

VC's: Crack the code on assessing management competence

Jeremy Gershfeld, The Gershfeld Group

Warren Buffet considers assessing management competence to be the most difficult challenge when considering a company's valuation. We crack the code of understanding a management team's contribution to valuation with data from developmental psychology.

“Evaluating managers along the **dimensions of rationality, candor, and independent thinking** is more difficult than measuring financial performance, for the simple reason that human beings are more complex than numbers.”¹

Even the Oracle of Omaha felt he was staring at a mysterious black box when measuring human behavior and its influence on a company's KPI (key performance indicators.)

Robert Kegan, a pioneer in the field of developmental psychology, asserts “if you want to understand someone in a fundamental way you must know where the person is in (their) evolution.”

Expanding this to organizational culture, if you want to understand a group, one must know where each person is in their developmental evolution, as well as the context in which they interact with their colleagues.

How does this relate to rationality, candor, and independent thinking?

The field of developmental psychology has identified a place on the spectrum where the influence of colleagues on opinions and biases is stronger than one's ability to develop ideas independently. In other words, in many cases, (58% of the general population²) if you want to know the opinion or bias of an individual, ask their peers – you'll get the same answer. An individual on this spectrum of development will also have difficulty giving a candid answer to someone if they aren't certain that their point of view confirms their own.

By using techniques from the Subject Object Interview method and assessment, (developed by Lahey, Souvaine, Kegan, Goodman & Felix, 2011 at the Harvard University Graduate School of Education), one can assess, with reliable data, the dimension of management and organizational effectiveness that Buffett has found elusive.

¹ Hagstrom, Robert, *The Warren Buffet Way*. 2013. Wiley. Hoboken, NJ

² Kegan, Robert. *The Evolving Self. Problem and Process in Human Development*. 1983, Harvard University Press Cambridge, MA

In addition, this assessment can also help predict management growth potential when combined with specific coaching and feedback training.

Understanding the evolution of a group's interactions, (organizational culture) and the potential to grow its potential, involves four things:

1. Learning how **individuals interpret and make meaning from their experiences**. In other words, observing data that describes how self-aware a person is, and how they learn from their experiences. (*Understanding where a person is in their evolution.*)
2. After learning how each individual processes their experiences, examine **how individuals work together as colleagues and how they understand these relationships**. This will reveal a group and its culture. (*Evolution of interactions.*)
3. **Examining the group's potential for innovation:** How does a group work together to identify not-obvious problems, which require broad contextual thinking from diverse sources? Are they able to organize this thinking into behaviors that get things done?
4. **Measuring the group's openness to feedback, reflection and coaching.** How open is the group to considering new ideas from each other, as well as outside coaching? *Everybody says they're open to feedback.* Who backs that up?

Self-awareness, and how individuals learn from their experiences.

The subject/object interview examines how an individual makes meaning from their experiences. The transcript of the interview provides data points, which indicate where individuals and their relationships exist, bring Buffett's dimensions of rationality, candor and independent thinking into a new light. One can learn whether an individual's decision-making is overwhelmed by what others are saying and doing.

- How will they experience feedback?
- If a person receives difficult feedback, will they take it personally?
- How do individuals react to information contrary to their point of view?
- Are people able to disagree and learn from each other, or win the conversation?
- Do people over index on confirmation bias?
- Are the group dynamics prone to socially influenced decisions, rather than discussions that produce an independent evaluation of ideas?
- Are individuals driven by personal ambition, to the extent where their candor (which benefits the group) is at risk to their personal motives?

In a typical interview, a candidate is usually asked questions that will evaluate how similar they are to the interviewer, perhaps how their skills fit the job or how well

prepared they are for the interview.

In contrast, a subject/object type interview seems like a conversation that aims to get to know someone in depth. A skilled interviewer is able to draw out thoughts on topics that are meaningful to the candidate. The act of asking a candidate to reflect on their experiences allows the interviewer to assess how much self-awareness the individual experiences, while reliving their experiences. The topics of conversation are often not about how they've performed in their careers, or how they've built their skill set, but rather about experiences that have had impact on their lives. This gives the interviewer an opportunity to learn how someone understands their world, removed from the rehearsed notion of how they describe their skills and resume.

Knowing how an individual understands their experiences directly impacts how they operate. It gives data on how much self-awareness they possess, as well as how they can internalize another's perspective, with direct relevance to how they work with others. These indicators reflect what type of leader and colleague they are.

Characteristics of people who exhibit leadership in learning/adaptive cultures:

- Self-awareness
- Maintaining identity while open to opinions being changed.
- Holding opposite notions in one's mind and synthesizing new ideas from their contrast.
- Ability to navigate situations and change roles within a relationship, as situations require.
- Ease with vulnerability
- Efficient flow of information
- Thoughtful disagreement
- High collaborative potential
- Strong learning with regular feedback

These characteristics embodied as leadership qualities have a strong effect on their colleagues. Our interview process also looks at the contour of the group's behavior, otherwise known as culture.

How well do people work together within the group's culture?

Once data is collected on the individuals that make up a management team, one can then look at how they are interacting as a group.

A group is not defined solely as a collection of individuals; it is important to understand how they interact to solve problems and navigate their work. One part of this is learning about the existing culture within the group. (Spoken and unspoken ways of how things are done.) In addition to the culture, one must examine how much developmental leadership individuals exert on each other.

