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HUMAN CAPITAL SCIENCE DRIVES VALUE CREATION

LODESTONE PEOPLE CONSULTING

The decision of whether to invest in a company is a hefty one, often informed by data: spreadsheets, reports, data rooms... Discerning investors also want to know about the management team, the company's culture, and the human capital processes that either make or break the company. People are the most important element of investment decisions. According to HBR, between 70-90% of acquisitions fail. Overwhelmingly, these failures are because of people, not strategy or market issues. Sometimes this is where well-meaning but still "armchair psychology" kicks in with subjective and cursory questions and answers (e.g., "Would I have a beer with them?" and "How did the place look and feel when we walked around?"). And post-close, the armchair psychology often continues: "They should do some 'team thing' to work together better." "I don't know if this CEO is capable of this heavy lift."
"We need to fix turnover. Who has any ideas?"

What if we told you there is a better way?

Human capital science provides answers to the important questions about the people of the organization. *Who* is creating value is as important to know as *what* you are investing in. *Who* directly impacts *how* you implement value creation gameplans and *when* those plans will pay off. However, people are complicated; they are intangible and harder to quantify than other key value drivers. Having engaged employees led by the right leaders and the right leadership team is essential to execute any value creation plan. Having science to support these critical insights is itself a key value driver.

Thankfully, a 100+ year science and body of evidence exists around predicting and enhancing behavior in the workplace. Industrial/Organizational (I/O) Psychologists are scientists who study all things related to work behavior and performance. While the roots of I/O psychology, or workplace psychology, are found at the beginning of psychology as a science, it gained traction during World War I through the utility of assessment for placing Army recruits. The success rates of such assessments carried over into private industry, and the rest is history.

To this day, workplace psychologists are sought after practitioners in the areas of selection and placement, training and development, organizational development, performance measurement, and so much more. We focus on executive assessment for selection and development, enhancing organizational culture and employee engagement, performance management, and leadership and team effectiveness. In other words, we are uniquely suited to bring expert science to Human Capital value creation.

What the workplace psychologists at Lodestone have learned and know is:

- Human Capital science has advanced with innovative tools and processes that will continue to radically impact the accuracy of people insights/decisions *when effectively leveraged*.
- Defining the specific leadership challenges the business faces to realize the investment thesis is crucial.
- Confirming and/or selecting the right leaders and building a strong executive team is an essential element in securing performance outcomes and embedding winning cultures.
- Leadership, employee, and cultural gaps are common in private equity companies and can be filled with robust and relevant people solutions.
- Prioritization decisions about people should be made with accurate, data-driven information in the context of the value creation roadmap.

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Scientific assessment secures leadership and executive team fit

Predicting which leaders will fit the business needs and work best together to drive value creation does not need to be a guessing game or armchair psychology. Too often, firms take an approach of conducting a plethora of in-person interviews, which are most often unstructured and repetitive. Or they combine these with simplistic personality style inventories that take minutes to complete but do little to predict actual business outcomes. Round robin interviews are often done in the name of creating buy-in and gaining confidence in the decision. Google developed a “rule of four” with their interviewing when they established that interviewers are 86% confident after four interviews and after that, confidence does not materially increase.

To make matters worse, bountiful research shows that even four unstructured interviews is no better than one unstructured interview—neither predicts success in role and the former simply increases candidate fatigue and irritation. Put another way, Google interviewers (and others) have a false sense of confidence after four interviews, because unstructured interviews are no better than chance.

At Lodestone, we promote and utilize scientific assessments that have the following components:

- A proactive definition of the correct assessment targets that accurately measure readiness of leaders to achieve the business imperatives of value creation.
- Reliable, state of the art, measurement methods including reliable and valid personality and cognitive measures and a business simulation. In other words, candidates don't just talk about they say they can do, they demonstrate it.

Unstructured interviews are no better than chance!

The impact? Significantly reduced investment risk, significantly strengthened rationale for a hire, proactively inform countermeasures for identified risks, or even the prevention of a costly investment mistake.

Executive teams can be built and developed for optimal business impact

Hiring effective individual executives does not necessarily mean you have a highly effective team. Team performance often remains a problem for organizations for a variety of reasons. Many teams are built quickly and expected to perform like a well-oiled machine without taking the time to build trust amongst team members, identifying team members' skills, responsibilities, and roles, or creating action planning for shared expectations, accountability, and clarity. Team cohesion, trust, and communication ability play a large part in the effectiveness, performance, and satisfaction of a work team.

