failure root causes for both internal and external successors were skewed toward behavioral blind spots instead of technical competencies. (This would not have surprised Abraham Lincoln who observed "nearly all [leaders] can stand adversity, but if you want to test [leaders'] character, give [them] power.")

Good leadership diligence should detect leadership risk. However, leadership diligence is commonly inadequate in the lower middle market. Some equity sponsors avoid it out of concern that it might alienate the seller and nullify the opportunity. However, determining the governance model is not necessarily contentious. Indeed, it can be as simple as asking how the business model works and who is responsible for what. A single cut-to-the chase question to the CEO may be illuminating: "If you were shipwrecked and incommunicado for a year on a remote island, what would you expect upon your return?" If the answer is unsatisfactory, the sponsor might want to know about policies, job descriptions, reports, and training. The long and short of this topic is that if we plan for worst case, we mitigate replacement risk and simply have more time to address succession risk.

Leadership diligence is essential to private equity transactions.

Reliable processes correlate with better decisions. In *How to Decide: Simple Tools for Making Better Choices*, Annie Duke explains that good processes do not eliminate errors; rather, they reduce errors such that all similarly trained professionals abiding common rigor have comparable odds of success. Navigating the succession decision may draw upon many worthy guiding principles. The first one is that CEOs have a poor track record of identifying their replacement. David F. Larcker and Brian Tayan wrote in a *The Wall Street Journal* article entitled “Why CEOs Should (Almost) Never Pick Their Replacement” that the conflation of a strong-willed leader with a lack of experience in picking a CEO may heighten the risk to effective succession. Edward J. Zajac and James D. Westphal’s “Who Shall Succeed? How CEO/Board Preferences and Power Affect the Choice of New CEOs,” published in the *Academy of Management Journal*, argued that a strong board of directors is an effective counterbalance to a dominant CEO for succession decisioning.

Eschew Unicorns in Favor of Wing-Persons

Revenue rainmakers and operational wizards rarely come in the same package. Time need not be wasted on the futility of the quest for such unicorns. Which profile should the company pursue and why? Suppose the succession process starts with a strike zone memorialized in a job description. Does the job description really capture what the job is or the skills the successor needs? What if the job description were juxtaposed with a 360-degree leadership assessment by a reputable vendor? Another consideration maps to the purported competitive differentiator expressed in the unique value proposition. Will the unique value proposition hold up under scrutiny from the customers’ objective feedback? Voice of the customer input via a tool like the Net Promoter Score is revealing. Finally, how is the company performing? If growth and profitability benchmark unfavorably to the industry vertical, isolating the root cause(s) should yield definitive insights on leadership criteria.

Unicorns are imaginary; complementary skillset tandems are practical.

Perhaps we should begin the vision of the ideal leader with what the company needs most. If excess capacity is laying fallow from a lethargic marketing and sales effort, then the scales tip to business development leadership. Alternatively, if orders with good margins are languishing in confirmed backlog concurrent with quality and direct labor issues, then the compass points toward a value chain warrior. These types of scenarios indicate the right type of “corner office” occupant.

The accompanying decision is logically covering the CEO’s blind spot with a wing-person. Examples abound on such tandems: Moses and Aaron, Buffet and Munger, Jobs and Wozniak, Gates and Allen, and Page and Brin. The leader and wing-person should be ordinal: first the CEO and then the wing-person. The wing-person may already be on staff, yet may require further training and development, depending on the prevailing governance mechanism. Otherwise, the search process renews. However, a CEO with wing-person orientation may already know superlative candidates absent assistance from a recruiter.

A wing-person covers the CEO’s blind spot.

The wing-person solution may be a windfall epiphany to the common conflict about acquirer and acquiree CEOs. Would it not be delightful if they were natural complements and the subordinate one was completely contented to pursue their passion instead of grousing over a title?

