the art of boring™

EP20 | The art of the management team interview

01:02	**Cam Webster**	Today, we're joined by Karan Phadke, who's an equity analyst with the global small cap team, and we're here to talk about the art of the management interview. Before we get to that—Karan, welcome to the podcast!
01:15	**Karan Phadke**	Thanks for having me.
01:16	**Cam Webster**	You're welcome. Give us a little bit of an overview of your experience in investing and how you made your way to Mawer.
01:32	**Karan Phadke**	Sure! I guess I've had more of a long and winding path relative to some to end up at Mawer. Just for context or background, I grew up in South Africa. I was there until I was 18, and then I moved to Canada, went to U of T, and did actuarial science, math, and stats...so that was a little bit removed from investing, I guess.
01:53	**Cam Webster**	How big was that class?
01:54	**Karan Phadke**	Well, the funny part is that it started off with a hundred and ended with thirty or so—
01:58	**Cam Webster**	Whoa! Get out!
02:01	**Karan Phadke**	They tell you "look to your left and look to your right—one of you is not going to be here in four years." So, it was pretty funny that that was the case.
02:09	**Cam Webster**	Wow.
02:09	**Karan Phadke**	So it was a pretty small class and an interesting time, but I wanted something more business related. So when I graduated, I was a management consultant for a couple of years at A.T. Kearney. That involved a lot of strategy and finance work, but also working with private equity funds—helping them act with due diligence. After that, I joined CPP

		Investment Board in Toronto, and over there I was part of a thematic investing team. So this was long-term, market neutral global equity.
02:37	**Cam Webster**	Did you have to be a Canadian citizen to be an employee at CPP?
02:39	**Karan Phadke**	I was already a Canadian citizen by then.
02:42	**Cam Webster**	You were? Okay [laughs].
02:42	**Karan Phadke**	So, luckily I didn't have to find out if, yeah. But I don't think you have to because they have global offices. That was really interesting and my first foray, I guess, into public market investing. I did that for a couple of years, and Jeff Mo (who works at Mawer and who I had known before) introduced me to Paul and Vijay, and that's how I got my first leg in. Three years on, here I am. I spent a year in our Singapore office—that was a lot of fun. I got an opportunity to meet management teams from different cultural backgrounds and different parts of the world, and now I'm back in Calgary for good!
03:17	**Cam Webster**	Thanks for that overview. Maybe we'll weave that Singapore experience into the subject we want to cover.
03:25	**Karan Phadke**	Sure.
03:34	**Cam Webster**	Why management is so important to our investment philosophy?
03:36	**Karan Phadke**	I think management increases in importance based on three categories or three areas. The first is, as you extend your time horizon or your holding period, people begin to matter a lot more. So that's one dimension to think about—how important is management to assess. The second is the size of the company. The smaller your team, the more impact each individual will have on the culture and the outcomes. And then the third one is the portion of earnings that they retain.
04:05	**Karan Phadke**	If a company retains a lot of earnings, that's owner capital, and they're going to reinvest it...so you better have some good stewards of capital to reinvest that for you.

I think management is really important along those three dimensions. And in general, I think the value of having good management teams is that they provide better skew. What I mean by that is you tend to create more surprises to the upside versus the downside if you have good people at the company.

04:30	**Cam Webster**	Okay, sorry. So you said skew?
04:31	**Karan Phadke**	Yeah, S-K-E-W.
04:33	**Cam Webster**	Okay.
04:33	**Karan Phadke**	The distribution of outcomes hopefully tends more towards more positive things versus negative things...that's what I mean by "skew." The second is that they extend growth runways, so they create opportunities to expand the business in intelligent ways. And then the third, again, is they increase the durability of the franchise. Hopefully, they can build this business for a long time, and you can get cashflows many years out into the future. Those three things are really important jobs of management. And in general, the better the management team is at doing some of these things, the slower you want to be at selling the security as it reaches your estimate of intrinsic value.
05:11	**Cam Webster**	Okay, well, we could probably end the podcast there because I think you covered it all [laughs].
05:13	**Karan Phadke**	There you go! [laughs]
05:15	**Cam Webster**	Maybe we can go from that great overview you gave us into: how do we go about that? How do we take those key characteristics? How do we ask the right questions?
05:27	**Karan Phadke**	There are two components to that. One is, what are some of the factors or the dimensions you want to assess? The next piece is, how do you actually assess that both empirically and qualitatively? And then the third piece is, well, what do you do with that? I think just in terms of the attributes it's helpful to have a framework on

how we assess them. And I think at Mawer, we have a guideline on some of the key attributes that we look for, or factors when we're thinking about.

