

# Using Management Assessment Tools to Maximize IRR



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Presented by  
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# Purpose

*The purpose of our session today  
is to help you achieve  
more career and financial success  
than you ever dreamed possible.*

*We will do this by helping you learn a  
solution to every private equity investor's  
#1 problem.*

# About ghSMART

*"If we don't get the people right, we lose.  
It is the most important thing in our business."* – **Jack Welch**

- Founded in 1995, ghSMART is a management assessment and organizational development firm serving major private equity firms, their portfolio companies, and CEOs and boards of Fortune 500 corporations.
- Our mission is to use our expertise in human behavior to help CEOs and investors build valuable companies through acquisitions, hiring, and talent development.
- We have conducted over 10,000 executive assessments and hundreds of coaching engagements in the past 12 years.
- ghSMART arms investors, boards, and CEOs with rigorous analytical tools to analyze and maximize performance of management teams. We enable our clients to apply to management the same rigor and fact-based approach as they deploy in other aspects of due diligence.

# Every Private Equity Investor's #1 Problem

## Hiringitis:

- Definition:** Making hiring mistakes/backing the wrong management teams.
- Symptoms:** Can't rely on your CEOs/CFOs/COOS. Too much time spent on issues with existing deals rather than sourcing new ones.
- Consequences:** Significant negative impact on career success and investment returns.
- Root cause:** Voodoo hiring and assessment methods.

# Hiringitis: Every Investor's #1 Problem

## Pervasive.

- The Economist Cover story "The Search For Talent" (October 6, 2006).
- Steve Kerr, Chief Learning Officer at Goldman Sachs: "Otherwise smart people suffer from making hiring mistakes; for many it is viewed as a 'black art' with a 50/50 chance of success."
- Peter Drucker estimated a 50% hiring failure rate.
- Jim Collins urges "First Who Then What."

## Costly.

- 15x salary per hiring mistake.
- Lower returns on investments, missed opportunities, slower execution.

## Preventable.

# Top Five Most Common Mistakes In Hiring

Sample of 33 CEOs and Investors

	Source	How Often Mentioned
1	Not evaluating cultural fit.	36%
2	Talented person, but not matched with needs of the job.	24%
3	Failing to invest enough time in the hiring process.	18%
4	Not finding out enough information about the person.	18%
5	Being fooled by resumes.	15%

Source: StreetSmart Hiring Study, ghSMART 2007

# Do You Use Voodoo Hiring Methods?

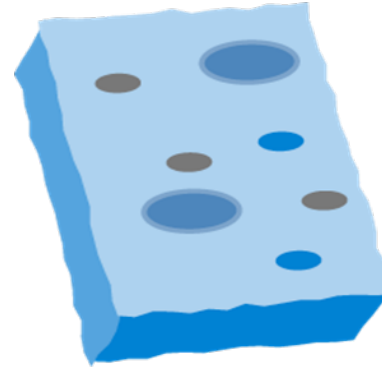
- The Wadded Up Piece of Paper Test.
- The Toll Booth Test.
- What Type of Animal Would You Be?
- Hypothetical Questions.
- The Spouse Test.
- The Prosecutor Method.
- The Sponge Method.
- The Art Critic Method.

