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THE ADAPTIVE LEADER

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The Peter Principle, formulated by Dr. Laurence J. Peter in his 1968 book *The Peter Principle*, states simply that people rise to their level of incompetence. The investment industry provides a classic case of this principle: three smart people start a firm, rack up early successes, gain momentum, and before long find themselves managing $5 billion with a team of 40 people. One of the three founders is now the CEO and in charge of—gulp—leading and managing the firm. Rarely is the founding CEO excited about this prospect. He loves markets and success, but not the actual job of leading the firm.

In the investment-firm context, the Peter Principle can also take this form: Joe Blow is a terrific individual contributor in the fixed-income department of a large firm. His skills are spotted early, so the department head names him the heir apparent. Eventually, Joe Blow is promoted to run the department. Surprise! He has no interest in or talent for managing people. His love is investing. How did this happen? he wonders. Everyone congratulates him, but inside he feels a sinking sensation.

These two hypothetical cases take place every day in the real investment world. Talented investment professionals are routinely promoted out of their areas of expertise and into jobs that have totally different requirements and use entirely different skill/ability sets. Before we get into the scorecard that we use for measuring management excellence in the investment world, our first important point is: don't get seduced into taking on a management role if your real gift—what we call "genius"—is running money. Or analysis. Or trading. Or any of the specialty jobs that are so vital to investment success. Stick to your area of excellence. Everyone will benefit, and you'll be a lot happier.

If you're still reading, then either you have a genuine interest in management or you are one of those unfortunate souls who feels trapped in a management role. In either situation, the most important predictor of success is your relationship to feedback. The adaptive leader is genuinely

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open to feedback from the environment. Adaptive leaders are willing to hear the tough feedback because they realize that only in this way do we learn and grow. The typical response to reading the last sentence is: “Well, of course I’m open to feedback, assuming it’s good feedback!” The problem with this reasoning is that “good” feedback invariably means “feedback that agrees with my position!”

Human beings have an amazing capacity for denial (just drop in to an AA meeting and you’ll hear some doozies). We instinctively avoid hearing things that upset us or deflate our egos. In the face of most tough feedback, we get defensive. We close down our learning faculties and fire up the fight-or-flight response. In contrast, adaptive leaders have learned to recognize when they are getting defensive and know how to shift back to an open and curious attitude.

So, skill number one for an investment leader is: cultivate an attitude of curiosity toward feedback. Create a feedback-rich environment in your team or firm. Make it clear that you are approachable and really want to hear people’s opinions. Manage your behavior carefully, so as not to create the impression (or reality) that you punish people who give you direct, honest feedback. If you haven’t received any “tough” feedback in the past two weeks, ask yourself “why not?” The best leaders solicit feedback. Warren Buffett asks first for the bad news in his executive meetings—and he makes it clear that the news is welcome.

Why the emphasis on feedback? Because if you are not responsive to feedback, you won’t manage well. Darwin was right when he said that survival of a species goes not to the strongest or the fastest but to the most adaptable. It may take a while, but if you are not responsive to feedback you’ll die out as an investment species.

The scorecard we describe in this article is a form of feedback. It’s a way to score yourself on the basics of management. If you don’t take the feedback seriously, though, the scorecard is pointless. You won’t make any changes. We’ve seen investment leaders receive horrible scores on this assessment and rationalize away the entire experience. Of course, these folks go their merry way without making any changes. As I said earlier, people’s ability to deny reality is remarkable. Especially smart people (read: investment professionals . . . read: you!), because their powers of rationalization are extraordinary. (For more on this important topic, see Chris Argyris on why smart people don’t learn).

The assessment described here is a feedback tool. We recommend it for measuring the effectiveness of your firm’s leaders. It is based on a great deal of research, and yet it is very practical in nature. Each of the 14 statements relates to an important aspect of the employee’s work experience—and each of the 14 items implies specific remedies for a low score. The statements are arranged in a hierarchy based on Maslow’s theory of needs.

Statements 1–4: Basic Survival

> *If a manager does not score well on these first four items, the odds are that the team is seriously dysfunctional. These questions involve the very basics of a team.*

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1. What are we trying to do? (What is our purpose?)
2. What is my role?
3. Do I have the necessary resources?
4. Do I have the right team members?

