

WHAT FACTORS COULD IMPACT EXECUTIVE SEARCH, FORCE CHANGE, OR POTENTIALLY UPSET THE LARGE PLAYERS TODAY?

Preface

At Prospect City, we're continuously trying to improve the products and services we provide to senior level executive recruiters and corporate hiring executives. Our in-depth knowledge of search processes affords us the opportunity to provide state-of-the-art solutions that promote change, not just for the sake of change, but to help recruiters and the industry to provide better services to their clients. With the assistance of our customers, we've generated new ideas based on the premise that executive search is long overdue for change.

Sources

In addition to our strong customer relationships and our industry experience, we witnessed a panel discussion in Spring 2008 with the leaders of large recruiting firms. In addition to the moderator, Peter Felix (AESC President), participants included Robert Hines, COO of Heidrick & Struggles; Joseph Kopsick, Head of Global Practices, Spencer Stuart; Hal Reiter, CEO, Herbert Mines; Paul Reilly, Chairman, KFI; and Brian Sullivan, CEO of CT Partners. Below is a summary of the discussion along with our thoughts.

The discussion can be heard using the audio link below:

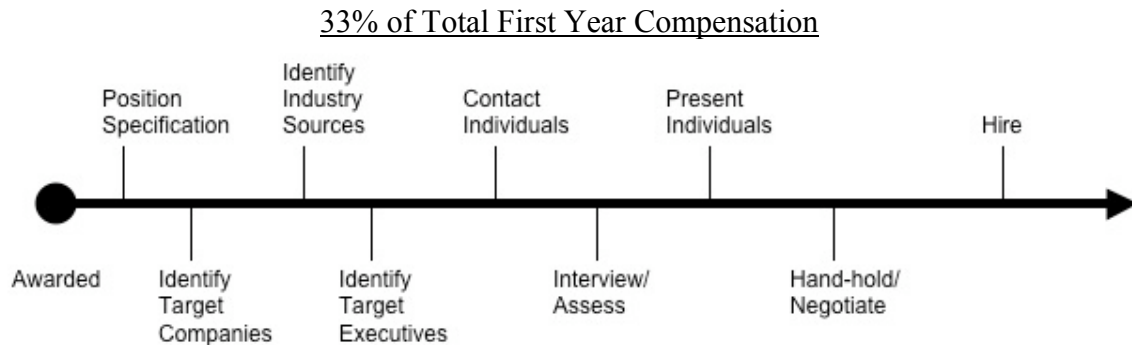
http://www.aesc.org/conferences/americas2008/audio/americas2008_focusing.mp3

“With access to talent becoming easier with access to the Internet and other premium resources, how has search changed?”

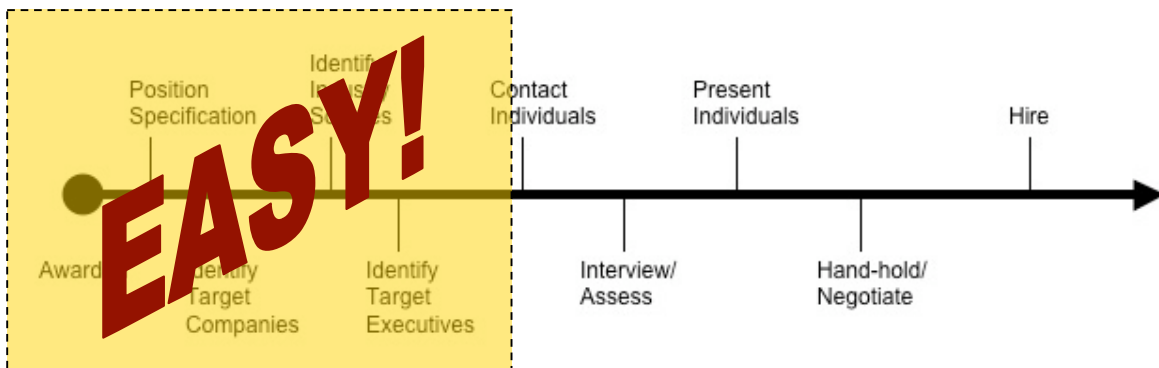
TOPIC ONE: The leaders quickly admitted that identification of talent at the senior level is easy. One respondent noted, “Anyone, even my kids, can get me a list of the top 60 CMOs in the Fortune 100”. The leaders responded by saying their deliverable is more focused on the assessment of fit rather than finding talent.

