REDUCE THE RISK OF INVESTING IN UNCERTAIN MANAGEMENT CAPABILITY

Pratch & Company helps corporate boards, CEOs, and private equity investors more successfully manage the human dimensions of executing corporate strategy. For our clients, we assess the leadership strengths and shortcomings of executives who must function well for mergers, acquisitions, and turnarounds to achieve their targets. We deliver targeted developmental feedback to executives in order to support lasting improvement in their effectiveness. We also advise investment firms on key aspects of finding, creating, developing and keeping executive talent.

We reduce the number of hiring mistakes and provide guidance for how boards and CEOs can get the most performance out of executives who should be (and are) hired. To improve the quality of hiring decisions we use a unique approach to psychological assessment, our *Active Coping Assessment* SM system. This system, rigorously tested in academic research and published in peer-reviewed journals, permits us to make fine-grained distinctions and powerful predictions that are not possible using any other assessment approach. Assessing key executives prior to deciding whether to fund a particular proposal dramatically enhances the chances of making the right decision and enables investors to collaborate most effectively with their CEO partners, vital to creating operational value.

The predictive power of our methodology for assessing business leaders is more than three times as great as the skills and talent methods used by most psychologists who act as consultants to business. Our methods tap into behaviors and attitudes that the subject cannot control but which nevertheless exert powerful influence over how he or she functions in the work place. Our clients regard our assessment as the best kind of psychological due diligence to be undertaken prior to making funding and/or hiring decisions. The Appendix provides three illustrative examples of our assessments, which measure the executive's coping, motivation, and cognitive capacity in relation to the role and business context in which the executive will be expected to perform.

Our developmental services help high-functioning executives gain a deeper understanding of their psychological strengths and weaknesses and how their personality can be leveraged to improve their decision-making. We evaluate management teams to assess their ability to meet corporate objectives. These audits identify organizational, interpersonal or goal-related conflicts or tensions that may be interfering with organizational effectiveness.

About Leslie Pratch

Leslie Pratch, Ph.D. is a clinical psychologist and MBA who specializes in helping public and privately held firms identify whether executives being considered to lead companies possess the competencies and psychological resources they need to be effective in a specific role. Over the past 20 years she has evaluated 700 prospective business leaders for 97 organizations. The predictive validity of her assessments exceeds 98%.

Her evaluations are derived from research she led at the University of Chicago Booth School of Business. These studies and her subsequent research focused on what makes successful business leaders effective: Do a firm's most capable managers possess personality attributes that can be identified years before those managers are ready to assume top leadership roles? In Looks Good on Paper? (Columbia University Press, July 2014) she describes this approach and its applications to assessing and developing high-performing business leaders.

Since 1998, Leslie's advisory work has emphasized the assessment and development of executives and succession planning by officers and directors. Her client base includes corporations and professional service firms. She also advises executives on ways to maximize their professional success. For the past 20 years, Leslie has focused on helping private equity investors reduce the risk associated with investing in uncertain management capability. She is also experienced as an expert witness in matters relating to leadership capability and performance.

Leslie received her B.A. in Religion *cum laude* from Williams College; an M.A. in Human Development from the University of Chicago, an M.A. and Ph.D. in Clinical Psychology from Northwestern University Medical School, and an M.B.A. specializing in Corporate Strategy and Finance from the University of Chicago.

Select Clients

Adams Street Partners
Center Rock Capital Partners
Emaar Properties
ESO Fund
Encore Consumer Capital
L Catterton
Santé Ventures
Strategic Value Partners Global
TreeHouse Foods
Winona Capital

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Appendix

Three Executive Assessment Case Studies

Management assessment leads to action and improved ROI

A good management assessment can help you understand the person behind the more easily observable track record and activities. Below is a much-abbreviated version of an actual report I sent to the investors who had hired me to assess a potential CEO whom I call "Mack." It will give you a flavor for the difference the assessment can make in maximizing ROI (and minimizing anxiety in investors).

THE HAPPY CASE OF MACK

Mack had turned around underperforming operations but had never been CEO. His 25-year industry record looked good to the investors who had bought a large, family-owned company with plans for dramatically improving its performance.

The investors were concerned, though, about Mack's ability to lead a billion-dollar business. And they were interested in how he would work with the founding brothers (who would stay as operating executives) and other top managers through the wrenching change program.

My report on Mack (abridged)

Mack is strongly motivated to succeed as a CEO. He is honest, reliable, hard working, and extremely competitive. He has high standards for himself and for others. Cognitively, he is limited. He is not a great thinker. He sees in black and white, without noticing ambiguity or nuance.

Mack is rigid. His implementation is mechanical and reactive, without intuition or feeling. Supremely self-confident, he presumes that all problems will conform to his ability to solve them. He expects subordinates to execute in a logical, let's-do-it manner. If they resist, he assumes they are wrong and he will not compromise. He does not consider that subordinates might not agree with his solution.

