

Detailed Reference Card (DRC)

Questioning Techniques for Obtaining Insights Using the ICE™ Framework

ICE™ Questioning Framework

The best interviews (or electronic exchange of information), by equity research analysts, journalists, authors, or any other interviewer, are the direct result of *thorough preparation*. It's critical to spend time preparing, usually well in advance of the exchange, in order to ensure the best insights are obtained for stock picking. Furthermore, when conducting an interview, 100% of your attention should be focused on the interviewee's verbal and non-verbal responses, rather than dedicating brain power asking yourself "what am I going to ask next?" which is another reason it's critically important to assemble questions well before the interview.

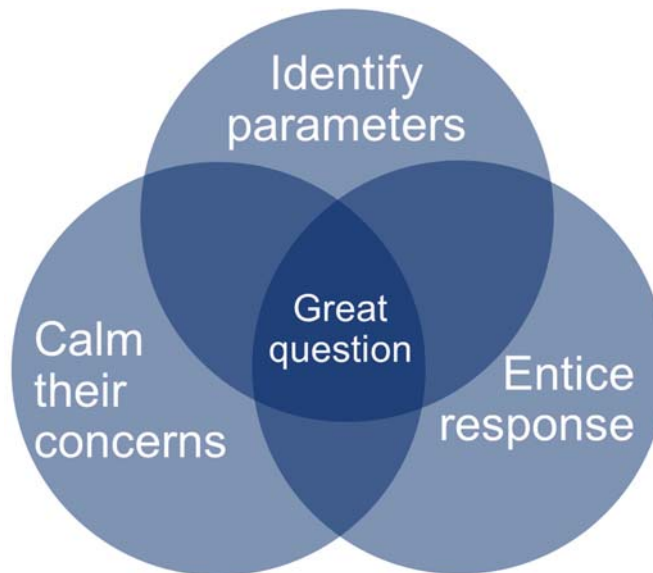
There are 3 key elements to a great interviewing, which makes up our ICE™ framework (as shown in the exhibit below):

1. **I**dentify parameters: If your question (or lead-in to your question) references specific parameters (e.g. historical trends, consensus expectations, your forecast, etc.) you have a much higher likelihood of getting an insightful answer that will help in stock picking
2. **C**alm their concerns: None of the individuals you interview are required by law to provide answers to your questions and as such, it's imperative to put them in a mindset where they are comfortable responding. The more interviewees are put at ease, the more likely they will give full and helpful responses. (Conversely, if they feel defensive, your likelihood of getting helpful information is almost nonexistent.)
3. **E**ntice a thorough response: Many interviewees will be reluctant to provide more than the basic answer to a question. A great question will evoke an emotion within the interviewee in a manner that makes them feel compelled to give you more than the basic answer. This can be a challenge because doing this successfully requires not violating the "calm their concerns" accomplished above

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Exhibit 1: Elements of a great question

