



Strategy, Organisation, People
and Business Performance

Predicting mid-market value creation

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Research on mid-market companies, and especially the factors that make them grow and build value, remains fairly thin on the ground.

As Catalysis has broadened the range, and grown the quantum, of data collected - during due diligence and in post-deal situations – we have been working to fill some of the gaps in knowledge that can make decision-making more uncertain and less likely to yield desired results.

Some of our investor clients analyse the role of situational factors to understand investment returns, considering factors like company size, deal type (MBOs vs MBIs et al.), financial ratios (e.g. leverage, capitalisation), entry price multiples, market dynamics and industry/geographical diversification. These can guide target selection.

Our work, however, focuses on more intangible factors – especially the interaction of strategy, organisation and leadership dimensions – and seeks to clarify the likelihood that certain starting conditions (the things we learn during due diligence processes) and post-deal levers of change will lead to better or worse relative performance.

In this October Update:

- Firstly, we provide an overview of how UK mid-market private equity investors have evolved their practice in considering factors and levers in generating performance and value
- Secondly, we provide further detail on how we are trying to capture greater insight and offers specific predictor results from recent analysis on CEO and FD performance

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The graphic below offers an overview of how mid-market practice has evolved since 2005 when we carried out a major review of investor approaches to management/organisation issues. Also marked is where we perceive our current practice with clients. Two main conclusions flow from this analysis:

- Although practices have evolved towards greater amounts of measurement, there is little sign of predictive tools appearing to guide investor decisions. We are slowly building in that direction with client help, but there is plenty yet to do.
- There is generally more robustness of insight at the time of due diligence than subsequently.

STARTING CONDITIONS (i.e. situation at time of DD)

STRATEGIC FACTORS	Minimal attention	Some discussion	Measurement	Data-driven prediction
Business model complexity	X		Y	
Market/competitive conditions			X	Y
Level of stretch in plan		X		Y
Strategy plan robustness		X		Y
HUMAN FACTORS				
Top team capabilities			X	Y
Top team as a team	X		Y	
2nd tier strength	X	Y		
Effectiveness of business functions		X	Y	
Organisational effectiveness	X			Y
Wider capacity and capability	X		Y	

LEVERS OF CHANGE & VALUE (i.e. post-deal)

STRATEGIC LEVERS	Minimal attention	Some discussion	Measurement	Data-driven prediction
Programme of bolt-ons		X	Y	
Strategic reinvention		X	Y	
Capex		X	Y	
Productivity improvement		X	Y	
Differentiation of capabilities	X	Y		
HUMAN LEVERS				
Management change		X	Y	
Management development	X		Y	
Organisational change		X	Y	
Quality of governance		X	Y	

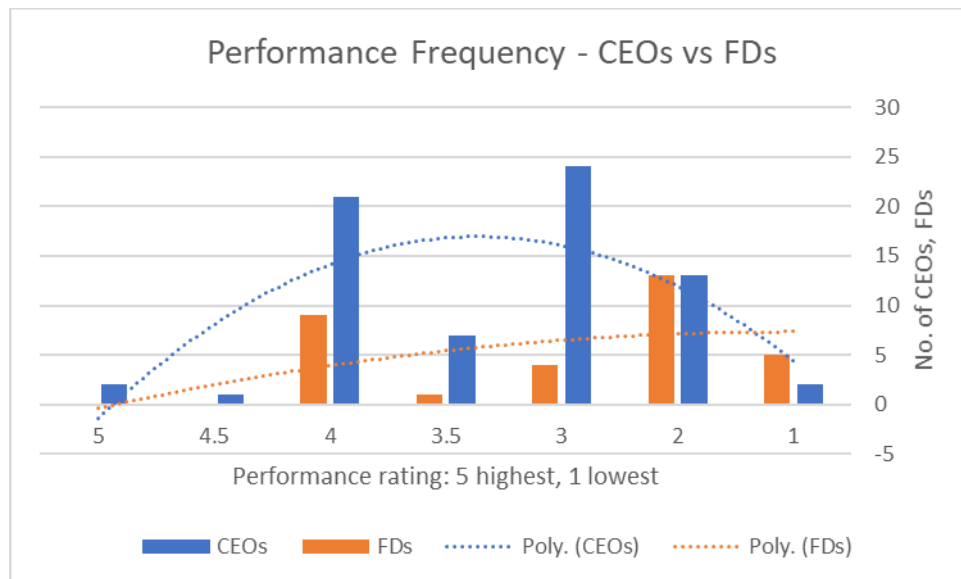
KEY	2005 practice	X
	2019 Catalysis clients	Y