05:58 **Karan Phadke**

Some of these would be alignment and governance, culture strategy, capital allocation, execution, and risk management. That's a pretty comprehensive list, and it's almost a checklist to go through. And, on each one, try to understand how management is doing.
In general, the idea is to get a sense for how and why they make the decisions they do—as opposed to what the tax rate is going to be in a specific quarter. And the way you do that is both empirical tests (using financial or operational metrics) and qualitative ones (what do they say they do? have they tracked against it?)—things like that.

06:39 **Cam Webster**

Within our philosophy, assessing word and deed is what I'm hearing you describe. Let's dig into it a little bit more ... how often do we conduct a management interview? In any given quarter? Let's take global small cap for instance—how many management interviews would you do in a quarter as a team?

07:01 **Karan Phadke**

I track the number of interviews that I do on an annual basis, and, as an example, last year I spoke with 176 companies. So quite a lot. That works out to around one every couple of days, at least. On average, every week I'll have at least one management interview—whether it's to assess a new company, speak with an existing holding, or do “scuttlebutt” as we like to call it on something related to a company that we own.

07:31 **Karan Phadke**

Across the Mawer platform we systematically track and share our notes. When I did a count on our internal database, in 2017 across the whole team—that's all of Mawer research—we conducted almost 1200 unique interviews, and over the past five years, we've done over 6,000 unique management interviews.

07:52 **Cam Webster**

Right, but everyone's different. You've got to think 6,000 interviews that everyone's different—

07:59 **Karan Phadke**

Yes.

08:07	**Cam Webster**	Within those 6,000 interviews...do you have a standard set of questions? What do you typically ask a management team? How do you prepare? How do you nuance each question and go from there?
08:19	**Karan Phadke**	I think it depends from person to person, but in terms of the preparation, it's really important when you're first meeting a management team that you build rapport and that they don't necessarily feel like you're wasting their time. It's very important to prepare beforehand. For me, that would involve going through the company's public filings, but it could also be going on the website, YouTube, customer review websites—just to get a sense for the product—what people are saying about the product. And also reading competitors: what are they up to? What are they saying about the industry? A lot of the time—because we've accumulated these 6,000+ interviews over the past five years and even more over a longer time horizon—typically on any given company, we may have already spoken with them before, or we've at least spoken with a competitor, or another company in the same industry and different geography. So you can review those as well just to get a sense for what this business does. That would be some of the preparation involved up front. I do have a guideline on the types of questions or general categories that I like to ask so that I can go through comprehensively what I'm looking for.
09:24	**Cam Webster**	You have a favorite within there?
09:32	**Karan Phadke**	One of my favorite questions is around customer satisfaction and customer loyalty. One of the questions I would ask is, "how do you measure customer satisfaction? And, where can you improve?" ... Or even a broad question like, "how loyal are customers?" and then seeing how they respond, and seeing what they have to say about it.
09:55	**Karan Phadke**	A couple of other quick ones would be, "which functions in the business could you outsource if you really had to?" And the purpose of that is to understand where the value is really being generated in the business, versus the ancillary activities that support that. That [question's] trying to understand what capability drives their competitive advantage. A couple of others would be, "how much time or money would be needed to copy

your products or services?" Again, related to the mode of a company. Or, "what are the three most important financial and nonfinancial KPIs (key performance indicators) on your dashboard?" What does management think is critical to the business that drives value?

10:36	**Karan Phadke**	And then the last two as examples would be, "when do you choose to build versus buy?" How do they make that decision of going to buy an asset versus go green field? Or, something like, "what are common mistakes you've seen others make in the industry?" This would be to get a sense of not just how the industry works, but also what management sees as a fatal flaw that they try to avoid—and whether they have a good understanding of what can break the business side; the risk management side of it.
11:00	**Cam Webster**	[Those] sound like tough questions. If I were a CEO, I don't think I'd want you to be asking me those questions.
11:07	**Karan Phadke**	Well, I think the general idea is we're not—at least, I'm not—trying to grill them. [The exercise is] just trying to get inside their heads to understand how they think about the business, and again, why and how they do things as opposed to getting specifics around, "what happened in the quarter?" It's just getting a flavour for why they do the things they do.
11:24	**Cam Webster**	Do you ever lead with that? Like, "excuse me, Mr. and Mrs. CEO, but the reason I'm going to ask you these questions is I want to understand how you think?"
11:32	**Karan Phadke**	No [laugh] I've never actually lead with that. Usually I just jump right into it. And sometimes it could be an innocuous, supposedly naive question—but [one] you can get a lot out of. An example would be if a business has really high returns on capital, you could ask, "well look, your returns on capital are really high. Why haven't they come down? Everyone else in the industry doesn't do as well. What's the secret sauce?" And sometimes a broad question like that—and you just pause and listen—you can get a lot out of what they actually believe are the drivers of the business.
12:04	**Cam Webster**	Technique-wise, what do you find is the most effective in terms of "I'll pause and listen to your answer now."