(Prospect City): If everyone can agree that part of the search process is now “easy”, why hasn't this affected the client experience? Over the past 50+ years, the execution of search has evolved significantly, while client-deliverables have not. For example,

Using the chart below to illustrate the search process of the 1980's and the corresponding (justifiable) fee arrangement,



compared to the search process of today,



we ask:

Why don't searches complete more quickly? The average time-to-completion has not changed over the years, remaining in the 110-130-day range.

Why hasn't the price of executive search changed? While clients are more knowledgeable about executive search processes, why haven't they forced a change in fees? Generally speaking, some clients have won adjustments of 2-5% in rare cases, but this is just a "rounding error". (using the words of a panelist)

Why hasn't the success rate of executive search improved over the years? While some of these firms claim a higher rate of completion, this is most likely the result of a change in the definition of successful completion. Firms have redefined a successful completion to include any search that has ended without the fault of the recruiter. These include,

- Searches that ended with an internal hire
- Searches that ended because the client called for it to end
- Searches that were exhausted and cancelled *with the agreement* of the client

The examples above illustrate the line recruiters can move in order to promote their success. However, an internal hire may have come as the result of a prolonged, unsuccessful search; the client may call for the end of a search because it's taking too long; getting a client to agree to close a search is not a clear indication of a successful completion. During the panel discussion, it was mentioned that Heidrick & Struggles maintains a 98% completion rate, which we find absolutely impossible to believe (using the original, pure definition of a successful completion). *In fact, we call on the AESC to provide strict guidelines on these definitions in order to preserve a level playing field among search firms and full disclosure to clients.*

TOPIC TWO: Is there a threat of commoditization in executive search? What pressures are firms feeling with regard to pricing?

The respondents indicated that there is no real threat of commoditization since they work at such a senior level. (in fact, one panelist referred to \$150K-\$200K searches as “mid-level” and under our range), even though this is more commonly a growing sweet spot for these large firms). They refer to mid-level and lower for a more dramatic example of commoditization.

In addition, they added a few clues as to how they resist pricing pressure from clients:

- Stay in direct contact with the hiring executive; resist purchasing and procurement personnel
- Focus on the assessment component of the deliverable;
- Move the discussion to a “rounding error” and push it back to the client as a “success fee”.
- Finally, “take it or leave it”.

(Prospect City): Clients, being more knowledgeable about search execution certainly have a right to pressure the industry for change. However, their success has been limited—here’s why:

- **What are the alternatives?** All of the big firms will respond the same way and moving to a boutique option might put me at risk (who gets fired for hiring Spencer Stuart?). Without a competitive option for clients, executive recruiters aren’t subjected to enough pressure to capitulate on fees, etc.
- **Do I want to damage my business relationship with this recruiting firm?** If I end my relationship with this firm, will my executives be targeted by the firm for other clients, including my competitors? If I agree to the terms, my firm is protected.
- **Personally, will I need this relationship?** Hiring executives overrate the relationships they build with executive recruiters. There is a belief that the recruiter will favor them in the event they need a new job. As most hiring executives later find out, it rarely happens.

TOPIC THREE: How have the needs of clients evolved?

The participants indicated that clients want much more information from their search providers, including market intelligence, competitive intelligence, compensation information and most interesting, they want “to be introduced to more great talent”. Clients want more access to industry talent on a regular basis – including talent outside the search parameters. While acknowledging that Private Equity firms do this, and are “ahead of the game” pressuring recruiters to deliver talent regularly, most clients can’t penetrate the recruiter’s defense:

- “Recruiters have relationships with talent and manage those relationships according to their needs and leverage those relationships to secure retained search work.”
- Recruiters are not willing to perform contingency search work (they wouldn’t even use the “c” word in the panel discussion). In fact, they indicated they were already willing to address this pressure by putting a small component of the fee at risk by collecting only in the event of a successful completion. However, one panelist referred to this as merely a “rounding error” – evidence that the risk is minimal.