# Hiring Methods

Art Critic



Sponge



Prosecutor

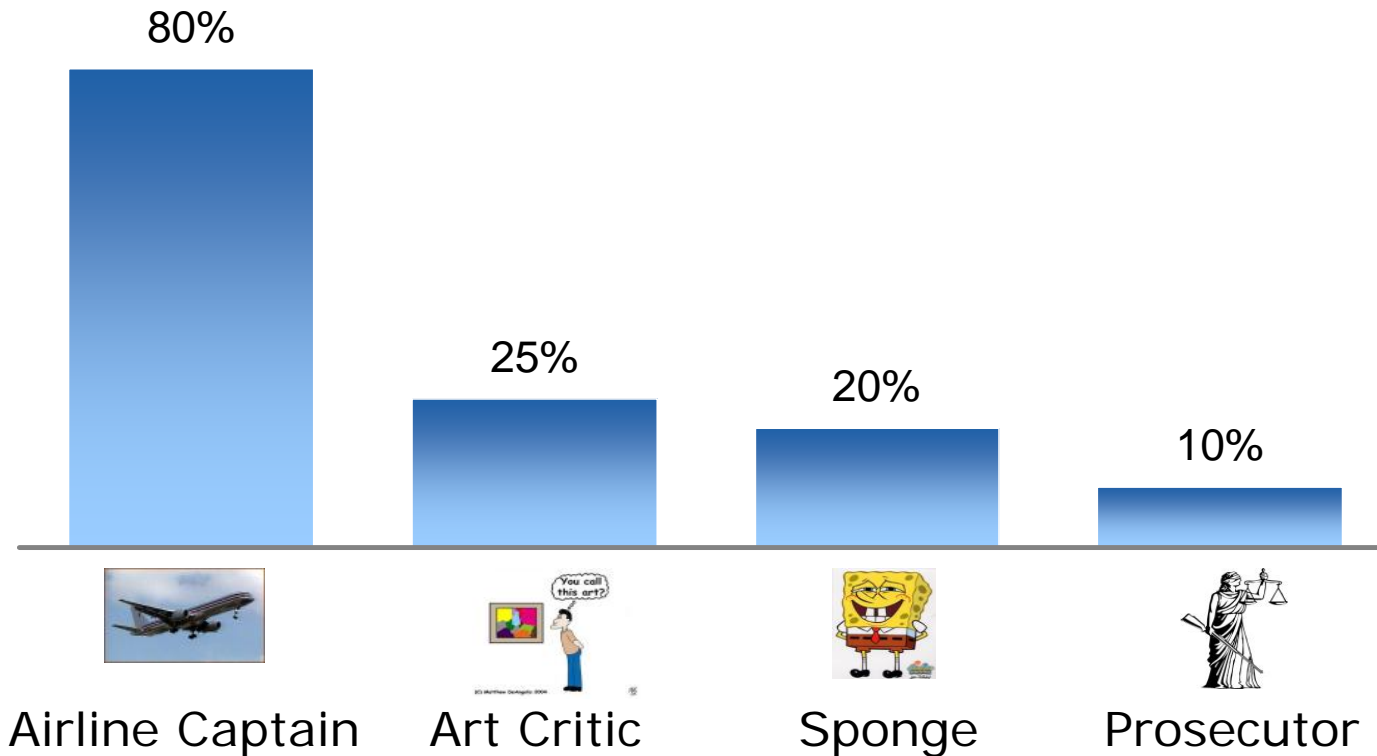


Airline  
Captain



# All Hiring Methods Are Not Created Equal

## Media Deal IRR by Management Assessment Approach



Source: "The Art and Science of Human Capital Valuation" by Geoff Smart (1998).

# ghSMART A Method for Hiring™



# Step #1 – build a Scorecard

- Mission/investment thesis.
- Accountabilities for “A” performance.
- Competencies.



## Investment Thesis

(Describe the “story line” of the situation and purpose of the role).

### Key Accountabilities

Accountabilities	Ratings & Comments <i>(to be completed after interview)</i>
<b>1. Accountability:</b> <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> </ul>	
<b>2. Accountability:</b> <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> </ul>	
<b>3. Accountability:</b> <ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> </ul>	

## Competencies

Competencies	Comments and Ratings <i>(to be completed after interview)</i>
<b>Leadership Competencies</b>	
Hires A players	
Develops people	
Removes underperformers	
Treats people with respect	
Efficiency of execution	
Network of talented people	
Flexible/adaptable	
<b>Personal Competencies</b>	
Integrity/honesty	
Organization and planning	