Statements 5–8: Belonging Needs

Once you understand the basics of who we are as a team and what we are aiming for, then naturally the attention turns personal, to discern whether you belong on that team.

5. Am I appreciated? Do I feel valued?
6. Do I trust and respect my fellow team members?
7. Can I be candid and open?
8. Do my opinions matter?

Statements 9–11: Self-Esteem Needs

When survival and belonging needs are satisfied, people naturally move up to self-esteem.

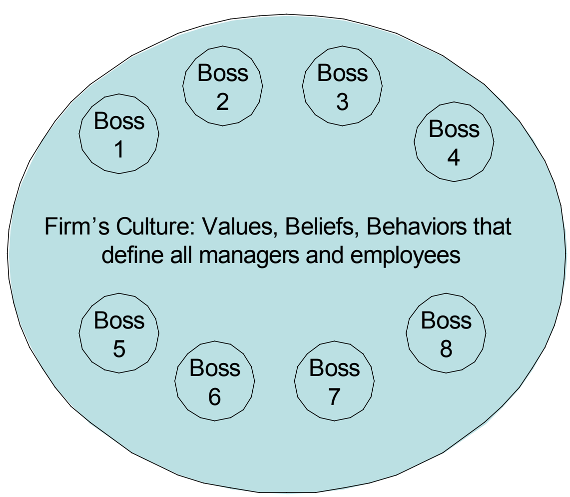
9. Am I respected?
10. Do I feel proud of what I'm a part of?
11. Is this a high-performing team?

Statements 12–14: Self-Actualizing Needs

Finally, people want to perform at their highest level.

12. Am I challenged?
13. Am I given opportunities to grow and develop?
14. Am I using my unique talents and gifts?

Before going into more detail concerning these 14 diagnostic statements, let me briefly explain the relationship between this leadership scorecard and our firm's work on culture in the investment firm. The following graphic shows a firm's managers as circles inside the larger circle of the firm's culture.



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The senior leadership team, and especially the CEO, is the caretaker of the firm's culture. The leadership team members determine and articulate the values, beliefs, and behaviors that they want all employees to embrace and practice. This is the "macro" piece of the culture concept. It's measured with a tool that determines:

- *Cohesion*: What percent of the firm's employees are embracing the top 10 values and behaviors? The investment industry on average scores around 45% (on a scale of 100%). A firm like Brandes in San Diego or Greystone in Regina scores 80% on this measure. These two firms have worked hard to create a very strong culture. Employees at cohesive firms are all on the same page.
- *Sludge*: What percent of the culture is slowed down by "sludge" behaviors (such as blaming, gossiping, etc.)? For Brandes and Greystone, it's less than 5%. The investment industry in general scores around 17%.

The culture issue is important for investment leaders. As David Fisher at Capital Group says, "Culture is our only competitive advantage." A key job for investment leaders, then, is to have a clear understanding of their firm's culture and to practice it themselves, thereby modeling it for staff. In our experience, the most important factor in having a strong culture is whether the senior team is aligned around it. If the senior team really practices the values and behaviors, those values and behaviors invariably cascade down to all the staff. Conversely, if the staff perceives that senior team members continually violate the standards of the articulated culture, then they assume it is okay to do the same.

Let's return now to the 14 diagnostic statements. The role of this tool is not to measure a culture but to measure the bosses within that culture. This could be viewed as the "micro" piece of leadership. The big picture is culture (macro), the smaller picture is individual workgroups (micro). Here's the critical fact for investment managers: people join companies, but leave bosses. In a business that is all about talent, it is hugely important to keep this idea front and center. Bad bosses will drive out great talent. No matter how good Joe Blow was as a bond trader, if he becomes a bad boss, he'll cost the firm millions by driving out the other talented professionals. Hence, the importance of the 14 items: They are the best gauge we know of for measuring employee loyalty and commitment. High scores on these 14 items translate into high retention rates.

So, here are the 14 statements, presented in their "Maslow" groups, with some commentary. (Scoring goes from 1 = strongly disagree to 5 = strongly agree.)