Mack succeeds by being intensely driven and self-confident. He responds to challenges directly, aggressively and with focus. Unfortunately, this style also means that Mack will likely cause conflict during the change program that a more listening, nuanced leader could avoid.

My recommendations

Mack operates best in a chain of command. He wants clear directives from the Board to implement and impose on subordinates. Mack won't see trends and conceive or adjust the strategy; you (investors) will have to devise corporate strategy. Then Mack will work hard to execute it.

You will also need to monitor the other managers' morale as Mack bulldozes over them to achieve your goals. Mack is neither interested nor capable in the softer aspects of organizational culture. In dealing with such issues, he will likely be ham-fisted and hard-hearted; he will fray human connections and will destabilize the company. On the many matters likely to significantly affect morale, you will have to act as a control rod and force Mack to think about how changes would affect others. You will need to develop relationships deeper within the organization to know how employees accept or reject Mack's directives.

Mack is not a perfect fit, but he is capable of doing what the organization requires.

Outcome

The investors addressed Mark's deficiencies, and his style and their guidance proved an effective combination in a turnaround situation. Investors created the strategy and told him to implement. They also monitored his impact on the organization, stepping in to communicate changes in ways others could accept. His implementation of an aggressive strategic plan yielded costs savings and revenue

enhancements. The strategy and Mack's outstanding, focused execution transformed the company into attractive platform on which to build a national competitor.

Four years after hiring Mack, investors sold the company to a financial sponsor. They called the investment “a home run,” having earned a return of 4.4 times their invested capital.

Conclusions that can be drawn

The assessment provided investors insight and confidence about what it would take for Mack to succeed. They understood what they needed to do, based on Mack's managerial strengths and weaknesses. That awareness led them to provide him strategy in bite-size pieces he could implement, and to mitigate the effects of his hard-charging style.

Experience can be deceiving when it comes to securing success

Sometimes the wrong person looks like the right person but backing the wrong person can be a disaster. Just because someone is in an industry and has been successful to date does not mean they have the "right stuff" for what you need now.

Are you confident the people leading your companies have the "right stuff," or are you just hoping based on what they've done in the past? Do you have a deal coming up where you'd be more comfortable knowing that the person leading the team has the skills and stability to thrive even in changing and unexpected times?

Consider the case of Jack, a CEO who turned out not to be what was expected...

THE SAD TALE OF JACK

Jack was the CEO of a start up exploiting opportunities in a rapidly consolidating but still highly fragmented distribution industry. He was a successful, smart corporate lawyer with a mergers and acquisitions background in this industry.

Jack’s start-up enjoyed no important advantages in terms of technology or marketing. The plan was to identify good targets and to close deals at attractive prices. Competition was intense as several of the industry’s global players were pursuing the same strategy. Management capability was crucial, and Jack was part of a management team with formidable strengths. Investors had already agreed to supply Jack’s company acquisition capital when they asked me to assess him.

What I reported after assessing Jack

Jack is hard working, self-reliant, and verbally very intelligent.

But his coping style is reactive and avoidant. He is especially weak when working with others. He is not good at generating goals or overcoming obstacles. He does not easily tolerate ambiguity; the more poorly defined the problem, the more passive his coping.

When confronted by matters that require him to take initiative, improvise, or be decisive he becomes extremely anxious. At such times, he is unable to withstand the tension that would accompany seeking a full understanding of issues and working to resolve them. In an effort to get rid of problems that vex him, he offers facile, simplistic solutions that gloss over crucial details. As a result, he forecloses options when he would be better off reflecting in order to develop effective solutions.

This passive coping compromises the quality of his judgment to the point that would put the venture at risk. Unfortunately, the issues most likely to make his business successful – such as finding targets at attractive prices and handling them in a timely manner – are precisely the issues likely to bring out his passive coping.

Jack has a narrow expertise, and beyond this range, his coping breaks down. If his company were to run into difficulty – if it missed deadlines, timetables, or forecasts – his passive coping would interfere with the venture being as successful as it needed to be.

What happened (the ugly, the bad, and the good)

As investors worked more closely with Jack in his first negotiation with a seller, they saw the poor judgment our assessment had highlighted. He entered into an agreement with a seller on terms the investors had explicitly rejected. After Jack rejected their directives and moved ahead without considering their concerns, they put on the brakes by withdrawing funding. Fortunately (for Jack), another private equity firm did the deal. Unfortunately (for Jack), they had to replace him with a new CEO. The company subsequently thrived under the successor CEO.

Conclusions that can be drawn

Assessment can help you identify a disaster waiting to happen before it happens. You have to know where to look.

When the CEO hasn't "done it all before" – but could still be the right choice

If you are like many investors, you like a CEO who has already done that job well in a similar situation; you believe that the CEO's documented experience reduces your risk. Would you be willing to go with someone who doesn't have "the track record"? What if there was a real downside to not going with the "novice"? Sometimes investors needlessly throw away important talent. You can frequently get the results you need if you understand the **person** you are considering, what makes them tick, and what would make them tick even better.

