I'm afraid to ask an executive to do a "touchy-feely" management assessment

Knowing before or shortly after you invest in a company whether management can do what you need done and can cope with unexpected change is important, especially in volatile industries. It makes sense to have management assessed with a method that informs you of what the managers can do and how best to work with them for all of you to be successful.

Some investors almost always do rigorous and informative management assessments. But others are very skittish about asking leaders of the companies in which they are investing to be assessed. They say they are worried about losing the deal by asking before it's closed or of straining relationships with management afterwards.

Happily, you can get you what you need – enough knowledge long enough in advance to be maximally useful – without risking the deal.

WHEN TO ASK – AND HOW – IN TYPICAL CASES

Normally, a deal progresses through some kind of formal or informal shopping period, where the target firm or its bankers are talking with several or many prospective investors, and those investors are exploring the facts as shown in the CIM. It's pretty hard to ask management to be assessed at this point, and rarely worth it.

In the next phase, you are the only investor negotiating. You've officially signed a deal, both parties have jointly issued a press release announcing the transaction, and you and the seller are working toward closing the transaction. I recommend that in typical situations, the investor ask the target key executives to do an assessment towards the end of Phase Two. The best way to ask is to politely suggest the assessment as part of the normal pre-closing activity for your firm. You can say, "We like to have our portfolio company managers assessed. It's something we ask for regularly. We know some people seem skittish about it so we don't insist upon it all the time but we would really like it if you would be willing to do it."

You can highlight the positives of doing an assessment, emphasizing how it helps both parties work better together. You can say, "Let us get the information that ought to help us to work well together. Management assessments are something we do because it's good for us, and most people find it's good for them because they learn a lot about themselves. You learn where you have an opportunity to grow and we learn where we can adjust how we work to fit with your strengths. We both benefit. Would you be willing to do it?"

If managers say "no" you can consider offering some inducements. You can suggest, for example, that you are more comfortable making adjustments in how the Board and company interact when a CEO has been assessed, and that you are more comfortable signing more lucrative or longer employment agreements after a CEO has been assessed because you have more confidence in his capabilities to deal with unknown events. If the response is still "no" you can back off and complete the deal.

If you close without an assessment, then I suggest you do an assessment shortly after the close. You can say, "We are happy with you in the organization but this is a transition and we want to make sure we do everything so that the investment in the company and its CEO works as well as possible, and this process is something that we have found helpful. Here's what it involves and here's what you get out of it. It's helping people find ways to improve where they're not yet perfect." In a control situation, the CEO is now an employee of a company you own. The CEO's likely to be hard-pressed to say "no." Of course, a negative response can happen, and then I'd suggest that your Board representation be particularly intense – with the explanation that in the absence of knowledge about how best to

manage the relationship – due to the absence of data that the assessment would provide – you need to take the most draconian approach to minimize downside risk.

Your goal in this approach is to do the assessment before problems arise, and ideally, to use the results of the assessment to prevent preventable problems. If problems do arise, relationships will be strained and tensions will be high, making it hard to get cooperation on an assessment.

ANOTHER ROUTE ALTOGETHER

An alternative and/ or supporting approach would be to have your own assessment first, and then say that the process was painless and educational. You can share what you learned, for example, "Here's what we learned about working with our portfolio company managers. We learned to tell them to ask twice for stuff from us because we're slow to respond to requests (hypothetical)."

SPECIAL CASES

1. **The management-backed rollup team**

   In a small minority of situations, you can ask in Phase One, when you're doing your due diligence on the company. Say it's a management team that has come to you for capital to pursue building a platform in a consolidating industry. They need your capital and can't really say no to cooperating with due diligence requests if they want to get it. You don't know them but you like the opportunity they're pursuing and they are looking for a backer rather than shopping among many eager backers and will likely accept your interest in assessing them. You certainly can at least try early on to see how they react; you can decide how much you'll insist by looking at how violent their reaction is and how eager you are to pursue the opportunity even while in the dark about them

2. **The deal where the wrong CEO would be so expensive you'd rather lose the deal than be stuck with him or her**

   Sometimes (probably rarely) a wrong CEO would affect the value of the deal so much that if he were in place for even a few months after close, you'd rather pass on the transaction. In that case, it's worth insisting on the assessment as part of the Phase Two diligence. My research suggests that up to 38% of deal day managers aren't really the right person for the job (and also that lots of CEOs are replaced in two years by investors as the target company situation and markets evolve and the strengths and weaknesses of the CEO become familiar to the investors through hopefully not too painful experience).

What should I do?

At an appropriate point, try to set up an assessment instead of being afraid of losing the deal. You can gain by establishing a much better way of working with the management team, and avoid the need to start trying to get the information to figure out how to fix a bad situation after it goes bad.