12:14 **Karan Phadke** It's interesting that a lot of different people have different perspectives on what you could use as technique. Some rules of thumb that I've picked up from colleagues at Mawer—guys like Christian, who's our deputy CIO; Stas, who works on the U.S. team, are particularly good at providing feedback around this—would be having open-ended questions. So, throwing in a combination of open-ended and pointed questions is a good technique.

12:41 **Karan Phadke** Often you want to ask an open-ended question but then dig deeper, so, follow up on the question and see where it takes you—as opposed to going from question to question on your list. That would be another example. The third one, as you mentioned, would be listening to the point of being uncomfortable with the silence.
Often when you ask someone a question, they'll have a quick couple seconds where they've got a scripted answer—frequently because they've gotten that question before—but once they've run out of that scripted answer...then (sometimes) the truth can come out.

13:12 **Karan Phadke** You want to pause and just reflect and digest to see if anything else comes out. Those would be three quick examples of techniques that you can use. While it's important to be mindful of [those techniques], at the same time, it's also important not be too preoccupied with the way you ask questions—as opposed to just trying to answer or refute your thesis.

13:34 **Cam Webster** Right. Maybe we can talk a little bit about your experience in Singapore, or maybe give us a compare and contrast. You were a consultant at one time, so you would have encountered more North American management teams, I presume. Is that right? [More so] than say, Asian?

13:53 **Karan Phadke** During my time in Singapore, I obviously got a chance to visit a lot of Asian countries because [they were] close by. Examples would be Japan, Malaysia, Thailand, Australia—which isn't an Asian country, but in APAC—and Singapore, of course ... sitting in the global small cap seat, we speak with companies everywhere around the world, and there are definitely cultural differences and similarities in management teams.

14:23 **Karan Phadke** Without drawing a broad brush, obviously, my observation has been that in Japan, as an example, if you do a management interview just through

the phone, you will have to use a translator. And that can take a lot of time and you won't get as much out of it—versus if you actually go visit them in person. When you actually go visit Japanese companies in person they give you English materials that are not available on the website. So there's actually a big benefit to visiting them, because you'll get investor presentations and resources that you would not have otherwise been able to find anywhere else—because they just don't share it on their website.
In general, my observation has been the culture—as it relates to focus on return on capital on minority shareholders—is quite similar in the U.S., UK, Australia, South Africa, Sweden, and Norway, and those countries in particular...whereas it can be a little bit different in other parts of the world.

15:24 **Karan Phadke**

In Japan, my sense is they're more optimizing around duration of the business. So, they want to make sure that this business is around for a really long time; that it maintains its relationships and maintains its employees without firing them for a really long time—versus going from 8% ROE to 9%, which might be more of the focus in the U.S., which is why you see a big disparity in debt levels too. Many Japanese companies will have a net cash position whereas many U.S. companies will be levered three, four, five times EBITDA.

15:57 **Cam Webster**

That's good! Some nuances in Japan that Dave Ragan didn't mention in his podcast about Japan [laughs].

16:02 **Karan Phadke**

Yeah [laughs] I know he doesn't like Japan as much, but I sort of view it as a trade-off between yes, low return on equity, but perhaps more durability and safety.

16:12 **Cam Webster**

This is the first time I heard it phrased that way.

16:12 **Karan Phadke**

And some [Asian] countries are also very entrepreneurial. Indian companies, for example—many of them are family-owned and the family will be quite entrepreneurial. Others too. When I went to Malaysia, for example, I went to Penang. I would never have thought of going there if I was here, but from the Singapore office it's very close. And Penang is a hub for machine vision technology, surprisingly.