Further, teams are often required to operate in conditions that inhibit effectiveness. Some examples of these conditions include the following: 1) understaffed teams with limited resources for completing work, 2) conflicting priorities that make it difficult to allocate resources effectively, 3) limited transparency due to competitive or secretive environments can inhibit team member collaboration and information sharing, 4) skill gaps amongst team members.

A final common problem associated with team effectiveness relates to the assessment and measurement of team effectiveness. Many organizations lack a clear definition of what team effectiveness looks like to them, and therefore are either missing measurement of effectiveness altogether, or using proxy indicators that don't accurately capture their intended target.

Many teams are built quickly and expected to perform like a well-oiled machine, without the proper investment of time, energy, and resources.

Organizations looking to develop their executive teams for ultimate business impact can implement the following solutions:

- Focus on building strong, collaborative teams that prioritize cohesion, trust, communication, and transparency amongst team members.
- Team synergy can be secured through a well-defined approach that builds out the executive mosaic and grows it to achieve the business imperatives of the value creation plan.
- Team composition should be intentionally designed to maximize the strength of impact, focusing on identifying team members that add to value creation.
- Invest in training and development to ensure that team members have the necessary skills and expertise to succeed in their roles.
- Define and identify key indicators of team effectiveness that can be measured to assess impact of team performance over time.

The impact? Organizations that emphasize teamwork innovate faster, see mistakes more quickly, find better solutions to problems, and attain higher productivity. More specifically, teams that communicate effectively are 20% more likely to be high-performing, and those that share accountability for results are 85% more likely to be high-performing. Additionally, team diversity (whether functional diversity, demographic diversity, or both) has positive impacts – diverse teams have been shown to have financial returns that outperform non-diverse teams by 25%.

Scalability requires accelerated development of mid-level leaders

Once you have confidence in the executive team in place, it can be tempting to think you've done what's needed to secure the organization's leadership. However, mid-level leader development is essential for three reasons:

- Mid-level leaders execute much of value creation as they drive performance on the ground level
- A growing and scaling organization will require even more of these mid-level leaders for which the previous organization stage did not prepare them
- A healthy, growing organization needs a robust leadership succession plan.

Many common issues can impede mid-level leadership effectiveness, and each should be identified and addressed. Most often, mid-level leadership lacks strategic clarity – leaders often have gaps in their understanding of the bigger picture context and struggle to identify how their role and key responsibilities align with the organizational strategic direction. Leaders may also lack motivation and/or knowledge on how to lead effectively and need to develop their identity and skillset as a leader of people, rather than just a manager of tasks. Finally, the ability to get work done through others is a common gap in leadership readiness.

Effective leaders have the knowledge and ability to delegate responsibilities, coach and mentor employees, trust others' capabilities, and engage, motivate, and inspire optimal performance from those around them.

Leadership isn't "set" when the executive team is set. Mid-level leadership development must be accelerated to meet the business challenges of a high growth organization.

Some evidence-based solutions to supporting leadership effectiveness include the following:

- Identification of "high potential" leaders is key and not always intuitive. Quick, but reliable, assessment tools exist to identify which leaders have the personality components which enable accelerated growth
- Leadership development programs must be thoughtfully and expertly designed to grow talent in key skill areas related to value creation initiatives in order to produce real business value

Simply put, leadership development must not simply be sending favorite leaders who achieved results last year through some "butts in seats" training at a famous university. High potential leader development is a substantial investment of time and resources which should include a well-designed, balanced mix of classroom training, individual and small cohort work on real business issues, the creation and execution of measurable individual development plans, and culmination in presentation of learnings and ROI to the business's top leadership/key stakeholders.

The impact? Highly engaged mid-level leaders committed to the organization's new trajectory. Tangible work on a real-world business challenge the organization had previously been unable to solve given limited resources. Business continuity with multiple, "ready now" leaders for succession.

Organizational culture within PE firms and portfolio companies has multi-level impact

Organizational culture is the unique way an organization delivers for its customers, empowers its employees, and ultimately defines its vision, mission, and purpose. Organizational culture is frequently discussed as a barrier to organizational change efforts, a key component to the attraction and/or attrition of employees and is often elusive to capture in a snapshot-like assessment if not adequately defined and well-understood by all levels of an organization.

By investing the time, energy, and financial resources into improving organizational culture, companies can realize an 85% net profit increase over a five-year period and 25% workforce growth over a three-year period.

