

CEO Search: Two Clear Front-Runners – A Case Study

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Special Meeting of the Board of Directors of Widget Manufacturing Company (“WMC”)

Meeting: January 27, 2022, 5:00pm

A. ISSUE AND ASSIGNMENT

Ryan Frost, 68, Chief Executive Officer, is retiring as of July 2022. The Board has just completed a comprehensive retained search for his replacement and has narrowed the search down to two finalists. Both candidates are qualified, however, their leadership competencies and compensation histories vary widely. (The CEO and BOD determined that there was no obvious successor, so an external search was required).

The Board Chair and the Chair of the Compensation Committee have called a special meeting and asked the full Board of Directors their opinion on the two finalists and help in deciding the appropriate level of compensation. As a Board member, you were involved in the initial round of interviews and feel the search committee has narrowed down the field to the two best finalists. Prior to this special meeting you are provided the background and detailed compensation for the two finalists.

What would you do as a Board member? Choose the best candidate for WMC and come up with the compensation package that considers:

- a) Current WMC CEO Compensation
- b) Market competitive compensation
- c) Candidate qualifications and WMC’s business, leadership, and culture needs
- d) Candidate current compensation and requirements

B. BACKGROUND

Company:

- The Company was founded in 1990 in Boston, Massachusetts creating machinery for traditional manufacturing of widgets and is now headquartered in Littleton, MA with manufacturing facilities in San Diego, CA, Detroit, MI, Atlanta, GA, and Greenville, TX.
- WMC is a profitable on-demand manufacturing company of 3D printing machines to meet the needs of the most innovative Fortune 100 companies in the world.
- WMC takes an integrated software driven approach, disrupting new product development cycles.
- The company has experienced strong organic growth driven by the acceleration in additive manufacturing and injection mold techniques and in other capabilities, i.e., precision sheetmetal, CNC machining and ancillary technologies.

- The goal of the company is to become one of the top 50 additive manufacturing companies in the world through mix of acquisitions and core growth.
- WMC is a privately held company with the two original Founders on the Board of Directors.
- WMCs two Founders own 80% of the shares, non-founder Board members and employees own 10% with another 10% of outstanding shares available under the LTIP.
- WMC has no current plans to file for an IPO or be acquired by another company or private equity firm.

Company Financials:

- \$252.4 Million of Revenue
- Target of 23% revenue growth in 3 years
- 52% gross margin
- Adjusted EBITDA \$69M
- Operating Income Margin of 6.7%
- Most recent YOY revenue growth of 12.3% compared to 1.7% of peers

Market:

- On-demand additive manufacturing represents a large market opportunity.
- WMC's past growth may be attributable to being an early entrant in the expanding market.
- WMC faces significant competition: the number of entrants in the market as early stage or SPAC has increased significantly with their revenue growth averaging 90% over the last three years.
- New entrants into the market have a competitive technology advantage by not having to re-tool their manufacturing capabilities.

Chief Executive Officer and Leadership Team:

- The current CEO of ten years has had success bringing the company forward from its original two founders.
- Reporting to the Chief Executive Officer are the Chief Financial Officer, Chief Technology Officer, Chief Sales and Marketing Officer, Chief People Officer and SVP Manufacturing.
- The CEO and current leadership team have worked together at WMC for the past 8+ years. They have built a well-respected collaborative culture as evidenced by an average annual voluntary attrition rate of 2.8% over the same timeframe.
- The CEO does not plan on being involved in the company going forward but will ensure an orderly transition before leaving in 6 months.
- The current leadership team has very limited M&A experience; the CEO has none.
- It is critical to retain the current leadership team members for the foreseeable future.
- Rick Frost's Compensation
 - Base salary: \$313,675
 - Incentive target % of salary: 50%
 - Last FY Incentive: \$130,567, 42% of salary
 - Total Cash Compensation: \$444,242

- Last LTIP award value of Restricted Stock Units: \$188,205, 60% of salary
- LTIP target % of salary: 70%
- Total Direct Compensation: \$632,447
- Ownership: 1.2%

Consultant Market Assessment:

- Consultant peer group consists of public companies in similar industry and revenue size, ranging from \$118.5M to \$607.5M
- Mix of base salary and incentives (annual and LTI) is 50%/50%
- Ryan Frost's compensation is at or below the 25th percentile in all components (see Section E for peer detail)

	Revenue	Employees	Base Comp	Short-term Incentive	Bonus % Base	TCC	LTIP	LTIP % Base	TDC	% Shares Owned
25th Percentile	150.3	579	\$374,697	\$152,921	35%	\$412,872	\$405,823	104%	\$619,400	1.3%
50th Percentile	232.3	789	\$434,980	\$376,410	81%	\$608,020	\$647,237	151%	\$1,235,484	3.1%
75th Percentile	376.1	1706	\$495,544	\$502,310	99%	\$950,993	\$1,166,731	264%	\$2,129,734	5.6%
Widget Manufacturing	252.4	590	\$313,675	\$130,567	42%	\$444,242	\$188,205	60%	\$632,447	1.2%
Percentile	56%	26%	10%	23%		28%	11%		26%	23%