Recruitment: Context, Pedigree, and Results

We are only getting started. The next question is where we look for candidates fitting our desired profile. The answer is analogous to marketing channels for customers. Recruiters often gravitate to big business as sources, yet this option comes with caveats. True, larger companies may provide valuable training in abundance compared to smaller companies. However, at least two things may not map cleanly to the lower middle market.

The first phenomenon is whether the candidate is a builder or an administrator. If the hiring business model is already architected to robustly scalable, the decision tips toward an administrator. Conversely, if the organizational architecture needs some revamping to robustly scale, then the decision nods toward a builder. A corollary to builder versus administrator is stabilizer or disruptor. If the hiring company has undergone a shock and its employees have lost confidence, then a stabilizer may be the role. Does the company have latent yet lethargic talent whose potential needs a catalyst? Then, the disruptor may be the profile. Which experiences did the big business background imbue in the candidate?

Is the CEO candidate a builder or an administrator?

The second big company caution regards a "supporting cast." Many large companies targeted by recruiters possess institutionalized bureaucracies. Accordingly, a successful executive in a large company may have enjoyed a posse which is not a budgetary possibility in a smaller company. In contrast to large companies, some lower middle market scenarios may be closer to an episode of Bear Grylls' *Man vs. Wild* whereby a small group of people are challenged to creatively overcome obstacles without a ready arsenal of support functions. Unless a large company candidate's history includes smaller companies, the absence of perspective may result in a struggle to scale down. The irony has a note of humor: a candidate may be challenged to scale down to lead a company aspiring to scale upward.

Does the CEO candidate require an execution entourage?

"Bureaucracy" is frequently perceived as a pejorative in the lower middle market. Perhaps it should be critiqued as a necessary evil. Institutionalized rigor can mitigate variation essential to productive scalability. The objective is accelerating manageable change—not destroying value. Thus, effective governance is attributable to debatable portions of art and science. A reliable benchmark for bureaucratic sufficiency is "enough" to promote agility without consequent chaos. The relevance of this point is that the builder CEO, for example, must acculturate iterative measures of bureaucracy. Total Quality Management is a form of the right kind of bureaucracy.

Especially if we are looking for builders—irrespective of revenue or fulfillment focused personas—we ask probing, open-ended questions that reveal a CEO candidate's ability to provide the leadership required by the company to digest growth. Several stress-tested favorites emerge. One is asking the candidate to walk the interviewer through something for which they were responsible in building from inception to steady state, replete with setbacks, solutions, and lessons learned.

Success is an opioid that may delude us into thinking accomplishment is a byproduct of individual genius. In fact, triumph may be serendipitous. Besides, some of the most celebrated success stories in history were preceded by failures. Failure is a scenario—not a person. Margaret Heffernan, a *TED* regular, imparts that "if you have never failed at anything, then you haven't been trying hard enough, aren't very imaginative, or have had such extraordinarily good luck that you have come to believe you are invincible." John Maxwell adds "fail early, fail fast, and fail forward." Indeed, Maxwell's maxim is the business model for many Agile intellectual property creators.

Leaders learn more from mistakes than successes!

Concurrent with the failure theme, another favorite probing interview question is asking for the biggest fiasco the candidate has ever experienced, followed by forensically dissecting the experience. Is this cruel? No. Desirable answers trace to all three of Patrick Lencioni's *Ideal Team Player* characteristics. A leader is *hungry* to even embrace the uncertainty of raw challenge. A leader is *smart* enough to avoid existential risk. A leader is *humble* enough to share lessons learned for the benefit of others.

Behavioral Proclivities

Behavioral profiling commonly explains tendencies in terms of key trait combinations. The Myers-Briggs Type Indicator and DiSC are such tools. Emotional Intelligence, or EQ, trumps them all. EQ is more important to leadership effectiveness than technical prowess. EQ regards two major virtues: self-awareness and empathy. The former is a sober awareness of propensities, biases, and triggers. The latter entails quick and directionally correct reads on people to adjust for effective discourse. EQ in the context of change-management is modeled by the prescient protagonist who navigates inherent stakeholder reluctance to adopt something different of their own volition. Returning to the interview scenario, a probing question might pursue the toughest change-management scenario the candidate overcame.