# Scorecard: Example Accountabilities

## Key Accountabilities for the CEO, CleanMax USA, Inc.

	ACCOUNTABILITIES	RATING and COMMENTS
1	<p><b>Grow revenue from \$25m to \$50m by 12/31/11.</b></p> <ul style="list-style-type: none"> <li>➤ Increase number of national industrial customers from 4 in 2008 to 8 in 2009 to 10 in 2009.</li> <li>➤ Reduce revenue from residential customers from 75% of total sales to 20% of total sales by 12/31/11.</li> </ul>	
2	<p><b>Increase EBITDA margin from 9% to 15% by 12/31/11.</b></p> <ul style="list-style-type: none"> <li>➤ Increase fluffo-matic 70% margin add-on sales from 33% to 90% of all customer orders by 12/31/07.</li> </ul>	
3	<p><b>Topgrade the management (build a team of A players) team.</b></p> <ul style="list-style-type: none"> <li>➤ Hire an A Player Director of Outside Sales by 12/31/08.</li> <li>➤ Hire an A Player CFO by 12/31/08.</li> <li>➤ Conduct Semi-annual talent reviews to identify non A players. Present action plan to the board.</li> </ul>	
4	<p><b>Establish a robust product development process.</b></p> <ul style="list-style-type: none"> <li>➤ Hire an A player head of product development/R&amp;D.</li> <li>➤ Put in place an industry best-in class process capable of identifying customer needs and developing appropriate products for a 24 month product cycle that can be sold at an attractive margin.</li> </ul>	
5	<p><b>Open a west coast sales office by 6/1/09.</b></p> <ul style="list-style-type: none"> <li>➤ Open a sales office in Los Angeles to better serve the industrial customers headquartered in California.</li> </ul>	

