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Larry Stybel, Ed.D. and Maryanne Peabody, MBA

Managing Growth Without Destroying Greatness.

How important are founders?

Ben Narasin of Triple Point Ventures and Michael Abbott of Kleiner Perkins (2015) examined 1.195 transactions between 1994 and 2014. These transactions involved private equity-backed companies going through exits: initial public offerings or being acquired. The authors gave the company “1” if the CEO at the time of the transaction was the founder or one of the founders and “0” the CEO was not.

Founder CEOs raised more capital than professional managers.

They produced higher valuations when it came time to exit.

Founders generate more value for owners than “professional” CEOs.

In their excellent book THE FOUNDER’S MENTALITY, Chris Zook and James Allen of Bain Consulting examined the same issue with a different database. Instead of private equity-backed companies seeking exits, they examined the world’s largest public companies.

Their conclusions were the same: owners are better off with founders than without them.

“Lessons for Boards: Keep Your Founders?

Not really…..

Using archival data from 126 private equity investments in the United States between 1990 and 2006, Gong & Wu documented a CEO turnover rate of 51% within two years of the transaction (2011). According to the authors, these removals are usually related to CEOs having failed to retain the confidence of the private equity dominated board of directors. They are not often related to the company having outgrown the CEO.

Zook and Allen agree. According to their data only one of every three founders is fired because the founder cannot or will not grow the business.

THE FOUNDER’S MENTALITY addresses the three critical values founders bring to the enterprise:

> Founders consider themselves industry insurgents. They are waging war on the status quo or are creating a new industry entirely. Insurgent. This creates a deep feeling of what the company stands for.
>
> They are obsessed with the details of their business and focus on the front line of the business.

They have an owners' mindset and foster an owner's mindset among employees through equity and insistence that employees think like owners.

As a company grows, Boards often find founders sloppy, inefficient, and self-centered. Trust is eroded. The founder is eventually replaced with a "professional" CEO.

"Professional" CEOs focus on bottom line growth while forgetting the Founders Mentality. This results in the destruction of customer loyalty and the hiring of bureaucrats who are obsessively focused on things other than customers.

The Case of Two CEOs:

We provided leadership coaching for the founder of one of the world's leading resort companies. When the founder visited resorts, he would ask local management questions like "why are those red flowers here when the blue flowers are more consistent with the surroundings?" or "I was reviewing the customer ratings of our Best Guest Club. And one customer complained that a waiter had been rude. What's going on here?" Through these constant detailed questions, those who ultimately reported to the founder also became obsessive about the details of guest experiences. They knew how important it was to the boss.

This founder was eventually replaced with a CEO who had been President of a Fortune 500 consumer products company. This individual got an MBA from a leading business school. We also accompanied him on visits to resorts. His first question to local managers was, "What is the occupancy rate this quarter?" That was the core financial index he would be measured on by his board. Stock price would go up it the occupancy rate was trending up and go down if it was trending down. Resort managers learned what was important to their new boss. And when you are managing to some financial index, operating managers know there are ways to boost quarterly occupancy rate measures at the cost of reducing the guest experience.

The Case of Home Depot:

Home depot founded by Arthur Blank and Bernie Marcus. Their mantra was “whatever it takes.” The two founders would tutor store employees in customer service. Employees were hired because they were experienced trades people. Home Depot leveraged their construction knowledge to help customers manage do it yourself projects.

From 1978 until 2000 Home Depot eclipsed its 20% annual earnings growth targets.

In 2000, the company missed an earnings target and the Board brought got rid of its two founders. It hired Robert Nardelli, as CEO. He was a senior executive from General Electric.

Nardelli replaced the “whatever it takes culture” with a command and control environment.

Instead of making customer relationships the top priority, Nardelli replaced full time employees with part time workers. Yes, they lacked trade experience but they reduced overhead costs.

By 2006 the University of Michigan released its annual American customer satisfaction index. Home Depot was dead last among U.S. retailers. It was eleven points behind Lowes.

It had four years of declining foot traffic and market value declined by 55%

Eventually the company replaced Nardelli with Frank Blake who tapped into the power of the original Founders’ Mentality.

Managing Growth Without Destroying Greatness:

Zook and Allen's book focuses on how to manage the following dilemma: How can we manage growth without destroying what made us great?

A good example of scaling up without destroying the founders mentality would be Sweden's Ikea International Group. With 300 stores in 40 countries, the original idea was one of insurgency within the home furnishing market: focus on the young, urban consumer who only wants furniture for "now" and not "forever." (Zook & Allen, 2013).

Ikea has kept its strategic focus on this core customer as it grows. It does not alter strategy in response to a dynamic business environment. It does not "reinvent" itself. It keeps focus and replicates its business model.

THE FOUNDER'S MENTALITY causes us to appreciate the brilliance of an Ikea and to take practical steps to keep the Founder's Mentality at the forefront of the way we define strategy, the way we hire front line people, and the way we design compensation systems.

It also is a reminder that substituting founders for professional CEOs is not a solution: it trades off one set of problems for another.

For more information check out:

Stybel, L. J. (2015) "Solving the "Problem Solved Problem:" Helping Private Equity Partners and Entrepreneurs Work Together to Build Great Businesses: *Strategic Management Quarterly* Vol. 3, No. 3, pp. 83-89.

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Gong, J. J., & Wu, S. Y. (2011). CEO turnover in private equity sponsored leveraged buyouts. Corporate Governance: An International Review, 19(3), 195-209.

Nasarin, B. & Abbott, M. (2015) “The Importance of Founders.” Techcrunch,https://techcrunch.com/2015/05/11/the-importance-of-founders/

Zook, C., & Allen, J. (2016). The Founder’s Mentality. Boston, MA: Harvard Business School Press.

Zook, C., & Allen, J. (2013). Repeatability thriving amid constant change: though many companies reinvent themselves in response to change, triumph comes, too, to those that focus on a simple core strategy and learn to replicate and adapt early successes over and over again. Financial Executive, 29(7), 28-33.

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Maryanne Peabody and Larry Stybel write monthly perspectives for PSYCHOLOGY TODAY called “Platform for Success: the making of Great Leaders.” To view their columns:

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For more information:

Maryanne Peabody

Stybel Peabody Associates, Inc.

Tel. 617 371 2990

peabody@stybelpeabody.com