Survival

1. We have a clear purpose. I know what our team is trying to achieve.
2. I know my role on the team and what is expected of me.
3. I have the resources to do my work well.
4. We have the right team members to accomplish our goals.

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Strange as it may seem, lots of teams score poorly on statement 1. Obviously, managers need to clearly indicate what the team is trying to achieve and how that purpose fits into the larger picture of the firm overall. Without clarity of purpose, employees feel lost and frustrated. They disengage.

Likewise for statement 2: I need to know what my role is and what is expected of me. Roles and responsibilities should be discussed with each team member and descriptions of each should be written out, along with criteria for performance reviews.

Statement 3 is clearly a survival issue. I have to have the right tools, equipment, and other resources to perform my job at the highest level. In the case of investment professionals, this item often draws low scores because travel budgets for company visits or conferences have been cut. Finally, we consider the right team membership to be a survival issue. This criterion is straight from Jim Collins. He states clearly that having the right people on the bus in the right seats is the first—and most important—management decision. Nothing kills morale on a team like having one or two nonperformers. Investment professionals are competitive by nature and take great pride in being on a top team. Add in the factor that nonperformers often are getting paid nearly the same as top performers, and you really have a morale problem.

If your average score on one or more of these statements is lower than 3, chances are your team is suffering. The leader is responsible for choosing a strong team, creating a clear purpose, defining each person's role, and giving people the resources to do their jobs.

Belonging

5. I feel valued and appreciated for my work.
6. I trust and respect the people on our team.
7. I experience a high level of candor and openness on our team.
8. My opinions matter on this team.

Statement 5 is so important that we devoted an entire chapter of High-Performing Investment Teams to this one topic: appreciation—the basic human need to feel valued. However, the concept of appreciation is more profound than simply back-slapping and issuing "atta-girls." In our view, appreciation is the antidote to entitlement. The latter is fueled by expectations: "I should get a raise. I should get a bonus. I should get stock options." Entitlement is all about expectations. As one pundit said, "Expectations are premeditated resentments." Wise managers learn to be appreciative of the little things in life, starting each day fresh. They develop an appreciative attitude toward themselves and their staff. The alternative is an entitlement attitude, which is fueled by ever-greater expectations.

Statement 6 measures trust and respect on a team. Investment teams will never function at a high level if trust and respect are lacking. We define trust in this way:

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A. Character
   - Integrity: aligning words and actions
   - Intention: showing concern for others; creating win-win scenarios
B. Competence:
   - Capabilities: talents and skills
   - Results: delivering on promised results

We've measured trust in this way for dozens of investment teams and found that trust correlates with fund performance. Quite simply, the higher the trust, the better the performance.
Why is trust so critical? As master investor Buffett has stated many times, the high level of trust at Berkshire Hathaway allows them to function with "less overhead and faster decision-making than any other place of our size in the world." Buffett's approach to choosing business partners is simple: "I only do business with people whom I like, trust, and admire." His trust and admiration for his partner is so high that he boasts, "Charlie Munger and I can handle a four-page memo over the phone in three grunts." Buffett doesn't waste any mental energy wondering, "Can I trust what he just said?" or "Will he remember that he made this agreement?" or "Is he telling me the whole story?" In fact, Buffett says just the opposite of his business partner: "Charlie never 'grabs' for himself and can be trusted without reservation. He has an absolute commitment to honesty, ethics, and integrity."

It is possible to develop extraordinarily high levels of trust on an investment team. The Delaware Growth team in San Francisco has nine members, all of whom averaged higher than 9 (on a 10-point scale) when rated by their colleagues.

Statement 7 is a logical follow-on to item 6. When trust exists on a team, people feel safe enough to be candid. We define candor as having these important elements:

a) *Honesty*: I say what is true for me. My words and thoughts align.
b) *Openness*: I say all that is relevant, and do not withhold important information.
c) *Awareness*: I make it a point to be well informed, and I avoid being naïve. This includes the awareness that *none* of us is fully informed; there is always more to learn on any subject. (Overconfidence is well documented in behavioral finance literature.)