(Prospect City): While it is somewhat understandable that executive recruiters are protective of their business, we question their willingness to develop new propositions that suit the changing needs of clients. While admitting PE firms have had an impact on search through their unwillingness to work under traditional fee structures and their desire for ongoing introductions to talent on a contingency-retainer hybrid, why don’t these firms offer these options to non-PE businesses?

Panelist comment: “PE firms are notoriously cheap, even though in many cases they are not spending their money.” Are traditional corporate hiring executives less concerned over cost than PE firms? Of course not, but since recruiter fees are paid from a budget (planned or unplanned), the hiring executive is not significantly impacted by the cost of search. In addition, the orders to use an external search firm usually come from very senior executives such as the CEO, who is viewed internally as budget-proof. Simply put, the concern over the cost of search is diminished when the orders come from a C-level executive. Ultimately it’s a high-value relationship gain for the client contact too.

TOPIC FOUR: At the request of clients or internal leaders, are search firms expanding to offer more services, peripheral to executive search? The answers from the panel varied from firm to firm:

- No, the core of our business is search, succession and assessment only. These are all components of our normal search process.
- Yes, there is some widening to include leadership assessment services through both recruiters and new practices.

- Overall, we're not interested because any expansion of services and subsequent expansion of clients will expand our off-limits pool. However, BOD work is an example of an expansion that does not impact our off-limits pool.

(Prospect City): Most interestingly, executive recruiters again focus on assessment as a key component of their deliverable. In doing so, they are claiming expertise in an area that may be better led by experienced consulting PhD psychologists. These individuals specialize in leadership development, culture-fit assessment and success prediction. In fact, it's common among recruiting clients to apply a third-party PhD's Psychological assessment as a final step before hiring an executive.

If the identification of senior level executives is easy (as stated by the panelists), and executive recruiters may not be best qualified as assessors,

- Why don't executive recruiters address the risk to their long-term survival? (Perhaps because today's firm leaders aren't concerned about the long-term survival of their employers – they'll be retired)
- Why won't recruiters change in an effort to adapt to a changing environment? (Perhaps because the firm's leaders are recruiters themselves and benefit from the current environment where firm's leaders have the exposure that results in more business development credit – and higher compensation)
- Why don't leading psychological consulting firms expand into recruiting? (Perhaps they should, considering their C-suite access and the admittedly easy process of identifying talent)

TOPIC FIVE: What has changed for you and your firm? (The moderator referred to “no change in 50 years”) and why have the top 5 firms remained the top five – and will they be the top five 50 years from now? Feedback from the panelists did not address any change in processes or fees, but instead provided their thoughts on issues they'll face in the future. They included:

- “Nothing is really broken”
- KFI is considering a shift in focus to include the talent side of the process, effectively an “agent” modeled on professional sports
- Concern over a lack of talent in the future
- A potential lack of recruiter talent
- A consolidation of services to include search, assessment, agency, etc.

A panelist, talking about the industry and specifically referring to Heidrick said, there is a lot of room for everyone to succeed in this highly-fragmented industry and said, “If anyone can improve the placement rate, improve the time-to-completion and improve the “stick-rate” of hires they can run the show”.

As one questioner mentioned, H&S is experimenting with the creation of a facebook page in order to expand their relationships through social networking sites. The panelists responded with overwhelming praise for the initiative.

(Prospect City): We agree strongly that the industry has not changed. However, we disagree with the reasons offered by the panelists.

“Nothing is really broken” demonstrates (in our view) the unwillingness to apply feedback from candidates and clients and make changes to improve their experience. As mentioned in the discussion, candidates are unhappy with their treatment during the search process. The notion that nothing is broken is simply turning away from the facts. Instead, we again focus on an unwillingness to change because

- Clients pay the bills, not candidates.
- Senior leadership at these firms do not want to risk any shift of power that might result from change. The firm’s leaders receive a significant amount of business “over the transom” based on their position and visibility in the market.