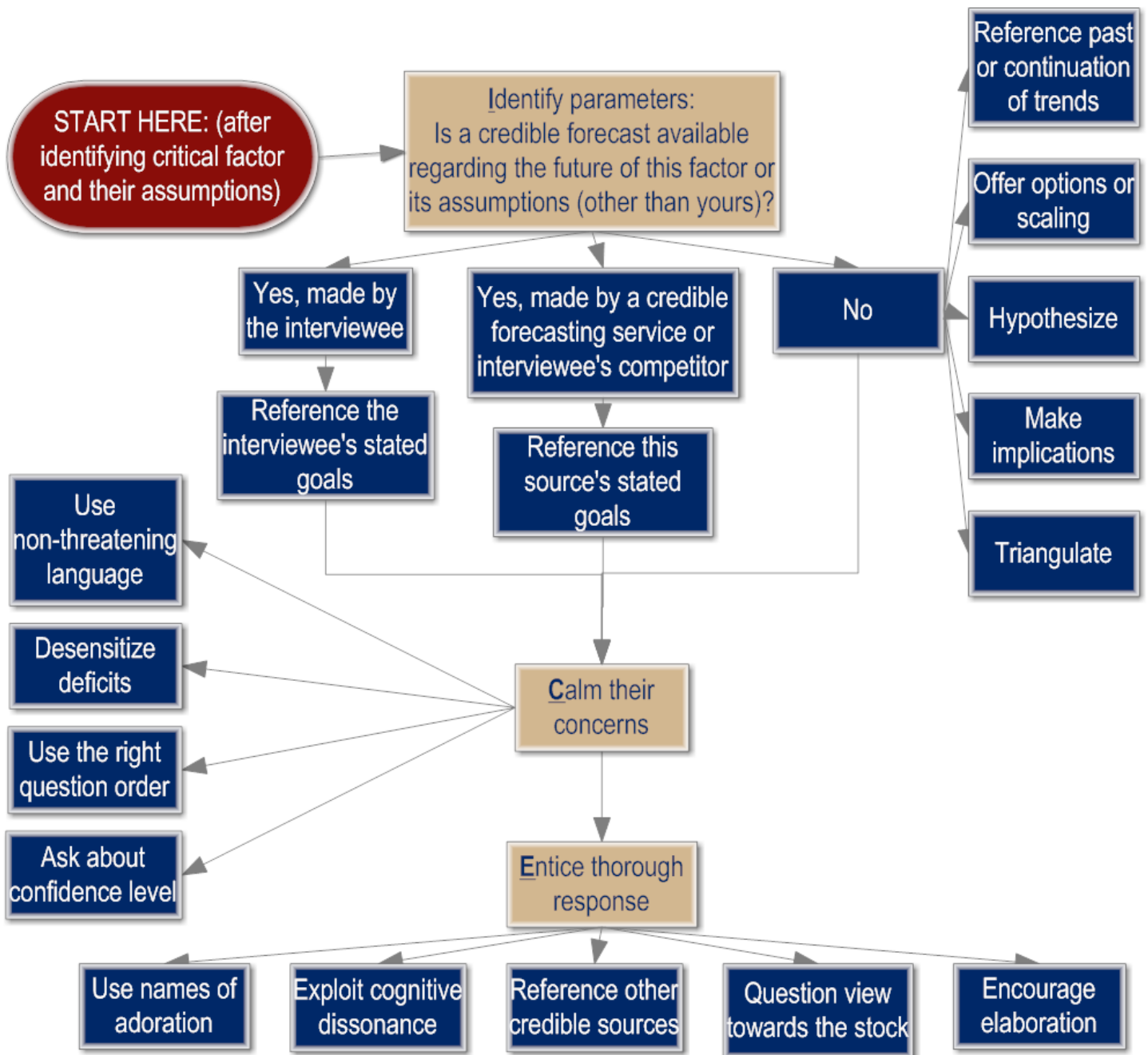


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Exhibit 2: ICE™ Framework for Obtaining Insights



We explore each of the elements of the ICE™ framework in more detail in the sections that follow

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Step 1: Research to Identify Parameters (“I” of ICE™ Questioning Framework)

Which question is more likely to evoke an answer that can be useful in analyzing a stock:

1. “So how are your labor costs going?”
2. “Was the 3% wage inflation in the quarter, which compares to only a 1% increase for the prior four quarters, because the company is beginning to lap its productivity initiatives from last year?”

Hopefully this illustrates that the more you know before the interview, the more you can narrow down the question (and thus the response) to get to the heart of the issue. The problem is that you don’t have endless hours to prepare for each interview, which is why it’s a best practice to focus only on the 1-4 *critical factors* for a stock (see Detailed Reference Card, “*Identify and Monitor a Stock’s Critical Factors*” to identify 1-4 critical factors for each stock being researched). For most elements of analyst’s role, we encourage staying intensely focused only on the 1-4 critical factors for a stock, but if time allows, it can be helpful to discuss the next 3-4 factors on an analyst’s list, as they may evolve into critical factors over time.

