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Headhunters' fees

For years, headhunters' fees and methods have been discussed guardedly, with the kind of discretion displayed by canny prospectors sifting for gold among the base and semi-precious metals of humanity.

They know, and hope their clients appreciate, that the sort of people who can transform the ailing fortunes of a large enterprise are thin on the ground.

How much should search firms be paid for the people they find? How can we quantify the value they add? How can the buyer and seller arrive at a suitable fee? These are perennial questions in the search business, rarely discussed in open debate.

When Denise DeMan Williams, president and chief executive of Branch International, a US-based headhunting firm, decided, therefore, to challenge the fee structure and service model in a recent edition of Executive Recruiter News, a respected industry newsletter, it was bound to cause a stir.

"After 30 years in the business, I have come to realise my profession is broken," she wrote. "Few in our service business will admit it. We have image, revenue, and our very existence to protect. Yet it is our own clients who recognise that the system we have co-conspired to create is one of the least truly client-focused service industries in the for-profit business community."

Her harshest criticism, all the more powerful in that it came from within the industry, was focused on the long-standing fee structure that remains what she called "the religious doctrine of traditional retained search."

Fees tend to be based on a third of the full year's cash earnings of the successful candidate, although sometimes the proportion may be discounted where there is strong competition for an assignment. Capping fees at an upper limit is also common for the most highly paid jobs. In the retained system fees are also expected whether or not the search is successful.

The classic payment terms demand one third of the agreed fee at the start of the contract, another third after thirty days and the final third thirty days after that.

"So let's be clear," wrote Ms Williams, "The customer has often paid entirely for something they have yet to receive."

"Where is the sanity in going to a high-end designer, purchasing a custom-designed suit, making three payments as it is being completed,

and emerging from the transaction with nothing, or, at best, an empty suit bag?" she asked.

Ms Williams maintained that it was reasonable for a client to expect a post to be filled by a headhunter at the end of a search. Acting in the client's best interest, she argued, demanded that, if the retained firm could not complete the assignment, it should partner with a firm that could finish the job on a fee-sharing basis.

Peter Felix, president of the Association of Executive Search Consultants, believes that such a commitment amounts to a contingency arrangement - a fee system that is not supported by retained firms.

"The retainer gives an exclusive mandate to the consultant to represent the client and to search the market on his behalf. It implies strict confidentiality, professional handling and feedback, sharing of market information with the client and so on. It is, in our opinion, the only basis upon which to conduct senior and often highly sensitive assignments," says Mr Felix.

Pressure for contingency arrangements has been a running sore in the retained search market for some years. Moreover, fees have been squeezed by discounting during the four-year long recruitment recession - now easing - that was regarded by many recruiters as the worst slump in the history of the search industry.

"I think that many in our profession would say that if executive search is done well and truly delivers exceptional talent to the client then it is cheap at the price. We all know what impact a truly successful executive can have on an organisation's health," says Mr Felix.

His view is supported by Joseph Daniel McCool, editor in chief of Executive Recruiter News, who points to the way spectacular increases in the market capitalisation of a company can result from a single high profile placement. In 2002 when Tyco International recruited as its chairman and chief executive Ed Breen, then the number two at Motorola, the company's shareholder value rose by \$1.3bn.

"In that case, the search consultants' fee amounted to one one-hundredth of one per cent of the shareholder value generated on that day alone," says Mr McCool.

If a single search can move a company's share price by more than a billion dollars it is no wonder that many headhunters argue that their service is cheap in comparison.

But what happens if a job move turns sour? Should headhunters be held accountable for mistakes? This may explain why an enthusiasm for taking equity stakes as payment for bringing talent to a start-up companies during the dotcom era did not persist to any great degree after the downturn in technology stocks.

"A search in many markets across borders will be more costly than searching solely in the home market. Equally it is usually easier to place someone in to a progressive company than in to one that has run in to trouble. The fee needs to reflect that," says Ashley Summerfield, a London-based partner of Egon Zehnder International

"By fixing a fee up front we are in a position to give advice and consult without any suspicion that it might be in our interests to put forward an expensive candidate. In the percentage system there is a perverse incentive to recommend someone who may not necessarily be the best candidate."

The irony of this system is that it can mean that some complicated searches end up costing a client more than a third of the first year's package.

"You are paying for the time of high quality professionals. You are not paying for an outcome. That said, we all know that we will not get repeat business if someone is not satisfied with the outcome so there is every incentive to do the very best job we can do," says Mr Summerfield.

This point runs through most arguments on fee structures, no matter where a headhunter stands on the percentage/fixed fee divide. Richard Boggis-Rolfe, chief executive of Odgers Ray & Berndtson, admits that discounting has entered in to search assignments, particularly where firms are competing in a so-called beauty parade. But he argues that it can undermine service quality if a headhunter is hard pressed to make an assignment profitable.

"I don't believe there is anyone who is completely inflexible," he says, "And I don't think it is unreasonable that a fee should be higher if an appointment is made than if it does not happen. But it should be realised that a search consultant can really add value, helping a client understand what is needed. Often we are dealing with a move that can amount to the biggest professional decision of someone's life. That's a big responsibility."

The danger, according to Ms Williams, is that these issues can be forgotten if a service begins to be dominated by sales. "As a culture," she wrote, "We have made humans and serving humans a commodity. Can anyone defend this?"

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