“Shifting to a talent agent model” is nothing new. For decades, executive recruiters have tried to develop strategies to capitalize on relationships with senior executives. We’ve participated in these discussions many times and found a few hurdles recruiters have to overcome:

- Agency = representation = ownership. How can a recruiting firm or recruiter claim ownership of an executive and how would this be impacted if a recruiting competitor were contacting the executive?
- Fees are an issue, as the firm needs to offer an attractive benefit to executives in exchange for a reasonable fee. From a candidate perspective, the fees will need to remain very low, yet offer substantial return for both the firm and the executive.
- Sports agency modeling is prohibitive because sports agents get a percentage of total income from the sports figure. In sports this is acceptable because the talent needs an agent in order to navigate the complexities of their environment, including personal expenditures, publicity, endorsements and league interaction. Many senior executives navigate a less complex environment that can be managed with less support. Their professional and personal lives are simply not as fragmented as sports and entertainment figures.
- To justify a fee, what services and expertise would be needed? Certainly the addition of legal counsel, accounting, concierge and other services would make this a low-profit return compared to traditional search.

“Concern over lack of future talent” is a real issue, highlighted by the retiring baby-boomers and the vacuum that could follow. However, we’re not convinced this will have a significant negative impact on executive search, and in fact, will probably improve their standing in the marketplace. Slots left vacant by retiring baby-boomers will be filled. Although it’s possible the quality level may drop, the

quality level is reflective of the competitor pool. The result is a comparative pool of talent not unlike the one that exists today. Even in today's climate there exists a shortage of healthcare executives, for example. A smaller pool simply translates to more work and a greater need for recruiters who can attract passive candidates.

“Lack of Recruiter Talent” could be an issue as illustrated by one panelist comment that “no one graduates college and wants to be a recruiter”. While true, today's recruiting talent comes from a similar place, so it may continue to feed the industry the same way as it always has: through a migration of business consultants moving across professional services platforms or from traditional corporate environments.

So, enough complaining: What can be done?

With the help of our clients, industry analysts and our client candidates survey results, we've put together a new business model that could have significant impact on the executive search industry.

We created and utilized the model with several clients in professional services, private equity and large corporations. While continuously refining the processes and deliverables, we've established a 24-month track record using this service in environments that had significant experience using traditional executive search firms. In many cases, the new model operated in parallel to the traditional search recruiter in an effort to compare “side by side”.

Pipelining

Pipelining is an ongoing process that delivers a continuous stream of top talent according to the parameters set by the client. The pipeline may support a specific role (i.e. CFO), a function (i.e. corp finance execs) or an industry (industrial executives).

Key ingredients:

- A technology component that organizes and presents information for clients and recruiters.
- A client who is engaged in the process and willing to interact with recruiters and direct strategy more frequently.
- A client who understands the value of meeting top executives for current and future needs – even those needs beyond hiring. Those include deals, M&A, competitive intelligence, market feedback, compensation information and networking.
- A client who has the patience and long-term planting/harvesting capabilities required to build and manage a talent pipeline.

- A service provider (recruiter) willing to exchange a high-profit, transactional model for consistent revenue and prospective long-term benefits of the relationship.
- A value proposition for the client that addresses their need for a long-term return on their investment. This requires a willingness on the part of the recruiter to transfer ownership of all data to the client company; a willingness to turn these services up, down or off without penalty; a willingness to forgo large financial rewards for successful completion in exchange for continuing work.
- A highly leveraged model that includes recruiting researchers capable of identifying and pre-qualifying individuals for executive recruiters.
 - Researchers dedicated to specific clients will refine their expertise in the industry, the function and with the client organization.
 - Eventually these researchers will have the ability to engage directly with clients on a regular basis (high-touch), with recruiters serving as relationship managers (lower touch).
 - To be effective and reliable long-term, recruiters must offer a higher compensation to these researchers that ties more directly to their success. This is critical, since the recruiter must extract a long-term commitment from researchers to capitalize on their investment. (researchers will become experts very quickly and replacing them will become increasingly difficult over time)

Examples

We applied our model to various positions and functions within several industries, with best results in the \$200K+ salary range (normal search fee range of \$65K+).