16:36 **Karan Phadke**

A lot of iPhones, when they're getting made, the cameras have to be tested in an industrial process, and the leading companies around the world that make the machines that test the cameras—they are made in Penang. So they have massive exposure to the semiconductor industry, to the phone industry...that whole ecosystem is set up there.

When you go visit them, you can visit a lot of smaller companies doing that led by entrepreneurial teams. And surprisingly, I found that in Thailand, Malaysia—a lot of these countries—India—English is very widely spoken. You don't need to translate in any of these countries. You can easily get around in English and conduct management interviews in English too.

17:24 **Cam Webster**

The question that occurs to me is, how do you capture this information that you gather from a management interview?

17:31 **Karan Phadke**

Usually, we would type up notes of the conversation. We would have a record of the key points that were said and what people were saying. Also, on site visits, most people take pictures and we can share that on our internal database too. The way it would work is, let's say I speak with a couple of companies that I find interesting...I'll type up the notes, put them on our internal database, and on that database I can then tag them. I can put them specific to the company I'm speaking to and also tag industries and other companies that are related. It will show up for others [on our research team] if it's a company in their industry, or related to the companies that they own—so they can review that as well.

18:10 **Karan Phadke**

In terms of synthesis, typically, in global small cap (and I've observed on many other teams as well) we like to have a summary or takeaways on, what was my initial impression after this?

In general, we try not be too judgmental. And the reason for that is because often it can colour someone else's perspective on a company. Let's say I speak with a new company and I say, “this is a terrible company; this is a wonderful company.” Someone else, at some point, may revisit and speak with them again and they'll read my notes...and if I said “it's a terrible company,” I might be wrong. And I don't want to colour their view on it too much.

18:49 **Karan Phadke**

That said, I will provide some thoughts around it. And we'll systematically in global small cap—after every management interview, especially for new companies—rank it on the matrix. The matrix is our internal tool, which is quality relative to value. We'll rank each aspect of the business on a scale of one to five, or zero to five...and that will be our way of providing an opinion of what we think the company is doing.

19:15	**Cam Webster**	Great. We've dug pretty deep in terms of the process. What might illustrate everything in one encapsulated little conversation would be for you to walk us through one of your favourite management interviews. Of 177, I'm going ask you to pick one.
19:39	**Karan Phadke**	One interview or response that stands out would be with what Paul Moroz, our CIO, categorizes as "an architect manager." He categorizes two archetypes for managers—either an "administrator" or an "architect." And what I mean by that is, an architect would be a real steward of capital; someone entrepreneurial who started the business, or a financial genius, for example. And they have a blueprint. They have a plan that they tell you at the beginning when they started this business or they took over, that "this is what I want to do, and this is why I think it will work" and then they go and execute on it as an architect would.
20:18	**Cam Webster**	Would Steve Jobs be one?
20:20	**Karan Phadke**	Sure, Steve Jobs could be one. But more tangible examples in our portfolio would be Constellation Software—Mark Leonard. He's an architect, but a financial architect specifically. Another one would be the person I spoke with, which is Matthias at VZ Financial. He built this business from scratch (and I'll go into the details of what they do) but he's more of an entrepreneur, customer-focused type of architect.
20:43	**Karan Phadke**	Jeff Bezos is an obvious [architect] that everyone knows. On the other hand, you got administrators. And an administrator is someone that's more like a caretaker. They come into a really strong business with a franchise and they make sure that the culture and the competitive position is maintained. But they'll often return all the excess capital instead of redeploying it, and wasting it. That doesn't mean that they're bad managers, it just means that they're not architects. They're

just caretakers making sure that the train doesn't come off the rails.

21:12 **Karan Phadke**

The interview that I had was with someone who I believe is an architect. It was Matthias [Reinhart] at VZ Holdings, which for context, is a Switzerland-based private wealth and robo advisor that we have ownership in in the global small cap portfolio. And what stood out was ... I asked him a pretty high-level question about how they can maintain really thick margins given that it's such a competitive industry (so, "how were you able to do it? What's the secret sauce?"). And he's the gentleman that started this business from scratch many years ago—and it's huge now, and it continues to grow—and he really very clearly explained what the idea was and what the business model was.

He said from the beginning, he's been building a business where their approach to client acquisition is substantially lower cost than their competitors. What that means is that, unlike many other private wealth advisors in Switzerland, they hire really smart young people out of school. They train them how to be really good financial advisors or financial consultants, and then they provide that advice on an hourly fee basis to customers that just want tax advice, or inheritance advice—things like that. And if they're really happy, then there is an option to then convert them to a wealth management client. But it's not an obligation. So they lead with the actual advice, and you still pay for the advice, but it's not a big profit center.

