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LOL: Help! We are not ready for the New Era. Data from London and Tokyo

FCG has started its "Mugs and T-shirt" world tour to present our new white paper, "The Investment Challenge." (Click white paper to read) We are very curious about how investment professionals (via local CFA societies) will respond to our message. First, do they agree that there is a severe challenge for "legacy firms" in the industry? So, we asked each room of attendees (about 30 in each city) to respond to the Casey Quirk quote: **"Legacy managers that refuse to change will, over time, see their business erode." The results were clear. 90% of respondents agreed.**[1] So, each room of investment professionals largely agreed that our industry faces significant challenges. Our white paper describes what we believe are solutions and includes a checklist to evaluate your firm. We used the voting results from the checklist as real-time data to evaluate the readiness of firms for the New Era. The topics below are presented from "Most ready" to "Least ready" based on the polling.

Firms feel most ready in the area of investment strategy. In response to the vote on:

Our investment team has a clearly defined edge and can execute on it. 64% of the audience agreed that their firms have such an edge.

You would hope so. Right? Nearly all the firms represented in both rooms were active managers, so they SHOULD have a clearly defined edge, or else—what?—they are just hoping to outperform?! FCG is suspicious of the 64% because we work with teams weekly on this issue of investment philosophy/process and most do NOT have a clearly defined edge. (Most common answer: "we will outperform because we are smart and work hard." Our response: show us the dumb, lazy teams!) Additionally, our research shows us that a big blindspot for investment leaders is their overconfidence around strategic thinking and planning. Hence, the voting seems to fall exactly into that pattern: overconfident about their firm's investment strategy, i.e. their edge in the markets. So, ask yourself and your investment team, what IS our unique ability such that we can win? And don't kid yourselves. Baron funds wrote a piece recently that highlighted their "secret" competitive advantage: 61% women in leadership roles. (Having just returned from engagements in which the teams were nearly ALL male, I think this "balanced" team of male and female may indeed be an advantage. It is clearly rare in the industry.) For more on this topic of creating a REAL advantage in your investment approach, see Michael Falk's paper called, "Investment Beliefs: Separating the Real Stuff from the Fluff." Real Stuff paper (Note: Michael will speak on this topic at the CFA Annual in Frankfurt.)

We have an Executive Committee of six or less qualified members that leads our firm well. 43% agreed.

[1] FCG used a Likert scale from strongly agree to strongly disagree for the voting. Results from each city were roughly the same. For simplicity, we lumped "strongly agee" and "agree" together to equal "agree" and all other responses—neutral, disagree, strongly disagree—to mean "disagree".

Interesting that less than half of the audience thought they were "well led." And yet the number one "gap" value that we see in firms today is "Leadership development/mentoring." Our culture surveys tell us that the staff sees little leadership development currently and wants much more of it. Further, our experience with investment firms indicates that the quickest way to build strong culture is to have a strong Executive Committee (Exco) that understands and practices the values of the firm. Far too many investment firms have Exco's made up of very qualified technicians (investments, IT, finance, compliance, etc.) who are NOT qualified leaders. Closing this gap is a major challenge in the New Era.

Our culture is clearly defined. We can all communicate our stated values, and they are used to hire, coach and fire team members. 42% agree.

Understandably, the culture measurement is in line with the Exco result. Strong Exco = strong culture. No surprise then that the numbers are similar. Our working hypothesis would be that the same people who said, "we have a strong exco" also said, "we have a clearly defined culture." Culture is important because it correlates highly with these two critical factors: 1) attracting/retaining top talent, 2) improved decision making. New Era leaders will need to have skills around culture because the challenge is getting harder. More younger people in the work force—a hedge fund we worked with recently has 50% Gen Yers—and more gender and racial diversity will require more savvy. (Current HBR magazine quotes Asian workers as saying that 90% of them feel misunderstood by Western bosses.) For more on building a strong culture see our white paper, "Linking Strong Culture to Success." Strong Culture

Our firm has a plan in place for assessing, coaching and developing talent in the New Era. 30% agreed.