C. DISCUSSION QUESTIONS

1. What are the **pros** and **cons** of each candidates' qualifications based on WMC's business, culture and leadership needs?
2. What should be WMC's:
 - a. Base salary versus variable (annual incentive and LTI)
 - b. Competitive compensation position relative to the market data regardless of the candidate (overall and by component, e.g., base salary at the market 50th percentile and variable at the 75th)
 - c. Ownership level and time frame
3. Which candidate would you select and why? In what way did compensation impact the decision?
4. What should be the total direct compensation package?
 - a. Base salary
 - b. Bonus target % of salary
 - c. LTI target % of salary
5. What should be the key performance measure(s)?
 - a. Annual bonus
 - b. LTI award

6. What other key considerations should be included in the offer?
 - a. Sign-on bonus/equity award
 - b. Severance
 - c. Employment contract
 - d. Relocation
 - e. Other

D. CEO Candidate Summary

Overall Interview Assessment:

- A search committee was established, and all potential candidates have been interviewed by the full Board of Directors and key members of leadership. These two finalists have the required skills and experience to perform the CEO role, i.e., both have led significant successful business transformation initiatives, have had P&L experience (\$200M+) and are well known in the industry.

- The Chief People Officer raised a concern that Candidate #2 may not be the right cultural fit given an “abrasive” leadership style (based on her interview with the candidate and acknowledgement by one other leadership team member who interviewed the candidate).

Candidate #1: Maureen Harhai

- Is a 2x and current sitting CEO, well respected by industry peers and colleagues, and has had experience in both prior CEO roles successfully acquiring and integrating companies.
- She has been at her current company for 7 years and does not have any reason to leave. She was not actively looking at the time she was contacted by the search firm.
- Her current company is private equity owned; \$250M revenue and will eventually be merged with another similar sized organization in 3-5 years (in her opinion).
- “Significant” equity ownership is a must if she is to make a move from her existing CEO role.
- Has expressed that she “has one more CEO role left in her before she considers retirement”.
- She was not looking to make a move but taking headhunter calls for the right opportunity.
- The opportunity to lead the transformation from traditional manufacturing to AI enabled is very appealing and like a position she held previously in her career.
- Currently, resides in Appleton, WI and has told us she lives with her husband and is willing to relocate.
- Current Total Direct Compensation:
 - Base Salary \$480,000
 - Bonus Target as % of Base Salary is 80%
 - LTI Annual Award as % of Base Salary is 100%
 - Current Value of Unvested Stock is \$500K

Candidate #2: Fazila (“Faz”) Patel

- Is currently a Division President of a \$700M publicly traded manufacturing company.
- She has led the turnaround of her business unit to become the leading revenue generating division in the company.
- She has been the lead on several acquisition and divestiture teams in her current role and prior experience.
- She has been at her current company for 3 years.
- Has expressed that the overall compensation has to be “significant” in order for her to make a move from her current company
- She is a CEO succession candidate in her current company in a 5-7 year timeframe.
- Sees the WMC role as an opportunity to accelerate her path to become a CEO.
- Currently, resides in Somerville, MA and has told us she is married and has children in high school. She wants to stay in the Boston area.
- Current Total Direct Compensation:
 - Salary \$340,000
 - Bonus Target as % of Base Salary is 50%
 - LTI Annual Award as % of Base Salary is 50%
 - Current Value of Unvested Stock is \$300K

Candidate names are fictitious for this case study and do not represent any individual known or unknown.

E. Market Assessment Detail

	Revenue	Employees	Base Comp	Short-term Incentive	Bonus % Base	TCC	LTIP	LTIP % Base	TDC	% Shares Owned
Astec Company	130.9	592	\$274,635	\$42,130	15%	\$316,765			\$316,765	0%
Aonty Inc	232.1	654	\$427,530			\$427,530	\$647,237	151%	\$1,074,767	6%
Astern Corporation	480.8	2646	\$482,198	\$88,194	18%	\$570,393	\$74,225	15%	\$644,618	0%
Atinex Inc	190.7	2148	\$465,285	\$376,410	81%	\$841,695	\$484,188	104%	\$1,325,882	6%
Cerisa3d	587.0	1558	\$418,233	\$337,201	81%	\$755,434	\$14,838,676	3548%	\$15,594,110	3%
Ciardy Print	556.1	2200	\$633,028	\$2,644,776	418%	\$3,277,804			\$3,277,804	
COY Company	140.2	366	\$430,780	\$498,035	116%	\$928,816	\$405,823	94%	\$1,334,639	3%
Eons3d	118.5	526	\$349,868			\$349,868	\$743,452	212%	\$1,093,319	1%
FRM3d	607.5	2728	\$376,629	\$914,671	243%	\$1,291,300	\$3,931,021	1044%	\$5,222,321	
Frius Company	120.8	480	\$444,373	\$201,275	45%	\$645,648	\$499,439	112%	\$1,145,086	10%
Hico Inc	341.3	1420	\$535,583			\$535,583	\$1,575,978	294%	\$2,111,561	2%
Innovation3d	195.6	538	\$613,279	\$506,585	83%	\$1,119,864	\$666,014	109%	\$1,785,877	3%
Pepton Manufacturing	153.6	654	\$368,899			\$368,899	\$147,939	40%	\$516,838	
SSP Holdings	308.7	842	\$588,835	\$428,689	73%	\$1,017,524	\$1,166,731	198%	\$2,184,255	3%
Techno Manufacturing	232.5	806	\$100,365			\$100,365	\$264,825	264%	\$365,190	1%
Zytry3d	282.2	772	\$439,180	\$104,567	24%	\$543,747			\$543,747	9%
25th Percentile	150.3	579	\$374,697	\$152,921	35%	\$412,872	\$405,823	104%	\$619,400	1.3%
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