One of the common problems related to organizational culture when working with PE firms and their portfolio companies has been a focus on surface-level factors of culture, rather than the deep-rooted and maybe even unspoken values, goals, and behaviors that are recognized vs. punished within the organization. Leadership and management can also fall victim to incorrectly thinking of organizational culture in extremes. For example, leaders may view culture as a back burner priority that can be subsequently changed quickly and with force, if necessary. Alternatively, they may perceive their organizational culture as a completely static bubble that employees at all levels are passively captured in. Finally, it is important to take stock of the organizational culture not only within portfolio companies, but also within PE firms.

Evidence-based solutions to tackling organizational culture include the following:

- Define and assess baseline organizational culture through quantitative and qualitative assessments to create a holistic understanding of culture from stakeholders at all levels (investors, executives, leadership, employees)
- If not already clearly defined, create a vision for organizational culture based on the organization's mission and values to serve as a reference point
- Identify, address, and problem-solve barriers to organizational change efforts as they relate to organizational culture
- Identify, select, and develop employees that embody and believe in the organizational culture to create long-lasting organizational impact

The impact? Organizational culture is a long-term investment that has large pay offs over time. Gallup has found that the best organizational cultures attract the top 20% of candidates in a given talent pool. Further, by investing the time, energy, and financial resources into improving organizational culture, corporations can realize an 85% net profit increase over a five-year period and 25% workforce growth over a three-year period.

Understanding your workforce is key for employee engagement

Employee engagement is one of the most important indicators of employee experience that effect individual, team, and organizational performance. Although everyone is talking about engagement, a reasonably large disparity exists between scientific research and business practice concerning the definition and use of employee engagement. Most definitions of engagement include some component of employee involvement, psychological investment, and attention given to or absorption of information from one's work. As much as engagement is discussed and studied, worldwide problems with employee engagement exist, and it may be at an all-time low after the COVID-19 pandemic.

Gallup and McKinsey & Company research show that only 15% of employees worldwide and 35% of U.S. employees fall into the "engaged" category. Further, employee engagement assessment is often poorly handled. Organizations can identify that employees are disengaged but lack an understanding of WHY. An overuse of pulse surveys, lack of action based on pulse survey results, over-complicated measurement, and a lack of qualitative probing leaves organizations with many blind spots when it comes to identifying the root causes of employee disengagement. Without this information, many companies rely on outdated beliefs about—and homegrown pseudo-scientific measures of—engagement drivers.

Finally, many companies still believe that engagement is simply an HR problem to be dealt with (think: more surveys!), rather than a result indicative of problems with leadership and organizational culture. Organizations looking to develop and sustain employee engagement utilize these research-backed solutions:

- Establishing a common understanding of their organization's definition of engagement before attempting to assess or make changes.
- Top leadership commitment to understanding through scientifically developed, current technology, the actual key drivers of employee engagement. These often include establishing purpose and meaning from work, growth and development opportunities, strong and frequent communication with team members and leaders, and having a supportive and caring team leader/manager.
- Top leadership ownership of building employee engagement. That is, leadership needs to provide the training, tools, resources, and development that managers need to meet the expectations of supporting employee engagement in an ongoing way.

The impact? High employee engagement can lead to several organizational benefits, including higher levels of job satisfaction and organizational commitment, increased productivity, lower turnover, and improved customer satisfaction.

About Us

Lodestone People Consulting is a firm of workplace psychologists who bring human capital science to sponsors and their portfolio companies. We help discerning Private Equity Firms understand people and people systems during due diligence. After your acquisition, we conduct your new executive selection, bolster or change HR practices, enhance organizational culture, and provide individual and team development. The result is a more effectively running organization, thus increasing your ROI.

If you need assistance with any of the issues addressed here, please contact us at info@LodestoneHR.com or see two of our executive team members at the conference.

Sandy Fiaschetti, Ph.D.
Dr. Fiaschetti is the founder and Managing Partner of Lodestone People Consulting. She has been both an internal and external consultant to both private equity firms and mid-cap and large companies across a variety of industries. Sandy's experience has been focused on organizational culture and effectiveness, talent assessment, and leader development. She has assessed and advised hundreds of C-suite executives. She is particularly passionate about the importance of pragmatically integrating people initiatives into strategic business plans to increase value.

Martin Factor, Ph.D.
Dr. Factor serves as Lodestone's Chief Talent Strategist, providing talent strategy process guidance, leadership advisory ("coaching"), and in-depth holistic executive assessment. Martin is responsible for quality and integrity in Lodestone's executive assessment and leadership advisory processes.
He has consulted with multiple large PE firms and with mid-sized and large, Fortune 500 corporations across an array of industries.

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