Out with the old, in with the new?

Expert opinions vary as to whether an acquired business is ultimately more successful when the founder remains at the helm or steps aside to welcome in a new CEO. Investors would benefit from developing a clear point of view: either a 'rule of thumb' (e.g., founders exit within the first 100 days in 95% of our investments) or alternatively, an agreed upon set of criteria, used consistently, to inform the decision. The data presented herein support healthy discussion and debate around these issues.

We interviewed 20+ private equity (PE) investment professionals and CEOs, all with direct experience acquiring founder-led companies.

One theme was consistent: alignment around the growth strategy is a critical factor to both close the deal and drive out-sized returns. **Despite its importance, true alignment is often unattainable for a couple of reasons:**

- A founder's scope is limited by their own experience; the biggest business they have ever run is frequently the one being acquired. Founders struggle to wrap their arms around a vision that seems broader or more complex than anything they have seen before.
- A founder's tenacity and fierce commitment to the business results in deep-rooted beliefs around the organization's future. This narrow frame hinders alignment if they are slow to shift their mindset toward a new vision.

What factors predict whether a founder can effectively partner with investors and lead as CEO in a PE-backed environment, especially for the first time?

Client perspectives and published research offer insights. The following perspectives were gleaned from Ampersand's cllient experts in the trenches, working directly with founder-led companies.

Founder-CEOs are more likely to be successful post-acquisition if they...

WILLINGLY SURROUND THEMSELVES WITH TOP TALENT.

Not threatened by A-players, these founder-CEOs put forth visible effort to develop, stretch, and mentor their executive team members. They give credit where credit is due and readily incorporate input from others. Aware of their own skill gaps, they surround themselves with leaders and advisors who excel in those areas. In addition, they are not blinded by loyalty or lulled into complacency; they proactively upgrade their teams when needed.

KNOW THYSELVES.

Gaps in training, experience, and education are common among founders, as they often embarked on their entrepreneurial journey single-mindedly and at a young age. These gaps are disconcerting when founders "don't know what they don't know." Blind spots, especially in areas critical to the value-creation strategy, suggest trouble ahead. In contrast, self-aware founder-CEOs are: candid about strengths and weaknesses, open to feedback, coachable, and nimble amidst changing priorities.

CONTINUALLY STRIVE TO LEARN.

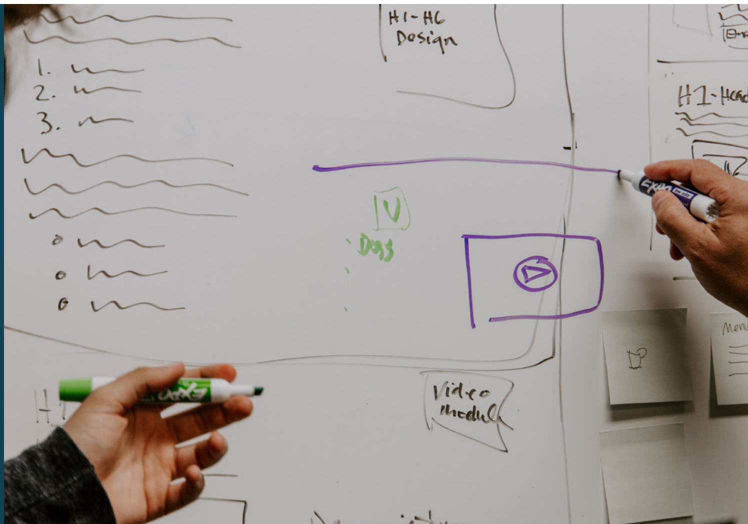
PE partnership brings many new sources of knowledge in the form of investing/operating partners, a network of portfolio companies, and best practices from other businesses and industries. "Learning CEOs" express genuine excitement and thrive on expanding their fund of knowledge. Evidence of learning is observed in the books they read, seminars and conferences they attend, roundtables and town hall meetings they organize, and questions they ask. Those who see PE investment as an intellectual growth opportunity, not just a financial one, have a much better chance of succeeding as CEO post-acquisition.

EARNESTLY EMBRACE CHANGE.

Founders of successful companies are often defined by a resolute determination to execute, a strength that can easily teeter toward intractability. Effective founder-CEOs reject the belief that "what got us here will get us there," and take pride in their ability to pivot or course correct. They eagerly pursue solutions that will make their businesses "best in class" and profitable, regardless of where ideas originate from.

Published research suggests that founders often bring innovation to the forefont.

Compared to companies led by non-founder-CEOs, S&P 500 companies with founder-CEOs are more innovative, generate 31% more patents, and create patents that are more valuable[1].



