Identifying Managers with Talent and Integrity

Robert Vinall
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About RV Capital

• RV Capital was founded in 2006.

• A one captain ship: Robert Vinall is the sole owner and employee.

• Rob advises the Business Owner Fund, a long only equity fund that invests worldwide in most sectors.

• Concentration is high. The fund has 10 holdings.

• Holding periods are long, biasing the fund towards companies with widening moats and excellent long-term prospects.

• High concentration + low turnover permits a wide investment universe and deep relationships with investee companies.
Capital Allocation Framework

Topic: May 2017

Topic: May 2014

Topic: May 2020?
Management Matters

• It is most obvious in the negative
  – Frauds, theft
  – Disastrous acquisitions
  – Toxic culture
  – Misalignment

• Non-trivial point as great investing is principally about avoiding errors.

• But also in the positive: Business owners know: “it always comes down to the people”.

• Great managers:
  – Live and breath the company’s culture
  – Allocate capital productively
  – Decentralize
  – Create alignment
  – Give permission to make mistakes

• Investments generally work out far differently than expected.

• Sometimes the bad guys win, but the goal is to gain an edge over an investing lifetime, not on every single investment.
Judging Character Is Possible

• There is considerable scepticism amongst investors about their ability to judge character.

• Many investors avoid management contact altogether to avoid “biasing their judgement of the business”.

• Buffett has a near 100% track record in picking his managers.

• We tend to overestimate our ability to forecast financials and underestimate the role of people and our ability to spot them.
  – When a new CEO took the reins at Berkshire Hathaway in the 1960s, it was not the economics of the textile industry that determined the outcome.

• People generally prefer to meet their future spouse before marrying them. Why is investing so different?

• It is a wonderful situation for a stock picker when a factor is important, knowable, and overlooked.
What Makes It Difficult

- Investors generally do not focus on evaluating managers.
- Managers self-select for good salesmanship (fortunately!).
- It is difficult to separate management excellence from the general tailwinds of a successful business (see: “The Halo Effect” and “Fooled by Randomness”).
- Management meetings tend to be in a fixed domain with a fixed script.
- No CEO ever volunteers negative information.
- There is a societal taboo against talking about people in the negative.
- Everyone has at least some positive attributes.
Strategies To Evaluate Managers

• Decide to focus on it:
  – Structure meetings and analysis accordingly
  – Reject investments where management falls short

• Look for very small details - “tells”.

• Stay within circle of competence.
  – Choose a universe of long-tenured managers, ideally founders and owner operators.

• Formulate short, precise questions (see: “Spy the Lie”).

• Break the task down into identifying a handful of desirable attributes rather than forming a holistic view of character.
Which Attributes To Look For?

Harder to identify

Talent

Less Important

High IQ

Strategic acumen

More Important

Harder to identify

Humility

Alignment

Capital allocation

Easier to identify

Strong leader

Sense of humour

Less Important

Charisma

Financial incentives

More Important

Talent

Integrity

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It’s All About Integrity

• Attributes such as strategic acumen, high IQ, and perhaps even talent speak to an old organizational model of a lone genius at the top filtering wisdom to the underlings below.

• In a modern corporation, responsibility and accountability are devolved to those closest to the customer. (see: “Reinventing Organizations”).

• The main job of the CEO is to protect the culture. This comes down to integrity or more broadly speaking “setting the right example”.

• An excess of energy or intelligence can be an actual burden.
Sources of Data on Managers

• Management meetings

• Annual Reports (in time series)

• Former employees

• Competitors/Suppliers

• Company biographies (see “The Buffett CEO”)

• Situations where there is “an opportunity for a reveal”
  – There is a huge payoff to being perceived as honest. It will only be revealed when there is a strong incentive to sacrifice values for a short-term gain.
The Most Important Source Is Yourself

• Live by the values that you seek in your managers.

• We like people who are similar to ourselves (see “Influence”).

• Liking is a very powerful emotional bias that can be harnessed to your advantage.

• Buffett on Ajit Jain in “The Snowball”:
  
  ´Buffett saw himself in Ajit, who quickly rose in his esteem to share Mrs B’s pinnacle. “He had no background in insurance. I just liked the guy.”´

• According to the Wall Street Journal, Buffett decided to invest in Precision Castparts after a 30 minute meeting with Mark Donegan.

• Life is more fun (and more profitable) when you partner people you like and admire.
Books referenced in this presentation

- “The Snowball: Warren Buffett and the Business of Life” by Alice Schroeder
- “Influence: The Psychology of Persuasion” by Robert Cialdini
- “The Halo Effect” by Phil Rosenzweig
- “Reinventing Organizations” by Frederic Laloux
- “Spy the Lie” by Philip Houston
- “Fooled by Randomness” by Nicholas Taleb
- “If Disney Ran Your Hospital: 9 ½ Things You Would Do Differently” by Fred Lee
- “The Warren Buffett CEO” by Robert P. Miles
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