Other than building rapport with the interviewee, all of your questions should help to *clarify assumptions around a stock’s critical factors*. (This is also the first step of our ASPIRE™ framework for generating unique insights.) If you have not identified the 1-4 critical factors for the stock(s) to be discussed, **STOP** here and do that work. This is the core foundation of every great interview – knowing the topics to discuss that will help generate alpha...and, more importantly, knowing which ones are a waste of time. Most topics are just noise, which takes time away from those that need answers. The QRC “*Potential Questions to Investigate When Researching a Company*” may prove helpful as a starting point for assembling your questions.

Furthermore, do not spend any time asking questions that can be easily answered by:

- Reviewing public documents (e.g. “In what countries does the company operate?” or “How many employees work for the company?”), unless you’re attempting to see if the interviewee is in agreement with the publicly-available information, such as a publically-available forecast
- Conducting a basic review of past data (e.g. “Is your business cyclical?” or “How does your stock react when interest rates rise?”)

When preparing your questions, ensure the interviewee has expertise or knowledge to thoroughly answer questions about the critical factor you are researching. This may sound obvious, but it’s surprising how often this gets missed, such as when the analyst asks the CFO a detailed marketing question. Also note, when interviewees are not among senior managers of a company or from the financial markets, they often do not understand your ultimate goal, which is to *forecast earnings or cash flows*. For example, a car dealership owner isn’t likely to have a full understanding of the

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automobile manufacturer's quarterly earnings or even its quarterly production, but it's plausible you can get an understanding of quality or regional pricing.

If you know your stock's critical factors and the interviewee's capacity to help answer assumptions that pertain to them, move onto creating great questions. The more specific the question, the greater the likelihood you'll receive a specific answer. In Exhibit 3 we provide question types that reference specific parameters, which should result in more specific answers from the interviewee.

Exhibit 3: Question Types That Reference Specific Parameters to Evoke Specific Answers

Questions Referencing Specify Parameters	Examples
Reference Interviewee's Stated Goals: Ensures response is reconciled with interviewee's goals	What is being done to achieve management's long-term goal of 1% labor cost inflation, given that it was up almost 3% in the recent quarter?
Reference Credible Third-party Forecast: Keeps interviewee within the parameters of this credible forecast	Do you believe the Global Aircraft Association's long-term forecast for 6% intra-Asia passenger traffic is realistic?
Reference Continuation of Past Trends: Frames future forecast using past trends which helps to keep interviewee's response more realistic	Should I assume that the lack of labor productivity improvement in the most recent quarter will continue?
Offer Options or Scaling: Keeps interviewee's response within a predefined range	Over the next 18 months, is it more realistic that labor inflation will return to the highs of 6%-7%, as seen 4-5 years ago, or potentially be flat, similar to a target set by your largest competitor?
Hypothesize (and then pause): Challenges interviewees to respond with their own hypothesis	I forecast the major productivity improvements of the prior year will slow to less than 1%, given the weak numbers in the most recent quarter. (you'll want to pause to see how the interviewee responds)
Make Implications: Uses your insights to build a well-constructed implication that will likely elicit a quantifiable response	Your largest competitor has stated one of its competitors has been dropping pricing and we see in your most recent quarter, your average selling price was down. Can I assume you are the company they're referencing?
Triangulate: Uses information from other related areas to narrow possible outcomes	I've heard management state it generates \$60 per unit from product sold in China. If your company sells 50,000 units per day in Shanghai and we've been told Shanghai is over 50% of your China revenue, the math suggests you generate \$1.4 billion per year in China. Are there any elements of my assumptions that appear off?
Ask for Estimate Around a Non-Material Topic (that helps to build the mosaic): Keeps the question focused on a quantifiable response for something relatively small so the interviewee is comfortable answering	Can you provide an estimate of the number of unionized employees you have in California?

