

Assessing People

Assessment of People

Before we begin, we wish to clarify that when we refer to People of a company, it is usually just the promoters (major shareholders), but sometimes also other members of the management team. This is because for a vast number of companies in India, probably the majority, the promoters also serve as most of the senior management team. That said, increasingly we are witnessing more companies without any identifiable promoters and/or where professional management teams are employed by the Board to run the company completely on their own. Such a situation is usually the norm in many other parts of the world, but not yet in India.

For assessing People, as with the way we conduct most of our assessments, we rely a lot on the track-record. To further elucidate, we try to learn more about two kinds of track-records:

1. Ethical
 - a. Fair treatment of minority shareholders in corporate transactions, and more generally, counterparts in personal transactions
 - b. Indication of any regulatory, compliance or legal lapses in corporate or personal settings
2. Execution
 - a. Abilities to consistently allocate capital to achieve OK to great returns (ROIC and/or ROE), while returning excess capital to shareholders through appropriate manners
 - b. Capabilities in achieving OK to great growth in the business, especially compared to competition

Please note that some of the above assessment is quantitative, starting with the calculations of historical growth and returns of the business and the competitors in the industry. We also read through the events in the company's and individuals' pasts, looking for confirming and disconfirming evidences. Last but not the least, we search for sufficient alignment of interests by checking that the People's shareholding in the company is high and their ownership represents a meaningful share of their total net worth. In addition, we also peruse their compensation structures to make sure that it incentivizes growth of long-term intrinsic value of the business, rather than other metrics, especially shorter-term targets.

However, an important, if not more useful, part of our assessment is the qualitative investigation of the People through secondary research, especially by talking to our network of friends across the professional world. Through this work, we often encounter trivia and anecdotes, often verifiable, of both positive and negative hues. If required, we also take the help of service providers specializing in background checks and forensic accounting who can dig deeper into pending questions from either of the buckets mentioned above.

Based on all these inputs, and our confidence in the same, we use the two tables above to classify People, and then consider only those companies whose People are assessed as High (rare; we estimate only 5-10% of all companies) or Very High (even rarer). It is probably salient to note that based on our experience, there are some yellow flags, which are possible areas of concern, in almost all our assessments of People. Of course, in a few cases, there are more explicit red flags, which are deal-breakers. We take into consideration the number and seriousness of these flags while ascertaining the relevant assessment.

At the risk of stating the obvious, the evaluation of People (and in fact, all other criteria) is a dynamic, and not a static, process. If we encounter new information that invalidates our assumptions, we will change our mind, and if required, act (buy or sell), based on the same.

Types of People we like to invest behind

As alluded to earlier, the promoters in most companies in India also double up as most of the senior management team. Individuals, often belonging to the same family, in such situations are sometimes known as Owner-Managers, which is the terminology we use as well.

Owner-Managers are, by far, our preferred type of People to invest behind. This is because there is usually a clear alignment of their interest with minority shareholders due to the high shareholding of the promoters in the company, which is also the source of most of their net worth. Our capitalistic society enables capable and driven owner-managers to achieve successes that are often much better than what they could have accomplished in any other set-up. Possibly for such individuals and families the intrinsic motivations of purpose and legacy matter as much as, if not more than, the extrinsic motivations of wealth and fame, at least beyond a point.

This does not imply that all Owner-Managers are a sure bet. We obviously would not consider individuals or families who do not possess promising Ethical and/or Execution track-records mentioned above. Unfortunately, there are many such examples. One reason for such an avoidable situation would be a highly distracted Owner-Manager who has multiple business interests, leading to poor outcomes in most, if not all, ventures. Another example of an Owner-Manager that we decided to not pursue was due to a succession risk i.e., when the anointed successor, in this case from the family, failed to pass our assessment of his track-records.

Apart from Owner-Managers, we are open to investing behind other types of People as well, though these are not as preferred, and our comfort to invest would be highly context-dependent. Below are the other major categories, in rough order of preference, that we have encountered and some views on each:

- Owners (including body corporates) but not Managers
 - This situation refers to either promoters who have relinquished active management roles or subsidiaries of companies, domestic or MNC, where the Owner is a body corporate (and not individuals).
 - In either of these set-ups, there is a professional management team who, most often, do not carry the same long-term ownership attitude as those of an Owner-Manager, even with the most incentivized compensation package.
 - That said, having an Owner, even if absent from managerial duties, is generally preferable to having a Temporary Owner or no Owner at all.
 - Side note: as we have mentioned in the past, our experience suggests that when the Government is an Owner (directly or indirectly through other Government owned entities), there is a secondary objective of “national service” that often overrides interests of minority shareholders. This is a misalignment of interests that we seek to avoid.
- Temporary Owners (primarily PE funds) but not Managers
 - These Temporary Owners are often Private Equity (PE) funds, but less frequently could be holding companies of conglomerates, where subsidiaries are flagged to be sold.

- These owners are best thought of as Renters (original credits for coining the phrase go to the successful practitioner, Anand Sridharan, aka [Buggy Human](#)), who will, one day, sell their ownership to others and move on.
- While Temporary Owners may bring in highly qualified and incentivized professionals, maybe even better than other Owners, this set-up is less preferred than Owner-Managers because here too the long-term ownership attitude cannot be replicated.
- Moreover, compared to the previous category, the clock is ticking (for a transfer) and you do not know what kind of Owner (or Manager) waits for you on the other side of that transaction. In other words, while we must always be wary of the People (Owner and/or Manager) changing in any of the companies that we own, and should be prepared to act quickly if the situation turns unfavourable, the odds for such a change are highest in this category.
- No Owner (institutionally owned)
 - No Owner refers to companies without a discernible major shareholder. Globally, especially in the Western World, such institutionally owned companies seem to be most common ownership structure.
 - Understandably, a lot of focus should then be on assessing the ethical and execution track-records of the various members of the management team, through each of their corporate careers.
 - That said, this is the unfortunate situation where a management team has the highest chance of behaving like an agent, often benefitting at the cost of shareholders, with no explicit Owner in place to keep a check. Hence, this is our least preferred option.