Founder-CEOs are less likely to be successful post-acquisition if they...

MICROMANAGE RELENTLESSLY.

Though technically no longer a start-up, the "all hands on deck" approach necessary during the start-up years is difficult to unlearn. Many founders immerse themselves in the details, meddle in the decision-making of their direct reports, and hold tight to customer relationships. Enamored with the trees, they fail to focus on the forest and lead strategically. Their need to touch every decision creates bottlenecks, and these habits threaten retention of the organization's best talent and bring the speed of execution to a halt.

FAIL TO SCALE.

To execute at the magnitude and speed required to achieve the investment thesis, organizational capabilities and talent must scale quickly – starting with the founder. Assessing the founder's runway in terms of strategic leadership, business acumen, talent management, and industry knowledge is imperative to making this critical judgment. Founders' skill gaps can be augmented with a strong executive team (e.g., a stellar COO), but investors are wise to be honest with themselves about how much they can prop up a CEO who lacks the runway necessary for the journey ahead.

HINDER INVESTORS' ABILITY TO "CHANGE THE DNA" – because the founder and the organization's DNA are often one in the same. Market conditions, economic trends, and industry innovations may necessitate a distinct change in direction for the company to survive and thrive. More than just investing in new capabilities, upgrading talent, or pursuing more efficient systems, there are times when the changes ahead truly reshape the company's identity. Retaining the founder, who created that company's identity and breathed it into every corner of the organization, can pose an insurmountable challenge.

WILL NOT MAKE THE CUT FOR THE NEXT BUYER.

Even with robust diligence, investors occasionally remain on-the-fence about what to do with a founder-CEO. Thinking toward exit and whether the next investor is likely to keep the CEO in place can be a helpful "gut check." If a future investor is unlikely to keep the founder-CEO in place, then succession/transition planning becomes a high priority to protect the future value of the investment.

Published research suggests that founders can get stuck in the mud.

Despite early success, they are less able to continue firm expansion mid-tenure[2]. The more time a founder spends in the CEO role and in the industry, the more committed they become to the status quo[3], partially explaining stalled growth. Entrenched founders who resist change also constrain new, externally-hired CEOs when they are allowed to remain on the Board[4].

Case in Point: Embracing the Role of Change Agent

Determined, practical, and resilient, this founder-CEO had been affiliated with the industry for 30 years. Ahead of her time and fiercely committed to efficiency, she pushed for the first fax machine and computer in the office. Fast forward 20 years to her implementation of a recommendation from a part-time analyst which not only solved a complex logistics problem, but had the added benefit of widening her company's geographic reach for recruiting quality workers. Clearly, her love of innovation was reflected in a broader commitment to embrace transformative ideas and challenge the business to adapt to changing market conditions. Candid about her experiential gaps but always eager to learn, she joked that a future autobiography would be titled, "Observations From an Airport Business Book Junkie." **This founder successfully completed a massive turnaround of the business; and fifteen out of seventeen markets met or exceeded top-line goals within twelve months.**

Case in Point: Failing to Change a Zebra's Stripes

Starting his business with his brother at age twenty with a truck and two pieces of equipment, this founder-CEO was the poster child for the "American success story." But wealth and reputational clout, combined with resolute ambition, led to entitlement, explosive exchanges with senior leaders, and a stubborn conviction that he knew best. His larger-thanlife personality stymied the few talented leaders surrounding him, and his blind loyalty meant key executive positions were filled by unskilled confidants who had shown undying allegiance to him. While he initially told investors he was 'ready for the next chapter' and would step away from day-to-day management, deeper diligence revealed a firm belief that the business would not survive without him. **Post close, this founder insisted on remaining hands-on "for the health of the business," stalling growth initiatives and delaying transition plans, which cost investors time and money.**

Key Takeaways:

- **Develop a clear point of view around founder transitions.** This may include a "rule of thumb" or an agreed-upon set of criteria used consistently to inform decision-making.
- **Assess the founder's runway in the context of the growth strategy.** Create a scorecard with specific accountabilities the founder must execute to achieve the investment thesis.
- **Ensure alignment among the deal team and the Board.** If a transition is in order, backchanneling and dissenting voices will only hinder progress and muddy the waters.
- **Make the transition sooner rather than later.** Most interviewees agreed that the fear of change is often worse than the reality.

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Ampersand Leadership Group | 3017 Bolling Way NE, Atlanta, GA 30305
P: (770) 788-6450 | **W:** ampleader.com | **E:** info@ampleader.com

Endnotes

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