CASE ONE: A large, global consumer company identifying individuals for a C position in their manufacturing function, to serve as a potential successor to the CEO. The client was attracted to the idea of owning the data, full transparency and an opportunity to meet top talent in peripheral areas. In addition, the company was open to identifying potential M&A opportunities as well as gathering competitor information.

Fee Structure: The client and service provider agreed to manage up to three project specifications at any given time, with additional work subject to higher fees. A monthly retainer of \$15,000 allowed the service provider to compensate the researcher \$5,000/mo. in exchange for ½ of their time (80/hrs).

- Client Fee: \$15,000/mo. (Net Revenue: \$10,000/mo.)
- Success Fee: The first two hires in each 12-month period require just a \$10,000 success fee (\$5,000 is awarded to researcher). Subsequent success fees require a fee equal to 15% of total first year compensation.
- The technology is included as the vehicle for delivery. However, if the client turns off the service on a temporary or permanent basis, a technology-leasing fee

applies (usually \$1,000/mo.). At any point the client can request the technology be cancelled, all data be extracted and delivered to client.

Client Results: Over the course of this project (first 16 months), the client identified a slate of candidates for President, meeting the criteria set in the original position specification; function-leading six-sigma experts who could build a formal program for the company; an executive who established a formal partnership with a non-competitive partner company (\$23B) to share and improve best practices for a specific type of chemical manufacturing to improve products for both companies. An exiting executive was introduced to a leading Private Equity firm that later resulted in a formal arrangement. In addition, the client engaged the recruiter to perform additional, peripheral work including reference checks, internal assessments and competitive intelligence projects.

Recruiter Results: Over the 16 month period, the executive recruiter received over \$370,000:

- \$240,000 in base fees
- Success Fees of \$30,000
- Add-on Fees of \$104,000 for peripheral work (reference checks, internal assessments, due diligence and competitive intelligence projects relating to compensation)

Client Reaction: The client saw a \$100,000 savings on recruiting fees over transactional search and a savings in peripheral project fees of \$60,000. In addition the client found additional internal clients in need of search work, which was later awarded to the pipelining recruiter. The most compelling reaction was the client's consolidation of vendors in the area of talent acquisition and the funneling of additional "peripheral" work to the pipelining team.

CASE TWO: A global professional services firm had a need to hire multiple executives with similar requirements – but across a global platform. The client was unhappy with retained search options, namely the time to completion and the low success rate, which compounded cost-per-hire. Like other clients, they were attracted to the return on investment as it relates to full transparency, owning the data and the ability to control resources by shifting from one need to another. In this case, the client pitted the service provider against a leading recruiting firm specializing in their space.

Fee Structure: The client was charged \$10,000/mo. to manage three active roles at a time, since the positions were similar across multiple geographies. In addition, the success fees were changed to \$7,500 per hire. This fee arrangement was agreed upon with an understanding that if successful the client would expand the relationship by removing other executive search firms as vendors while funneling additional work to the service provider.

- Client Fees: \$10,000/mo. with \$4,000 to researcher

- Success Fees: \$7,500 each
- Technology included unless the service is turned down, at which time a \$1,000/mo. leasing fee applies.

Client Results: The client benefited greatly from this project, now surpassing 24 months old. The client hired over 22 individuals and lowered their average cost-per-hire from \$80,000 to just under \$20,000. The hiring timeline was cut by 60% too. In addition, the company used competitive intelligence to restructure their internal compensation plans to be more competitive. The recruiting firm that was hired to compete with the service provider at the outset was unsuccessful. In addition, the firm was able to improve the quality of services they provide to their clients by sub-contracting the service provider for peripheral services, including reference checks and assessment.

Recruiter Results: Over the first 24 months the recruiter received over \$400,000 in fees. Because this project required little or no recruiter involvement, the recruiter received over \$100,000 annually for minimal hands-on work. As a result of this relationship, the service provider established a partnership with the client to provide subcontracted services in support of their clients, including due diligence, reference checks and market analysis projects. These additional projects resulted in add-on revenue of \$180,000 directly to the recruiter for their participation and analysis. Today the service provider team is considered the “go-to” resource for the clients and *their* clients.