# Scorecard: Example General Management Competencies

## 1. Leadership Competencies

Hires A players

Develops people

Removes underperformers

Treats people with respect

Network of talented people

## 2. Personal Competencies

Integrity/honesty

Organization and planning

Calm under pressure

Aggressive

Moves fast

## 3. Interpersonal Competencies

Listening skills

Oral communication

Teamwork

Persuasion

Holds people accountable

## 4. Intellectual Competencies

Brainpower/learns quickly

Analysis skills

Strategic thinking/visioning

Creative/innovative

Attention to detail

## 5. Motivational Competencies

Enthusiasm/ability to motivate others

Persistent

Proactive/takes initiative

Work ethic

Sets high standards

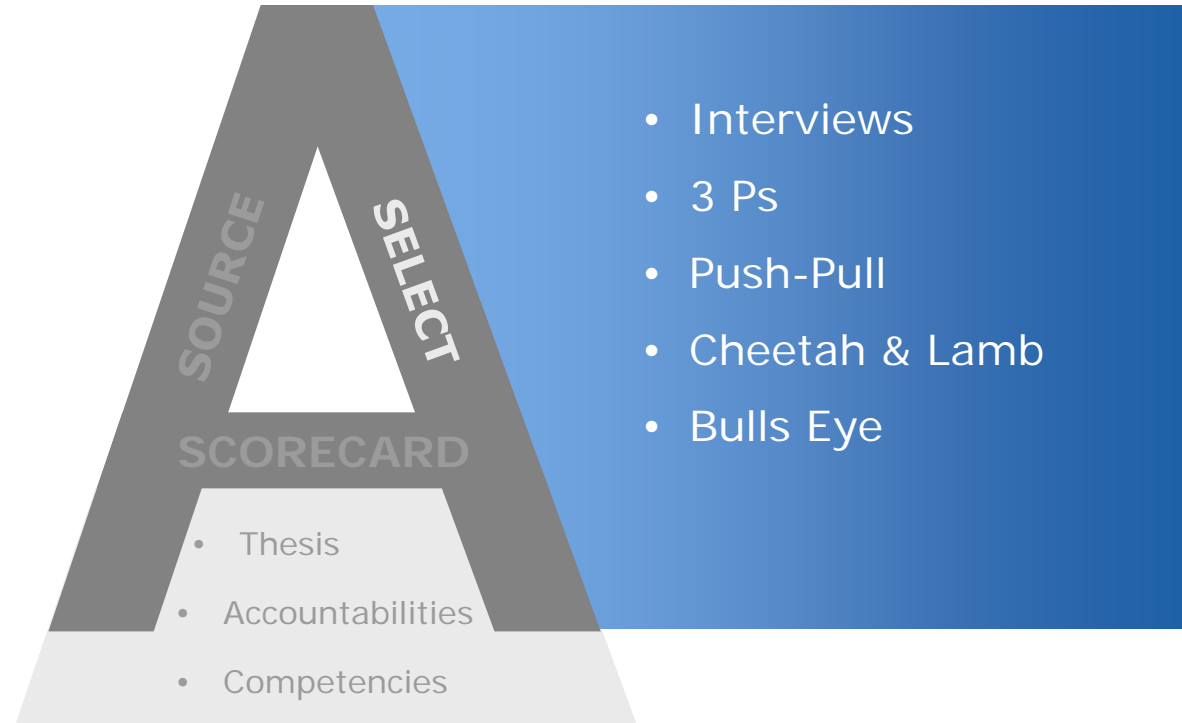
# Key Takeaways for each deal

1. **Develop a scorecard for the deal overall and every member of the management team**
  - » Synthesize your investment thesis
  - » Agree upon the 7 to 10 key accountabilities or outcomes for the deal/CEO– think SMART goals
  - » Create role specific scorecards for the 3 or 4 key lieutenants critical to the value creation plan (e.g., CFO, COO, VP of Sales, any likely CEO successor)
  - » Get the whole deal team involved

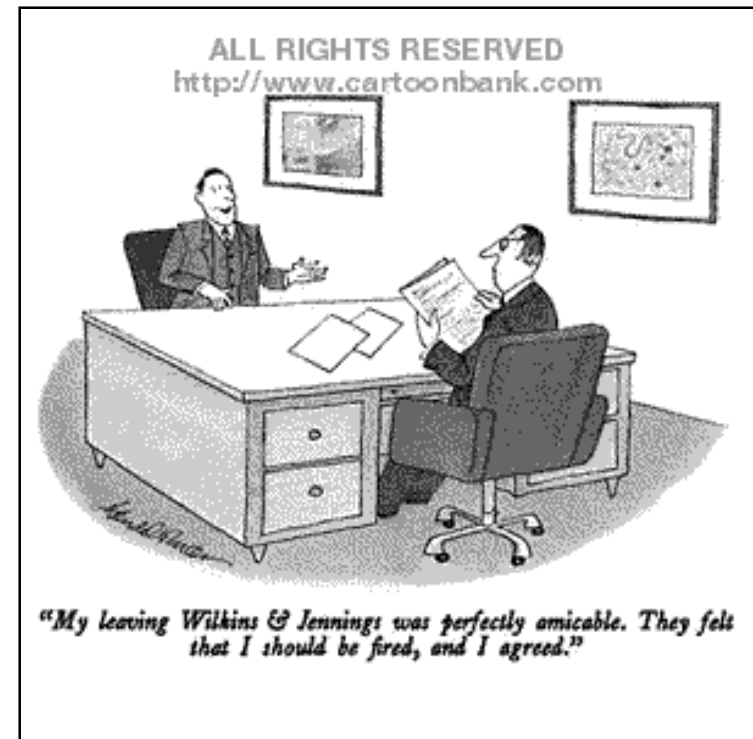
**“I hired your resume.  
But what I got was you.”**

–Jay Jordan.

# Step #2 – Select A players



# Topgrading Interview



# Topgrading Interview Guide (~ 3 hours)

*3+ hrs. Used to get in-depth data on past performance to assess probability of success in the role across the entire Scorecard.*

- High school: high points and low points (5 minutes).
- College/grad school: high points and low points (5 minutes).
- For each job in the past 15 years (2 hour 40 minutes):
  1. What were you hired to do?
  2. What accomplishments were you most proud of?
  3. What were some low points during that job?
  4. Let's talk about the people:
    - i) What was your boss's name? What was it like working with him/her? What will he/she say were your biggest strengths and areas for improvement?
    - ii) Please tell me about the team you inherited. Did you hire anybody? Fire anybody? What was your hiring success rate? How many As, Bs, and Cs did you have by the end?
  5. Why did you leave that job?
- What are your career goals for the future (10 minutes)?

Probe "5 questions deep" to get data on each area:  
What? How?  
Tell me more!

# Three Ps

*You can calibrate how impressive an accomplishment is by asking one, two, or all three of the “Three P” questions:*

- How did your performance compare to **PREVIOUS** year performance? (e.g. this person achieved sales of \$2m and previous year sales were only \$150k, 13x previous year).
- How did your performance compare to **PLAN**? (e.g. this person sold \$2m and the plan was \$1.2m, which is 166% of plan).
- How did your performance compare to **PEERS**? (e.g. this person sold \$2m and was ranked #1 of 30 peers; the next best performer sold only \$750k).