Performance score distribution for CEOs and FDS

Catalysis collects investors' performance scores for CEO and FD performance, typically between 6 – 12 months after they have been assessed either during a DD context or as part of a selection process. For the avoidance of doubt, this is about individual effectiveness in an absolute sense, regardless of whether the business has thrived or not for other reasons, and regardless of any (high or low) initial expectations. Investors are asked to rate executives using the following system:

- 5 Unusually effective in playing their role
- 4 More effective than most
- 3 About as effective as others
- 2 Less effective than most
- 1 Unusually ineffective

Sometimes investors place executives between the main categories, hence the few 3.5 and 4.5 scores. The graph below displays results for 70 CEOs and 32 FDs.



What is most striking about the cumulated results is how different scores look for CEOs and FDs:

- In the case of CEOs, there is a distribution curve leaning in a positive direction (44% are rated above average, only 21% below).
- For FDs, however, scores lean markedly to the low side: 31% are rated above average but 56% below.

Personality and performance - CEOs

Catalysis uses performance scores to compare psychometric attributes (from our favourite tool, Saville's Wave) of the CEOs rated above average from those rated below average. The table below shows items which show significant variation. As with any psychometric personality instrument, these scores need to be treated with some caution because they reflect self scores rather than independent data. Consequently, scores may reflect not only respondent's genuine beliefs (which may be more or less well-grounded) about their own attributes but also how respondents want to be seen.

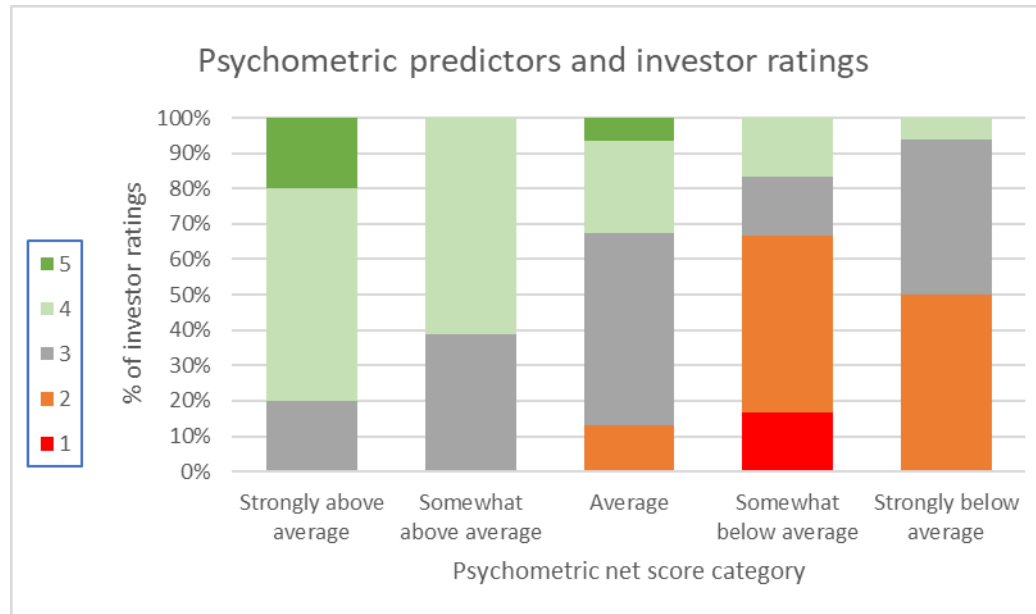
- Above all, higher rated CEOs rate themselves highly in several analytical/cognitive areas such as 'Fact oriented', 'Ideational', 'Learns quickly' and 'Strategic'. However, in addition, they also score higher on some aspects of 'Attention to detail', 'Thorough' etc.
- Lower rated CEOs paint a different image of themselves: more outward facing ('Becomes centre of attention; Interest in networking'), optimistic, intuitive, practical and observant of commitments.