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Give the Interviewee Some Room...But Not Too Much

The goal for using the “options”, “scaling” and “hypothesize” question types above is they allow the respondent some room to answer the question in a manner that makes them feel comfortable, while not avoiding the question altogether. Notice in the second example below, the analyst is making the assertion that the employees will unionize and so if the interviewee responds, he or she is not stating the employees are going to unionize:

- Avoid being this direct: “Are your California employees likely to unionize?”
- Instead, hypothesize: “I suspect your costs will increase if the unions are successful in unionizing your California operations”

Technically, the second bullet above isn’t a question, but the interviewee will likely respond with their input.

Interviewees are often more likely to answer your question if you provide “response scaling” such as: “Do you expect to add 30 or 35 planes to the fleet?” (Notice the presumptuous question type) rather than “How many planes do you expect to add?” If it turns out your 30-35 range is way off, management will usually try to correct. **Great managers thrive on being great “problem solvers” and so, by their very nature, they can’t allow a problem (your incorrect range) to go by without being solved.** In another example, “How many days this quarter did you not meet your revenue target?” will not likely get an answer whereas, “Did you miss your target on at least 20 days this quarter?” gets under management’s skin because it doesn’t want to be portrayed in the wrong light, which means it will be motivated to provide the right answer.

You may even throw out an absurd hypothesis so that management will put parameters around the real answer. If you suspect margins in Germany are slightly better than those in France, you could say, “I suspect your margins in Germany are twice as high as in France.” But don’t do this too often or the interviewee will see through it and stop providing insight.

Rather than seek a specific number, ask for an estimate or range of estimates:

- Avoid being this direct: “What is your R&D spending going to be next year?”
- Instead, ask for a range: “Can you give us some thoughts about the higher and lower ends of R&D spending likely for next year?”

Ask what could go wrong:

- Avoid being this direct: “Will you achieve your cost-cutting target this quarter?”
- Instead, ask what would cause a target from being achieved: “What would prevent your company from achieving its cost-cutting target this quarter?”

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Step 2: Calm Their Concerns (“C” of ICE™ Questioning Framework)

In situations when the interviewee has no restrictions on what can be said (such as senior management of a non-public company or industry consultant), this step has less importance, but when the interviewee is concerned about sharing too much, these tactics can help extract answers that will develop unique insights critical for stock picking.

Use Non-Threatening Language and Terms

- Phrase questions positively; if you're too forceful or negative, it will exert control over the interviewee, who will likely attempt to gain back control by being restrictive with the response
 - Avoid this: “Why has management allowed margins to drop to such disappointing levels?”
 - Instead be more positive: “Can you help me understand why margins are 300-500 basis points lower than your competitors?”
- Use "and" rather than "but" to be less confrontational
 - Avoid: “As I understand it, the company saw the new expansion wasn't going well, but continued to do more marketing.”
 - Instead be less confrontational: “As I understand it, the company saw the new expansion wasn't going well and continued to do more marketing.”
- De-personalize sensitive questions, by avoiding the use of "you" and instead using "company" or “management.” Use “us” and “we” (instead of “I” or “me”) to show it's not just you that have a concern:
 - Avoid: “I would like to know why you had such poor holiday traffic.”
 - Instead be less confrontational: “Why did NewCo (the interviewee's company) have holiday traffic well below its competitors?”
- Avoid using words and phrases that will put the interviewee on the defensive. Examples of bad vs. good words include:

Bad	Better
<ul style="list-style-type: none">• Missed the quarter	<ul style="list-style-type: none">• Fell short of expectations
<ul style="list-style-type: none">• Huge mistake	<ul style="list-style-type: none">• Poor strategic decision
<ul style="list-style-type: none">• Crash	<ul style="list-style-type: none">• Collide/accident
<ul style="list-style-type: none">• Tell me...• Give me...• What is...• How much did you...	<ul style="list-style-type: none">• Can you help us understand...• How much would you estimate...