The right kind of management assessment can get you the insight that you need. And the right assessor will tell you **how you should behave differently** in order to maximize the executive's performance. That's what happened in the case of Wayne....

THE VERY HAPPY CASE OF WAYNE

Investors asked me to assess Wayne, the COO of a company they were planning to acquire. They had a bit of a problem. Wayne said he'd leave if he were not made CEO upon the change of ownership. Did he have the leadership and management skills to be CEO – a major strategist and the executive driving operational change and growth? As detailed below, the assessment answered with a definitive "Yes!"

My report on Wayne

Wayne is extremely intelligent. He is a logical, sequential, quick, and flexible thinker. He analyzes alternative scenarios in a sophisticated way. He creatively brings disparate pieces into a meaningful whole. He lives with the fact that he has made mistakes, and having made mistakes, tries to learn from them.

Wayne also has social intelligence. He has insight into himself and is aware of what transpires around him. His eagerness to seek out information (including typical hard facts but also how people feel and are

behaving) and weave it together allows him not only to formulate effective business strategy but also to motivate and work well with others in executing it. To the extent that his intuitive style biases him to take action without a full consideration of evidence and counterarguments, Wayne solicits the viewpoints of others before making final decisions. He encourages constructive conflict as a way to explore fully opportunities and problems and to resolve them. These are admirable qualities and evidence of sophistication in his functioning.

Unusual for an executive in his late 30s, Wayne has a mature identity as a leader. He sees himself as a father figure, at times encouraging, forgiving, and empathic toward his subordinates, at other times critical, reprimanding, and willing to mete out deserved punishment. Related to Wayne's maturity is his serious and pragmatic style. He accepts basic social values. He plays by the rules. He seeks others' input and makes decisions after consulting them. He prefers that his subordinates accept his leadership without his having to invoke the formal authority of his role. He wants the support of his team while clearly seeking the responsibilities as leader.

Important to Wayne's self-image is that he be perceived as a good person. He does not easily handle criticism that appears to question (or that he construes as questioning) his morality or his fundamental decency as a person. One Wayne's few weaknesses is that he becomes defensive when he fears that others have judged him as having done something bad. His need for others to perceive him in a good light makes him slightly rigid and less open and creative than he could be. It also makes him dependent on superiors for recognition and praise.

Wayne pushes himself to take advantage of business opportunities and to do the best he can, and he expects the same of others. He does not tolerate subordinates who do not live up to expectations. He will not hesitate to be critical when necessary and is a demanding boss. He requires integrity, reliability, and competent performance in others. He does not tolerate mediocrity or dishonesty.

Wayne's tendency to be somewhat rigid does not interfere with being pragmatic. He understands bottom-line pressures and responds to them in a way that is appropriate for the success of the business, which includes dismissing subordinates who do not meet expectations or are otherwise dispensable. Wayne is likely to demonstrate the leadership that you expect. He possesses the resources to cope with the demands of the CEO role, now and in the future. He is extremely ambitious and believes he is now at a point in his career where he is ready to run an organization. We agree. Your role in working with him should emphasize supporting him so that he can live up to his own high expectations.

My recommendations

One, **you should be as explicit as possible with Wayne regarding expectations, goals, timetables, and resources he will have available, now and in the future.** He tends to get touchy when presented with demands or expectations that were not previously established. He is sensitive to criticism and does not want to make a mistake and responds defensively to what he perceives as vague and poorly defined expectations.

Two, **you should give Wayne a clear understanding of how you intend to work with him.** He will keep his end of the understanding and will expect you to live up to your end. He'll become frustrated if you fail to perform as promised. You should state up front what the process of control will be, and what the limits are. You should put these ground rules in writing so that Wayne cannot later complain he did not know.

Three, Wayne seeks recognition and support without being needy or exhibitionistic. He is a conscientious and moral person. It is important to him that others recognize those qualities in him. This bears on how investors should recognize Wayne's achievements. He would like to be valued in the same moral terms he understands himself. He might like financial rewards but would also like others to see his skills and ability to grow the business. **You should give him appropriate feedback if things are going well, and encourage him to keep up the good work. You should couch your criticisms** to minimize the chances that he feels he is perceived as a bad person.

In sum, Wayne is a conscientious but pragmatic and bottom-line focused executive. He will do what it takes to help the Company be successful, achieving expectations in a moral way.

The very happy outcome

Two years later, investors sold the business. They rated Wayne as an "outstanding CEO who beat his budget every single month." Their investment yielded 3.3x invested capital and had an IRR of 115%.

Conclusions that can be drawn

If investors had insisted on having a CEO who had previously been a CEO, Wayne and his valuable knowledge would have left. Someone else who may or may not have been able to lead the company would have been hired. But the investors were willing to rely on my prediction about Wayne's ability to do the job and my guidelines for how, as controlling investors, to interact with him in order to capitalize on his strengths and minimize the risks posed by his weaknesses. As a result, they harvested the ample fruits of Wayne's efforts. They didn't unnecessarily trade in the actually very good card in their hand for a draw from the pile.