Without candor, a team cannot fully vet investment ideas and cannot operate at a world-class level.

Finally, statement 8 gets at the heart of the issue: does my opinion matter on this team? When I belong—that is, when I am a valued member of a team—my voice counts. We use the term key opinion leaders to designate people in firms who are listened to. Similarly, each team member wants to be heard and valued for his or her contributions. When this is not the case, team members tend to disengage.

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Self-Esteem

9. I have clear performance goals that measure my success on this team.
10. In the past three months, I have received performance feedback from my manager.
11. We make and keep clear agreements on this team.

These three statements address the issue of excellence and pride. Once my basic needs for survival and belonging have been met, I then move up to self-esteem issues. I want to feel a sense of mastery. I want to be excellent at what I do.

Statement 9 measures whether the manager has established clear performance goals for each individual. A low score here indicates that team members don't know if they are succeeding. We recommend very clear, written performance goals based on thoughtful discussions between the manager and each employee. Statements 9 and 10 relate to the content of Ken Blanchard's famous little book, *The One Minute Manager.* Each manager must negotiate a written performance contract with each staff member; then the manager must provide constant feedback (item 10) to indicate if the employee is on track or off course.

Statement 11 is the basic proposition of accountability. In high-performing teams, individual team members pride themselves on making and keeping clear agreements. The team's efficiency and pride grow as the team builds a reputation for accountability. High marks on these three items tend to indicate a high-performance team, one that thrives on being the best.

Self-Actualization

12. My work allows me to use my talents and abilities.
13. Leadership encourages my development and growth.
14. I feel that my work is important to reaching our firm's goals.

At the top of the Maslow pyramid is self-actualization. Skillful managers who score well on statements 1 through 11 are mindful that team members still have another level of aspirations. Individuals want to play the game at their highest level. This involves discovering and leveraging their natural strengths. Again, this notion is so important that we devote an entire chapter to it in High-Performing Investment Teams. We call it genius. We don't mean genius as in Mozart, Shakespeare, or Einstein. Rather, we use the term as a name for the natural abilities that allow an individual to perform at an extraordinary level. Some may call it simply talent. Whatever you call it, genius goes beyond learned abilities to tap into the energies of our true passions. Smart managers encourage their staff members to find their genius areas, so that they will be intrinsically motivated. They will love their work. Capital Group practices this concept. They have a program called TAP (The Associates Program), which allows new employees to try various positions within the firm until they find something that really turns them on.

Statement 13 dovetails with statement 12. Individuals may be in their area of genius, but feel like management has put a lid on their growth. Smart managers understand that investment professionals are naturally ambitious and curious and love to challenge themselves. Hence, a good manager will continually challenge the team members and give them opportunities to grow to higher levels in the areas they love.

Finally, statement 14 gets at the all-important issue of meaning. Do I feel that my work is meaningful? Does it contribute to the firm's success? Can I see the direct impact of my work on the firm's overall mission? When the answer is no, chances are that the employee's commitment will suffer and sag. At some level, the employee will wonder, "Why am I doing this? What difference does it make?" Astute managers make sure that employees see the direct connection between their day-to-day tasks and the firm's overall mission.

Summary

These 14 statements provide a comprehensive tool for measuring the effectiveness of managers. They are great feedback for identifying and honing management skill. If managers are committed to their own improvement, they will embrace a tool like this. Leaders of investment firms realize that they are in the talent business. As with professional sports teams, you can't win without a certain minimum level of talent—and bad bosses drive out top talent. Hence, there is a double incentive for investment firm leaders to measure the skill of their managers:

1. Bad bosses will drive out good talent.
2. Mediocre bosses will not get full commitment and effort from their teams.

The good news is that these 14 "pressure points" are not illusory or cryptic. They are readily identifiable and, if necessary, fixable.

It all depends on the first and most important skill: Is the leader adaptive? What is the leader's relationship to feedback? Will the leaders take the results of this assessment and use them to improve team performance? Or will they rev up their powers of rationalization and dispute the facts? As the old saying goes, when people are confronted with the choice of changing or proving that there is no need to change, most people get busy with the proof. In our experience, top leaders have mastered the ability to adapt.

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