# Push-Pull

*You can tell if somebody was a great performer by whether they were pushed out of their jobs or pulled to better opportunities:*

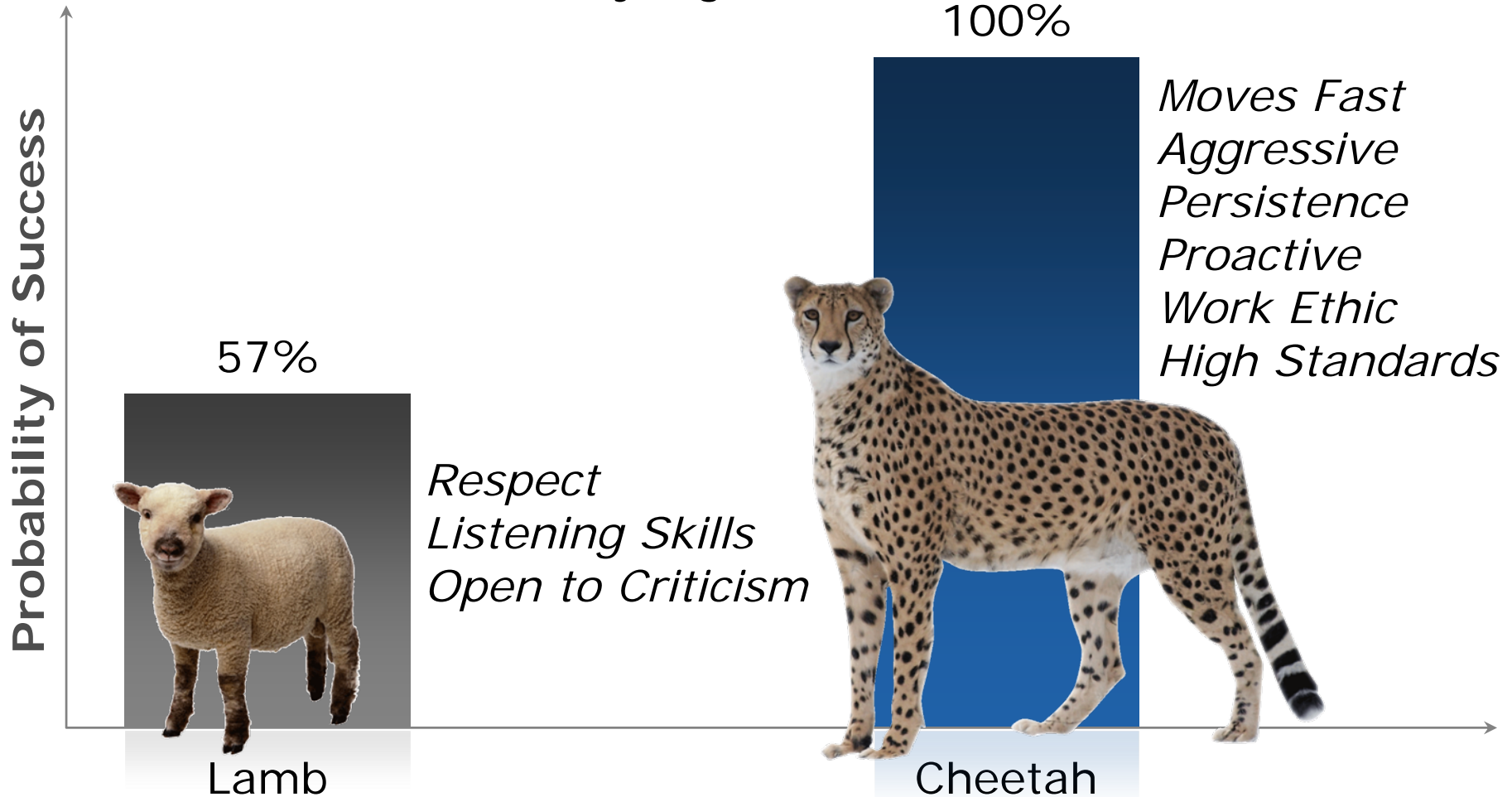
- Why did you leave that job?
  - » **Push** = "It was mutual." "It was time for me to leave." "My boss and I were not getting along." "Judy got promoted and I did not." "My role shrunk." "I missed my number and was told I was on thin ice." "I slapped the CEO so hard that I lost my \$3m severance package."
  - » **Pull** = "My biggest client hired me." "My old boss recruited me to a bigger job." "The CEO asked me to take a double-promotion." "A former peer went to a competitor and referred me to his boss."
- Don't hire anybody who was pushed out of more than 20% (1 in 5) of their jobs.