- Use terminology and vocabulary level that puts the interviewee at ease. If you're speaking to the manager of a coal mine, use mining terms that will be understood and avoid financial terms like “ROIC”, “EBITDA” or “DCF” which could cause anxiety
- For sensitive topics, refer to the past rather than ask for a forecast:
 - Avoid asking for a forecast: "Do you expect pricing to continue to drop?"
 - Instead reference the past: "Has pricing continued to decline?"

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- Use passive voice (vs. active) to avoid putting the interviewee on the defensive. With the active voice the interviewee (person, manager, company, etc.) performed the action, whereas passive implies the action was performed on the interviewee. Here are examples:

Active (not recommended)	Passive (recommended)
"Did management invest too much into the new model handset?"	"Was too much invested into the new model handset?"
"Will your company likely achieve its growth target?"	"Will management's growth target likely be achieved?"

Desensitize Deficits

When probing management about its company's deficit areas:

- Blame criticism as coming from others..."I noticed Golden Bull Securities recently downgraded your stock over concerns your growth rate is slowing. Is their thesis warranted?"
- Focus the criticism on the numbers or performance, not the people:
 - Poor practice: "Why did you so badly disappoint this past quarter?"
 - Best practice: "Why were EPS 10% below consensus this past quarter?"
- When applicable, start the question with a lead-in to show the company is not an outlier. "Many companies didn't think they would be significantly hurt by the recession and yet every stock in the sector is down at least 20%. What are some things that could have been done at your company to soften the impact of this downturn?"

Use the Right Question Type and Order

- Start with easy questions first and then move on to more difficult ones; it will help the interviewee build confidence and feel less defensive, which is critical for getting insightful answers to some of the more sensitive topics
- Be careful not to use too many closed questions because they take control from interviewees (for example, "Which is your most profitable product line?")
- Avoid these question types because they will not likely yield an answer that helps in stock picking:
 - **Rhetorical**: making an assertion or eliciting a response from the interviewee that the interviewee is unlikely to answer directly, such as "Why does the company seem to get beaten up so much by the sell-side?" (What value does the analyst gain in the response?...probably nothing and it ultimately wastes time that could have been focused on a much better question.)
 - **Complex or nested**: when multiple topics are covered in one question. For example: "When and where will the next generation of the software be introduced, and why has it not occurred in the original forecast timeframe?" The interviewee may choose to only answer the easiest part of the question, hoping the other elements are forgotten.
 - **Insulting**: delivered and received in a manner that is likely to be interpreted negatively by the interviewee. For example: "With all due respect, can you explain why your operating margins have been horrendous forever?" Instead, ask in a manner that will elicit a good response such as, "Can you help us understand why your margins are among the lowest in the industry?"

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Ask About Confidence Level vs. Specifics

Although the goal is to get as specific answers as possible, sometimes you'll want to fish for a less specific answer such as when covering very sensitive topics (where specific answers won't be provided) or at the beginning of the interview when you're trying to put the interviewee at ease. This can be done by asking the interviewee's confidence level rather than a specific number:

- Avoid being this direct: "Will you achieve your cost-cutting target this quarter?"
- Instead ask for a confidence level: "How confident are you that the company can achieve its cost-cutting target this quarter?"

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Step 3: Entice Thorough Response (“E” of ICE™ Questioning Framework)

Great interviewers utilize influencing skills in a manner that evokes the interviewee to want to fully answer the question in a non-threatening manner. Many of the tactics below can be used when assembling the questions before the interview, although some are used based on responsiveness of the interviewee during the interview.

Use Names and Adoration

- Starting the question with the interviewee’s name (said in a friendly tone), can help promote the ego and thus compel him or her to feel obligated to provide a response. For example: “Jerry, why has NewCo’s return on investment declined over the past two years?” Be careful not to overuse this tactic because it, if used repeatedly, can begin to appear disingenuous.
- Play up interviewee’s level of experience or role within their firms to make them feel like not responding would expose their lack of knowledge: “Based on your 20 years of experience, would it be better for revenue to grow at double digits or to see the firm's return on capital exceed 10%?”
- If the interviewee works for the company being discussed, attempt to work the company name into the more important questions because it suggests the company is a leader in the field, and so the implication is that management must have thoughts on the topic. For example, if meeting with Delta Airlines management: “How many new aircraft do you expect Delta to purchase next year?”