EQ trumps IQ!

Succession: The Changing of the Guard

Suppose the hiring scenario is succession. How does the existing alpha dog yield the yard to the new alpha dog? This should not be taken lightly, especially if the "retiring" executive intends to hang around because they like having a role without responsibility. Whereas there is an argument in favor of a Vulcan mind meld of undocumented tribal knowledge, there is an equally potent need for rules of engagement to avoid (perhaps) unintentional subversion to changing what the predecessor built.

Loyal lieutenants may be unwittingly caught in an awkward crosscurrent between someone they know well with waning power and someone they do not know as well with increasing authority. A logical response is overt new leader assimilation for establishing the go forward rules of engagement. One of the biggest hurdles in assimilation is acculturation. The bridge must be built between the new hire's previous culture and the culture of the hiring organization. Even if forging a new culture is part of the challenge, understanding the existing culture is

What confidential sounding board options to we provide new CEOs?

imperative. One of M3's most profound observations about new leader assimilation is the degree of difficulty for a C-level joining a company with familial culture comprised of homegrown talent. Even the new boss faces the ritual of "joining the family" to become effective in the CEO role.

Sometimes the new CEO is in a "challenge" assignment. This means that they had never held a CEO job but were performing on a logical trajectory of eventuality. How does the board hedge its bet? Executive coaching is an option. Who, then, is this Luke Skywalker's Yoda? Sometimes Yoda may be a retired executive. However, a couple of contraindications should be considered. One pertains to the previously successful executive projecting onto the CEO that their way is the preordained solution. The other is antiquation, i.e., the business model's competitive arena may be changing so dynamically that the coach's perspective is stale. In *Range: Why Generalists Triumph in a Specialized World*, David Epstein makes a good case for a generalist executive. The crux of the argument is that a generalist may see ecosystem trends and company penchants that elude a specialist. The argument extends to coaching. The generalist executive coach consequently relies on posing the right questions for the new CEO to ponder when formulating the best game plan to make their team competitively productive in a perpetually evolving scenario. This may be a particularly virtuous approach for assisting the new CEO in implementing the wing-person concept. Alternate outlets include Young President's Organization and Vistage. Both are ripe with talented mentors who are eager to pay-forward to the next generation of leaders.

Assure fit between the mentor's toolbox and the mentee's developmental aspirations.

Conclusion

Perhaps the best encapsulation for intrepid leadership is Teddy Roosevelt's "Man in the Arena." As a father of two exceptionally accomplished professional daughters, I must update Teddy's wisdom to the 21st century reality that women comprise half the workforce—and are also graduating with more advanced degrees than their male counterparts. Therefore, Teddy's masculine allusions were modified to gender neutrality to preserve the contemporary essence of the argument.

> It is not the critic who counts; not the [observer] who points out how the strong [person] stumbles, or where the doer of deeds could have done them better. The credit belongs to the [person] who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly; who errs, who comes short again and again, because there is no effort without error and shortcoming; but who does actually strive to do the deeds; who knows great enthusiasms, the great devotions; who spends [themself] in a worthy cause; who at the best knows in the end the triumph of high achievement, and who at the worst, if [that person] fails, at least fails while daring greatly, so that [their] place shall never be with those cold and timid souls who neither know victory nor defeat.

Several types of women and men are presently in the CEO arena. When it comes time for their replacement or succession, the question is whether those responsible for the transition are asking the right anticipatory questions to match future needs with prerequisite skillsets to perpetuate the legacy of value-creation. A thoughtful process increases the odds for success for the next generation of women and men who grasp the reins of leadership.

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