# University of Chicago Research On Profiles of PE-backed CEOs

- A team of University of Chicago PhDs lead by Professor Steven Kaplan independently analyzed 313 ghSMART assessments of PE-backed CEOs conducted between 2000-2005.
- Regression analysis of ghSMART assessments of each CEO's capabilities (30+ capabilities assessed for each CEO) against outcome measures:
  - whether the CEO candidate is hired;
  - whether the PE firm invests;
  - whether the CEO who is hired is successful as measured by appraisal by the PE firm and/or IRR on exit and/or EBITDA tracking against projections for deals still in the portfolio
- Results compared for LBO versus VC.

# What Type of CEO Makes Money for Private Equity Investors?

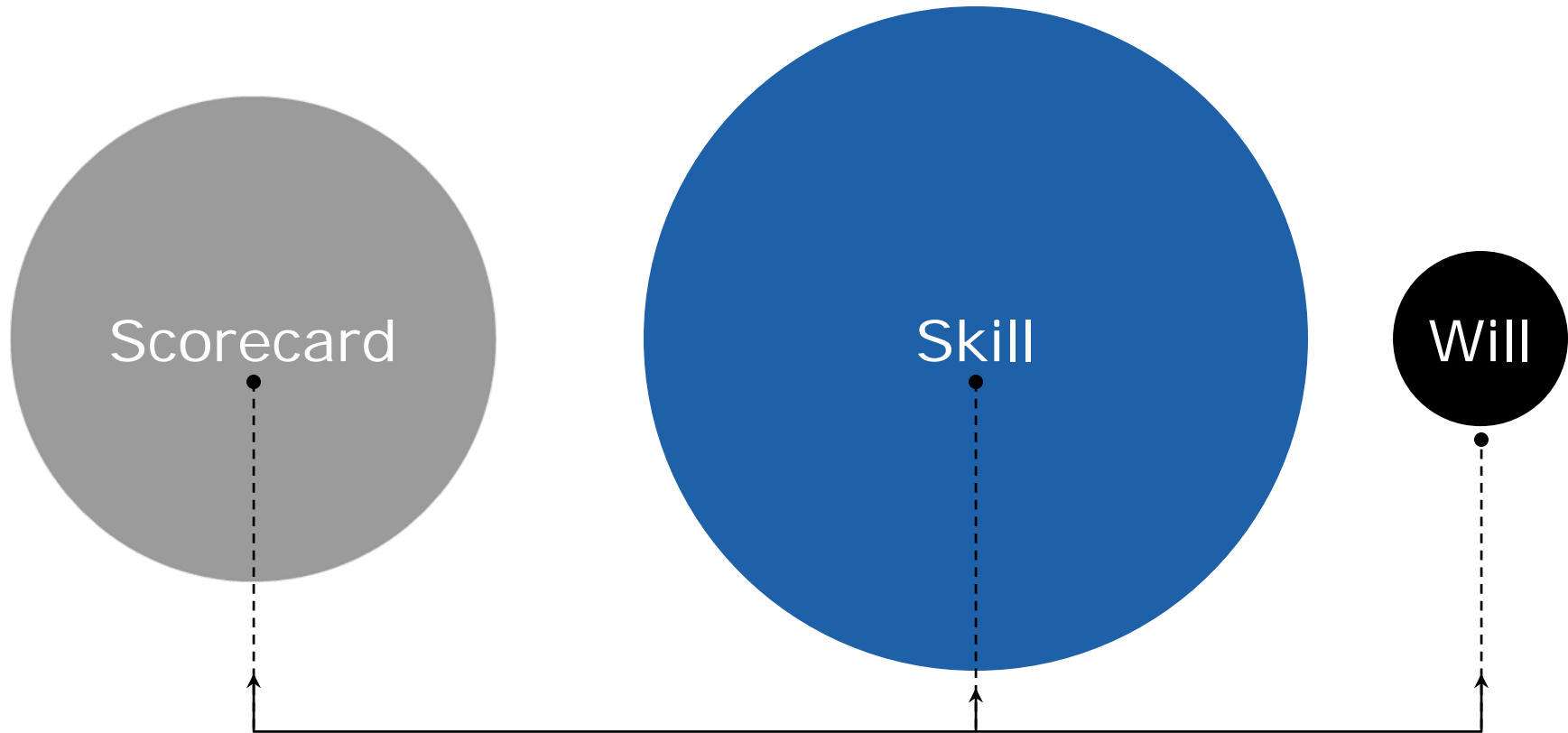
A CEO who scores very high on:



# Don't ignore the "Will" to perform

The Job

The Candidate



0% Chance of Success

# A Player



100% Chance of Success

# Key Takeaways for each deal

1. Develop a scorecard for the deal overall and every member of the management team
2. **Conduct a Topgrading interview for the members of the existing management team and any new hires**
  - » Develop scorecards before the interviews
  - » Utilize a tandem (two-person) approach and take notes
  - » Use the data to grade the scorecard
  - » Consider both “skill” and “will”
  - » Develop a post-close action plan for each member of the team – modify the thesis as needed

# Step #3 – Conduct Talent Reviews post close

## What are they?

- Formal process to assess talent level throughout the organization
- Identifies each person as an A, B, or C

## Why do them?

- Ensures CEO's don't leave B and C players in critical roles
- Provides a check to make sure the role hasn't become too big for the individual
- Helps instill a performance culture and retain A players

## How often?

- Within 3 to 6 months of closing the deal
- At least annually in conjunction with the presentation of the strategic plan to the board

# Talent Review Best Practices

- **CEO led** – Topgrading starts at the top. Necessary to be taken seriously. Findings presented to the board.
- **Data driven** – supporting data could include Topgrading interview, 360 feedback, results against key objectives (graded scorecards).
- **Tied to the Strategic plan/Scorecard** – convert strategic plan to overall and individual scorecards. Do you have A players driving key initiatives?
- **Bias toward action** – Each individual should have an action plan. NOT “business as usual” or “live with what we have”. Possibilities include:
  - » *Remove from organization*
  - » *Redeploy and/or narrow scope of responsibilities*
  - » *Provide training, coaching, mentoring, consulting*
  - » *Expand responsibilities*

# 9 Box helps define action plans

Potential	High	<p><b><u>C1</u></b>  <b><u>Diamond in the Rough?</u></b>          Diagnose the Problem</p> <p>Redeploy or Dismiss</p>	<p><b><u>B1</u></b>  <b><u>Talented but Blocked</u></b>          Emerging Leader</p> <p>Development Plan &amp; Coach</p>	<p><b><u>A1</u></b>  <b><u>Star Power</u></b>          Invest heavily in development</p> <p>Reward &amp; Recognize</p>
		<p><b><u>C2</u></b>  <b><u>Red Flag</u></b>          If less than 90 days, Coach          If more than 90 days,          Dismiss</p>	<p><b><u>B2</u></b>  <b><u>Fully Competent</u></b>          Solid Performer</p> <p>Can grow? Redeploy          Can't grow? Dismiss</p>	<p><b><u>A2</u></b>  <b><u>Superior Performer</u></b>          Very strong in current role</p> <p>Consider stretch assignments</p>
	Low	<p><b><u>C3</u></b>  <b><u>Career Liability (Yours)</u></b></p> <p>Dismiss Immediately</p>	<p><b><u>B3</u></b>  <b><u>Red Flag</u></b>          Not Worth the Investment</p> <p>Redeploy or Dismiss</p>	<p><b><u>A3</u></b>  <b><u>Valuable Expert</u></b>          Strong technically but not          willing/able to advance</p> <p>Ensure adequate rewards          are in place</p>
		Low	Performance	High

# Key Takeaways for each deal

1. Develop a scorecard for the deal overall and every member of the management team
2. Conduct a Topgrading interview for the members of the existing management team and any new hires
3. **Conduct Talent reviews on an annual basis**
  - » Incorporate into the strategic plan review
  - » Consider incorporating into the CEO's goals and objectives
  - » Tie people to key initiatives
  - » Demand data! It is not a popularity contest
  - » Follow up on the action plans for management team members

# Where to Go For More Help

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