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Lead Left Interview – Dr. Tim Kelly (Part 2)

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This week we continue our conversation with Tim Kelly, a 30+ year veteran of private equity and capital markets. Since retiring as a senior investment Partner with Adams Street Partners, Tim has completed his Ph.D. in Organizational Psychology. His focus is what investors, LPs, GPs, and capital market participants can learn by applying new perspectives on people, culture, decision-making, and performance. ***Second of two parts –*** ***View part one***

The Lead Left: Anyone paying attention to presidential primaries this year would agree with that.

Tim Kelly: In a comical sense, people are as irrational as the moth that flies into a candle flame. We commonly use cognitive shortcuts, or heuristics, when we make decisions. We rely on past experiences, our perceived judgment, and other factors to arguably inform our decision whether to invest or not, and at what price. But, many investment committees display similarly common techniques and, yet, experience varying results.

If one studies *how* decisions are made, it often uncovers subtle and oftentimes unconscious errors in the process that directly impairs the investment's long-term potential. An overly simple example is when we believe we have deeply rooted and repeated success in an area of domain expertise. People have a tendency to be overly confident in their abilities and in assessing their judgment on a given matter of uncertainty. I help uncover how investment teams and committees unconsciously imbed such error-prone tendencies into their processes.

Add an organization's cultural imperfections into the equation and you end up with potentially disastrous outcomes. Consider Chernobyl, American Flight 191 that crashed in Chicago, and many other well-known engineering disasters. We all remember Flight 191 crashed because of a cracked pylon; but, did you know the real cause of the crash was a widespread organizational culture across the aviation industry that prioritized expense reduction above safety? The same with Chernobyl. The disaster was blamed on human error initially, but later found to be the result of organizational training procedures that were grossly deficient. I help investors uncover potential errors in their decisions that appear sound and complete on their surface, but problematic when analyzed objectively.

TLL: How does "branding" intersect with the other work that you are doing for your clients?

TK: This area is intriguing to me. Firms, like individuals, perceive themselves in a very defined way. I wrote a LinkedIn article recently entitled: "No really, tell me the truth, do I look fat in this outfit?" It explores a common problem that sponsors experience when they rely on their investors' feedback on how well they are doing in terms of performance, strategy execution, crisis management, etc. But, like consumer surveys and focus groups, interim performance feedback is not as telling as the moment the same consumer/investor commits to make a purchase or actually buy into your next fund. That's the moment real feedback is obtained.

TLL: How do you get the right information you need to be successful?

TK: I try to advance the feedback loop so that firms that rely on investors for capital are acting in their best interest to maintain high investor satisfaction ratings even when performance may be slipping. Having been an

LP for 30+ years, I blend academic research with real life examples and experience to help firms create the best brand that they can for who they are, what they are good at, and why their investors should remain confident in their long-term potential.

TLL: I suppose it starts with good communication.

TK: Yes. A good example is how annual meetings are constructed and delivered. Investors often compliment GPs for the quality of their meeting, but are these compliments really honest or merely our human cognitive tendency to avoid confrontation?

TLL: What type of research are you considering that could be helpful to private equity?

TK: It goes without saying that the research on the consistency of returns across multiple funds and even multiple investments is highly uncorrelated. A first quartile fund today does not really predict with any degree of accuracy the likelihood of the next fund being top quartile. Similarly, three prior successful investments, contrary to the "hot hands" theory, does not correlate well with the likelihood of a fourth successful investment.

I'm trying to figure out a way to analyze and better understand how otherwise successful firms have failed over time. While poor investment performance is the easy answer, wouldn't it be exciting to identify the real underlying organizational, decision process, or other firm-level dynamics that more accurately lead to failure? This would be an exciting study to perform. A type of firm morbidity or psychopathology study that would help investors better gauge and maybe even predict what firms are most at risk of failing. That would be valuable research!

TLL: Tim, as you know, we always end these interviews by asking what your biggest surprise has been.

TK: My biggest surprise was realizing how often highly successful managers, founders, sponsors, and employers more generally through our industry can be at buying and building companies, while being awful at building and retaining talent on their teams. I'm a believer that few professionals fail for lack of skills or talent. Most professionals fail because of poor management. Talent development should not be a passive or reactionary activity, it requires an active focus and dedicated effort. One firm I think highly of has begun offering professional coaching to every team member when they become a Principal. This eliminates the potential stigma associated with being assigned a coach, and converts it into a value-added activity reflecting the firm's commitment to talent development and job satisfaction.

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