Sub-category title	Impact areas	CEO High low diff
Makes plans	Service & product delivery	2.25
Ethically focused	Managed risk	1.52
Encourages others to criticise	Communication	1.35
Analysing information	Expert reputation	1.34
Quality focused	Service & product delivery	1.25
Explores facts	Managed risk	1.22
Learns quickly	Expert reputation	1.21
Develops concepts	New products/markets	1.21
Generates ideas	New products/markets	1.13
Numerical data	Expert reputation	1.12
Develops strategies	Organisational growth	1.12
Accepts new challenges	Organisational transformation	1.10
Sense of self-worth	Expert reputation	1.04
Attentive to detail	Service & product delivery	1.02
Thorough	Service & product delivery	0.98
Clear vision for future	Organisational growth	0.93
Establishes rapport quickly	Organisational commitment	-0.61
Becomes centre of attention	New products/markets	-0.61
Radical solutions	New products/markets	-0.73
Trusts intuition	New products/markets	-0.86
Interest in networking	Communication	-0.91
Takes optimistic view	Organisational commitment	-0.92
Honours commitments	Managed risk	-1.03
Practical work	Managed risk	-1.06
Maintains confidentiality	Managed risk	-1.27
Learning by doing	Managed risk	-1.31

Personality presentation as a predictor of CEO performance

The graph below shows the relationship between a numerical representation of personality prediction scores (subtracting low-rated CEO items from high-rated ones) and performance as reported by investors. Although there is clearly statistical noise in the relationship, the overall trend is pretty clear with higher prediction scores generating higher performance ratings in the real world. The goodness of fit scores (R of 0.6 and R-squared of 0.35 – albeit both uncorrected) are good by social science standards

None of the 27 CEOs who has a net positive prediction score over +5 was subsequently rated below average by investors – and 18 were rated above average; by contrast, only two of 20 CEOs with net scores below -5 was rated above average – and 12 were rated below average.



Personality and performance - FDs

We have conducted a similar analysis with the 32 FDs rated by investors.