To understand the impact of how developmental leadership impacts culture, ask these questions:

- Are people free to disagree with one another without feeling threatened?
- Do the group's social norms enforce "stay in your lane" rules?
- How seriously are thoughtful questions entertained, at the expense of time and performance?
- Do people need defined roles in relationships, or are they able to negotiate terms of interaction in a collaborative manner?

A management team that is free to disagree with one another without feeling threatened is a group that is ready to give and receive feedback to each other. They are more likely to learn from their collective experiences, and navigate unpredictable terrain together. Likewise, if people on the team feel the need to win arguments, they may be missing opportunities to learn at the expense of being "right."

The types of interactions that stand out as advanced on the developmental spectrum point to leaders who are comfortable with sharing vulnerability, and insist on a psychologically safe atmosphere to encourage the same from their colleagues. This makes it easier to put down the performance shield of always appearing invulnerably competent, when it isn't always the case. This type of leader is good at asking non-judgmental questions to understand the nature of problems, and foster collaborative thinking to solve those problems. Hidden individual ambitions often make it unsafe for colleagues to share this type of vulnerability. Self-aware leadership will understand this about themselves and their colleagues and give cues to put aside self-serving behavior to grow the norms of cooperation. When the group has behaviors that embody these features, the observable contour is different. Conversations become about learning instead of making points that show one perspective's merits over another's.

Can the people think together to identify issues beyond the most obvious ones, with large revenue implications?

I ask management groups this question:

Which sentence describes how your team responds to a challenging situation?

- Quickly assess the problem and start right away at solving it.
- Consider what the problem is for a while, and search for larger issues, from which the problem may be a symptom of a more fundamental problem.

The first response is indicative of a performance culture that expects immediate results. The implications of the outcome are secondary. This leads to reactive behaviors. The second response gives the opportunity to learn about the problem before assuming

that the issues are already settled. This is the systemic thinking of a learning culture.

The social psychologist Jacob Getzels comments:

“The quality of the problem that is found is a forerunner of the quality of the solution that is attained. It is in fact the discovery and creation of problems rather than any superior knowledge, technical skill, or craftsmanship that often sets a person apart from others in his field.”

Daniel Pink writes about the over-availability of information and how too much data can lead to more confusion. He comments: “If I know my problem I can likely solve it. If I don’t know my problem, I might need some help finding it. Today, when information is ubiquitous, the premium is on ‘the ability to hypothesize,’ to clarify what’s going to happen next.”

How coachable is the group?

Few management groups are already fulfilling their potential. The goal is to find the ones who have to the potential to reach higher levels of effectiveness through coaching.

New England Patriots: Players with interactive skill sets, who can change schemes accordingly.

The NFL builds parity into team building by having the best teams like the Patriots choose last when they draft players out of college. Other teams, picking ahead of the Patriots, are able to draft the most physically talented players. Picking later, Bill Belichick looks for interactive awareness and schematic flexibility. Some of the talent may not be apparent to other teams because they become unlocked in combination with other players in his system. His competitors may be evaluating data based on impressive physical traits, or gaudy playing statistics in college. This data can be misleading when statistics are inflated because of inferior competition at the collegiate level.

The Patriots opponents are usually playing to their strengths. The Patriots change their playing style each week to take advantage of their opponents’ weaknesses. This requires players who can learn to play multiple styles. Other teams pick players based on athletic brilliance under certain conditions. Belichick is looking for players who can adapt and thrive in multiple schemes.

There are a lot of demands on the players and coaches to build the skills to fit multiple schemes. 6 championships later, the results are incontrovertible.

What’s behind this schematic flexibility?

An adaptive system, whose players are able to learn new schemes and adapt. They are very coachable, not threatened by new information that might challenge their beliefs about what they can do.

- An independent thinking coaching staff that is able to dissect their own weaknesses, as well as their opponents, so that they continuously improve.
- Players who can absorb the specific coaching to adapt to multiple schemes as well as perform interactive team skills at a high level.
- A culture of candor and trust. The highly professional relationships, established between the coaching staff and players enables the players to execute their complex schemes with force and precision without hesitation.

The leaders of Pixar took Disney's previously struggling creative team and turned them into the same type of creative powerhouse that Pixar was known for. They did this by changing Disney's creative work process. They identified problems that mattered, taught Disney's creative team how to coach each other through a psychologically safe feedback process and the results followed.

Pixar's chief reengineered the culture so the impromptu and more formal conversations were both creative and productive.

He knew to do this because Pixar didn't start out as a blockbuster fountain of creative brilliance.

Daniel Coyle writes about how Pixar's chief, Ed Catmull, described how Pixar's movies start out rather lousy.

"The stories can be flat, and characters that were boring. In the original Toy Story, Woody started out bossy and unlikable."

From the Pixar experience, Catmull understood that projects often begin as painful disasters.

"They are really just open systems, with choices that require rigorous development to turn them into gems. It is about building a systematic way to evaluate lots of ideas in order to unearth the right choices."³

Pixar's leaders taught Disney's teams how to bring about this rigorous development process by teaching them how to evaluate ideas and develop them through feedback and peer coaching.

Disney's commercial and critical hits can be traced to this change in culture.

Why is this is important?

Understanding these four psychological facets of management teams answers Warren Buffets question about how to evaluate a management group, beyond their skill specific

³ Coyle, Daniel. 2018. Penguin Random House, New York, NY.

qualifications.

1. Leadership's developmental maturity.
2. Developmental maturity of a group's culture.
3. Potential for innovation.
4. Openness to feedback, reflection and coaching.

Considering these elements when evaluating a company's growth potential is an important aspect of any due diligence.