Client Reaction: As stated above, the client no longer engages with executive search firms. The client has referred the service provider to every geographical leader, who has in turn promoted the service provider to their client companies. In addition, the client provides better, more robust services to their clients by adding deliverables provided to them by the service provider. The client is a huge fan and internal introductions have expanded to every senior executive globally.

CASE THREE: This leading Private Equity firm, like many, has an ongoing need to identify talent applicable to their organization and their portfolio companies. Their needs change often and move from general to specific in nature. These changing needs prohibited the firm from engaging with traditional executive search firms who offer transactional services and retainer fees. The extent of the firm’s engagements with search firms is to accept top executives and pay a fee only when a deal is made or a hire is made. Because this translates to contingency search, most senior firms would not put forth much of an effort.

Fee Structure: This PE recruiter arranged a fee of \$20,000/mo. for ongoing pipeline services. In addition, they negotiated a “true-up” success fee annually that measures the monthly retainer fee total against any hires, and targets a per-hire fee of 23%. In addition, the recruiter relinquished ownership of the executive pipeline, but retained success fee requirements for a period of 18 months beyond any point of cancellation. Should the PE firm hire or make a deal with an executive in the database within the 18-month time frame a fee would apply. If the project is inactive (cancelled) a negotiable 30% fee would apply for each hire.

Client Results: The firm directed the team to identify top C-level executives within a tight industry within the U.S. The PE Partner later expanded to add new projects, similar in nature for other industries over the course of the relationship. The PE team viewed the project as one that would give them an advantage against their competitors, allowing them to more quickly identify and introduce top talent and up-and-coming talent for future needs as well as greater knowledge capture from the industry in general.

Recruiter Results: The service provider generated base fees of \$240,000 per year and established a relationship that resulted in being awarded exclusive search work (traditional fees) for the PE firm's portfolio companies. The introduction to additional executives at the PE firm as well as its network of senior executives led to several new engagements totaling an additional \$540,000 within an 18-month period, including pipelines, reference checks, traditional search and market research projects. In addition to this work, the service provider was awarded due diligence projects associated with M&A activity and long-term planning initiatives of the client.

Client Reaction: The client is extremely satisfied and has convinced its internal executive team to use the pipelining technology to manage their contacts (instead of MS Outlook), which resulted in a consolidation of data and a successful sharing of information internally, among partners. In addition the firm expanded the technology to:

- Allow portfolio company leadership to participate in the process, initiate pipeline projects and direct the service provider's team to support their needs.
- Allow external executive recruiting partners to submit prospective candidates (contingency) into the database directly, resulting in a clean process that effectively assigns "credit" for introductions and assessment. This was critical in giving the PE firm greater leverage in negotiations of fees for engagements, deals and other projects.
- Allow interested executives to express interest and submit appropriate information directly into the system for further analysis. It is an effective solution that bridges high-touch services with efficiency for the firm. The process was received very well among prospective partners and employees.

What are the requirements of technology to organize and deliver information for clients?

There are several requirements for the technology:

- Accessibility: The technology must be accessible to as many individuals as possible, regardless of location, and should not require any significant technical support. Local client software likely requires local technical support and serves as a barrier for others to access information (multiple operating systems, geographies, languages, etc.). A web-based solution is ideal, but requires multiple layers to ensure confidentiality, reliability, and security.
- Security: Any system requires a high-level of security. Any breach would likely be catastrophic, so solutions must be extremely secure, using secure operating

- systems, code, physical location-based security and user-level security. Any system would require an equalized level of responsibility among clients and service providers, including the confidentiality and secure handling of assess information (location, login, etc.).
- Simple, Intuitive: To eliminate or reduce the need for personal training, any system should be light-touch or no-touch from the client's perspective. The system is often opened up to additional employees or business units on a regular, frequent basis, so training can be cumbersome to clients. A simple intuitive system that requires few clicks, few tabs, etc. for navigation is needed. In addition, presenting information in a logical format, massed on one page is ideal.
 - Portable and Scalable: Any system should be transferable, customizable to meet the individual needs of each client, and scalable to support user groups ranging from 1 to 100's. The system should allow for the transfer of information internally within the client company and able to produce detailed reports highlighting the results, the volume, the interaction, frequency of use and other information that will help clients best analyze the work of the service providers and internal users.

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