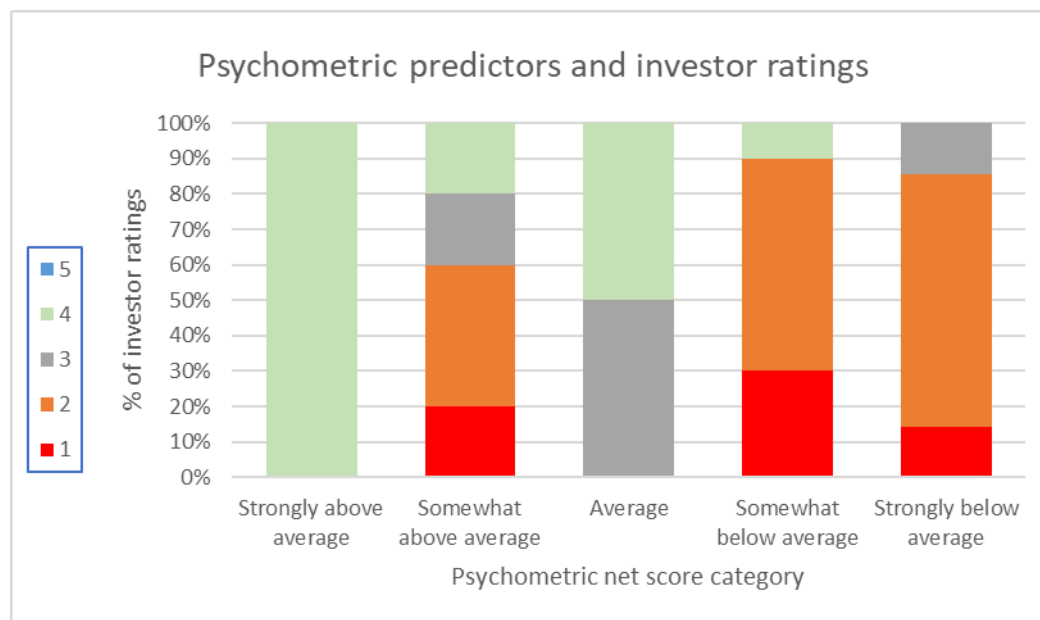
- Like their CEO counterparts - higher rated FDs rate themselves in several analytical/cognitive areas. Like high-rated CEOs they are also more likely to be receptive to others' views.
- Lower rated FDs paint a different imagine of themselves: more outward facing ('Extrovert'), People oriented 'Empathetic' and Confident/Assertive. Like low rated CEOs they see themselves as relatively more observant of Confidentiality.

Sub-category title	Impact areas	FD High low diff
Logic of argument	Managed risk	1.77
Common sense	Managed risk	1.65
Makes decisions from facts	Expert reputation	1.35
Accepts change	Organisational transformation	1.33
Receptive to feedback	Communication	1.28
Applies theories	New products/markets	1.26
Learns quickly	Expert reputation	1.25
Original ideas	New products/markets	1.22
Studies underlying principles	New products/markets	1.04
Analysing information	Expert reputation	0.88
Persuasive	Communication	-1.66
Focused on finishing tasks	Service & product delivery	-1.69
Self confident	Expert reputation	-1.70
Voices disagreement	Organisational growth	-1.74
Maintains confidentiality	Managed risk	-1.74
Makes things happen	Organisational transformation	-1.93
Understands why others do things	Organisational commitment	-1.94
Confident with new people	Communication	-2.03
Motivating people	Successful teams	-2.08
Empathetic	Organisational commitment	-2.23
Lively	Communication	-2.34

Personality presentation as a predictor of FD performance

As with the CEO analysis, the graph below shows the relationship between a numerical representation of personality prediction scores (subtracting low-rated FD items from high-rated ones) and performance as reported by investors. Although there is clearly statistical noise in the relationship, the overall trend is pretty clear with higher prediction scores generating higher performance ratings in the real world. The goodness of fit scores (R of 0.6 and R-squared of 0.36 – albeit both uncorrected) are good by social science standards

Three the 10 FDs who has a net positive prediction score over +5 was subsequently rated below average by investors – but six were rated above average; by contrast, of those 17 FDs with net scores below -5, just one was rated above average – while 15 were rated below average.



Conclusions

Our observations from using this predictive tool in practice in recent weeks is that the results need to be interpreted with appropriate consideration for context in several forms:

1. The level of self-awareness of the individual.
2. The exact nature of the role and the demands on the business.
3. The construction of the overall team and complementarities between individuals.
4. The quality of governance being provided.

For example, one group CEO who scored quite badly in his predictive score has few illusions about his weaker areas but has a strategy built around strong operating MDs, has brought in a more thoughtful FD and is actively seeking a strong chairman.

In a Tech business, two of the founders are husband and wife with the former holding the CEO title. He scores quite low on the CEO prediction but his wife (who is a kind of COO) scores high. That combination, together with a third individual who is strong on detail and process, seems to work well.

Ultimately, the real unit of analysis is the team, faced with a specific set of challenges. Our on-going work, therefore, will focus on the ability of teams to deliver value.