Exploit Cognitive Dissonance

“Cognitive dissonance” is the discomfort for holding two contradictory beliefs, a condition that can be used to your advantage. First ask the interviewee about a belief the interviewee holds and then follow with a question about a specific related concern. Cognitive dissonance compels interviewees to show how their actions are consistent with their beliefs.

- For example, start with, "Does management have a hurdle rate for investments?"
- Presumably, after the interviewee responds “yes”, follow it with this question: "Does management review completed projects to determine if they exceeded or fell short of the hurdle rate?"
- Presumably, after you receive another “yes” answer, follow it with this question:
 - "Why did the major oil sands project not generate the expected returns?"; or
 - "Which major projects have fallen short of the hurdle rate over the past two years?"
- Management will feel compelled to explain that its actions are consistent with its philosophy, which often leads to a more detailed answer than simply asking the last question in this example

Reference Other Credible Sources of Information

The interviewee often wants to be considered the smartest person in the world on the topic (which hopefully will be the case if you have great information contacts). With this in mind, bringing up the following can often lead the interviewee to provide a more detailed answer than if these other sources were not mentioned:

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- **Competitor's performance:** "Why does XYZ (competitor to company being interviewed) spend less capital as a percentage of sales than ABC (the interviewee's company)?"
- **Competitor's disclosure:** State that a competitor of the company has shared a specific piece of information with the hopes that this management will divulge the same piece of information (or at least provide information about where they stand relative to the competition). "When I spoke with XYZ (competitor to company being interviewed) last week, I was told their production was running at 100% of capacity. Are you experiencing the same?"
- **Respected Expert:** Reference a respected expert's view to tease out management's forecast. For example, "Can you help explain why ABC (the interviewee's company) is more optimistic than McKinsey Consulting's report forecasting demand for this product to be relatively small for at least the next two years?"
- **Consensus:** Referencing consensus can be a powerful tool to extract insights. For example, "Consensus appears overly optimistic to assume ABC (the interviewee's company) can grow EPS faster next year than this year."
- **Your forecast:** If the above tactics are not applicable, reference your forecast. For example, "If I assume only modest growth in each of your divisions and average cost inflation, I arrive at EPS growth of 15% for each of the next three years, which is more conservative than management's guidance. Can you please help me better understand what I'm missing in my forecast?"

Question View Towards the Stock

- Mention your internal portfolio manager or external clients have a concern that needs to be addressed: "Many of the PMs/clients I speak with have trouble understanding how the company will achieve a double-digit growth rate."
- Suggest you cannot get more positive without a better answer: "I'm not sure I can get more constructive towards your stock unless I can get more comfortable with management succession plans."

Encourage Elaboration

- Encourage the interviewee with terms such as "I see," "Interesting..." or nodding (do not overuse the nodding or it will become disingenuous)
- Specifically encourage the interviewee to elaborate with phrases such as:
 - "Can you elaborate?"
 - "Please tell me more."
- Use silence. When interviewees haven't fully answered your question, pause for 5 seconds. Often they will feel the need to fill the awkward silence by elaborating further
- Restating the interviewee's answer will often result in receiving more detail (referred to as "echoing"). For example: "So the entire shortfall in the quarter was due to weather?"
- Taking it a step further, restating the interviewee's answer in terms of how it will play out in the future, often will result in a more thorough response. For example: "Just so I'm clear, the entire

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quarterly shortfall was due to weather and so next year, assuming normal weather, you should have an easy comparison?"

- Imply that the critical factor must not be important to the interviewee. If the interviewee stonewalls, ask a question that implies the critical factor being discussed isn't important to management. For example, "So there isn't a strategy to defend market share losses in Asia?" or, "So it sounds like there's not much effort being put into this new product line?" This is one of the few exceptions where a negatively-worded question is appropriate.