22:34 **Karan Phadke**

If they do a really good job, then they can come on as a wealth management client where the margins are a lot thicker. Now, you compare and contrast this with the usual private manager in Switzerland that have very high cost advisors that are highly incentivized to get [customers] as a wealth management clients. So that customer acquisition cost is materially different. And he went in and built the business based on that, and created this low cost flywheel effect where he keeps getting more customers and is able to reinvest in the business to offer better products for them as he scales.

23:06 **Cam Webster**

I'm going to ask you to do a top two answers and a bottom two answers of any management interview you've had.

23:13	**Karan Phadke**	Well, that was one of my top answers. One of the bottom answers would be, surprisingly, with the chairman of the board at a company. Again, we not only speak with investor relations but sometimes the CFO, the CEO...also board directors. And, sometimes even triangulate the old company that a CEO [previously] worked at to get a reference check to see if they did a good job there.
23:41	**Karan Phadke**	So, when I asked how they decided on some of the remuneration metrics for their bonus plan, the response was mainly that they developed it based on advice from consultants and just went with what was used historically. (If I was to paraphrase—which didn't seem particularly thoughtful for a chairman.) And then, when I later asked, “what could you do to improve the board?” or, “which areas would you like more expertise in and add board members [to]?” the reply was, “good question,” followed by a deep pause, and then, off-the-cuff, “I'm not sure I can give you a good answer to that.”
24:19	**Karan Phadke**	Depending on the business, it's not necessarily like, you kill the idea. But at the same time, if that's your corporate governance and that's your board...then it's not the greatest rating you can give a company.
24:30	**Cam Webster**	Gotcha. I'm thinking, based on that example, that sometimes no answer is a complete answer.
24:36	**Karan Phadke**	Yes. And it can be tough, right? Because depending on the person you're speaking with, sometimes they may not know. If you're speaking with a relatively new investor relations person, and you decide to ask them a question like, “why do you generate higher returns?” or, “how do you measure customer satisfaction?” they may not know. But a CEO, for example, should know something like that, or if you ask a governance question to the board of directors, they should have thought about it, hopefully. So yeah, sometimes no answer is an answer. Either it means that they haven't thought about it before, or it means that they don't want to share that with potential partial owners in the business—which means something as well. Well, Karan, I think you've given us a great rundown of how we conduct a

25:15	**Cam Webster**	management interview at Mawer, and you've given us the "art of the interview" right down to some specific questions. Thank you for joining us on the podcast. Really appreciate it.
25:29	**Karan Phadke**	Thanks for having me.
25:30	**Cam Webster**	And you're not done yet!
25:32	**Karan Phadke**	Okay [laughs].
25:33	**Cam Webster**	What we like to finish with is, "One Mawer Thought" and this is where we ask you, I guess, one personal interest question and get you to try to relate it to investing. I was told you're a fan of the show "Billions," which admittedly I've watched about three minutes and 26 seconds of—a segment called "Never Settle." I don't know if you remember that one, but what I want to ask you, is there a favorite quote out of that show that really rings true for you?
26:01	**Karan Phadke**	You have to watch it for a bit longer to get into it, I'll admit. It's a little bit over the top, but that's kind of why I like it.
26:08	**Cam Webster**	[laughs] Okay.
26:09	**Karan Phadke**	I got two quick ones as they relate to management. The first one is, "sometimes you just got to trust people to be who they are." And what that means to me is, if a management team has a track record of making poor decisions and squandering shareholder capital, then you've got to trust that they're going to keep doing that. So that's the first one. And then the other one, a bit lighter, is it's very easy sitting on the other side of the table as an investor to forget that building great companies is really hard work, and we probably couldn't do it just as public market investors...and "everyone has an opinion on how you should run your business." This was one from Bobby Axelrod, who's the main guy in the show.
26:45	**Cam Webster**	Okay—Fast Bobby.

26:46	**Karan Phadke**	Yeah, exactly. And his quote was, "Lots of guys watch Bruce Lee movies, doesn't mean they can do karate." So that's another one.
26:55	**Cam Webster**	There you go. All right. We'll end it on karate. Thanks again for joining us, it was fantastic!
26:59	**Karan Phadke**	Thanks for having me.