Now the weaknesses become more dramatic. Only 3 out of 10 respondents believe that their firm is properly developing talent. With the strongest request being: provide career paths for us. The younger workers have planted a flag in the ground on this topic: show us the steps in our career, or be ready to lose us! FCG's Keith Robinson is busily addressing this issue with clients. For example, borrowing from the martial arts, he has developed a "belts" approach to being a research analyst. White belt is for rookies, then yellow belt, blue belt, etc. This approach allows staff members to experience progress in their careers even though their basic job function remains unchanged. Theresa Amabille at Harvard has written on the power of "progress" in motivating people, and it works! We all want to feel we are improving, so give us some "medals" as we advance. If you are still skeptical about the benefits of developing talent, read the piece by Citi Finance called "People Alpha" which shows that hedge funds who invest in developing their people outperform the ones that don't! People Alpha

Our marketing and sales mindset has shifted from "friendly and responsive" to "challenging and teaching." 30% agreed.

Also at 30% was the vote on shifting the sales approach. Research since 2008 indicates that the traditional methods of selling—becoming the "trusted advisor/great listener"—will not be sufficient in the New Era. FCG has met with many firms who are moving to the Challenger Sale, which means that sales people understand the prospect/client's needs and have a hypothesis ready to address them. The goal of this sale is not to befriend the prospect/client (e.g. relieve their tension) but actually to challenge them around their investment approach in the New Era. Given that many clients are moving to passive solutions, it behooves firms to sharpen their selling edge. How do you distinguish yourself in this new, tougher environment, which Casey Quirk calls, “Life After Benchmarks.” I wrote more on this topic in my last LOL journal: Challenger Sale

Our senior team members know their strengths, weaknesses and blindspots via feedback from peers. 28% agree.

Because they are bright, many investment leaders do understand their strengths and weaknesses pretty well. So, the operative word in this question is “blindspots.” If someone asks you, “Do you know what your blindspots are?” don’t fall for this trick question by answering yes! The only way any of us knows our blindspots is via feedback. Which is why FCG recommends feedback-rich environments. Our 360 reviews of leaders indicate that MANY investment leaders have significant blindspots that are hurting their performance. The whole field of behavioral finance dives into this aspect of decision making. For example, nearly every leader we meet has a blindspot around “confirmation bias.” They form a hypothesis—Frank is a weak team player—then they look for data to make their case. Not very objective! We should all remember the wonderful example from Darwin in which he kept a journal dis-proving his hypotheses! Darwin’s approach gives us a chance to be even-minded about our views. So, ask yourself: who keeps me honest? Who gives me straight feedback? Believe me, the higher you rise in a firm, the less likely you are to get straight feedback. Good CEOs keep a constant vigil of seeking honest feedback and appreciating all those who are willing to give it. Is the absence of reliable feedback a blindspot for you? ☺

We have a merit-based succession process for key positions. Only 23% agreed.

Investments is a talent business, right? So, shouldn’t promoting the right leaders be crucial for investment firms? If the wrong people are promoted then the talent won’t be optimized. FCG sees this continually. The Peter Principle is alive and well in the asset management business. A great PM gets promoted to CIO. And the talent races for the exits. FCG occasionally finds a CIO who admits, “I’m not the best investor in this organization, but I know how to lead quirky investment types.” (For more on the specifics of leading quirky people, see my LOL journal: Leading Clever People) FCG is so committed to talent and leadership that we completely revised the way that succession is done. Keith has a wonderful process that is participatory, merit-based, and transparent. If your firm is looking to promote a new CIO, then you start the process well in advance: 3-5 years. FCG’s process works like this. Key opinion leaders at the firm discuss the role and collectively define the competencies and skills that are necessary for success. The candidates for the role are peer-reviewed based on these skillsets. In every case so far, the proper person emerges from the process as the logical successor. And all the other team members see the fairness of it because they were PART of the process. FCG’s goal for succession: the right person gets the job, and none of the other talent leaves when it is decided.

We have shifted our mindset from "comp" to "rewards." Our rewards system is fair, transparent and simple. Only 20% agreed.

And bringing up the rear is comp! What a shocker. FCG would agree with the voting results: comp is done poorly in our industry. In the first place, we train people to focus on comp and then complain when they do! A research study was done with children and reading habits. The researchers paid some children to read and encouraged a control group to read without monetary rewards. The study showed that both groups read during the trial period at about the same clip. But when the study ended, the paid readers stopped reading. They had been taught: reading is a paid activity. If no one pays you, don't read! The control group continued to read because they associated pleasure with reading good books. The investment industry has trained their employees to be extrinsically motivated (by money) rather than intrinsically motivated (by having passion for their work). Smart firms hire people who love the investment work—many would do it for free—and then use a blend of rewards (i.e. flexible working hours, career development plans, mentoring/learning, etc.) to motivate and retain top people. Importantly, FCG recognizes that fairness is hugely important to comp. Investment professionals value meritocracy and want to be paid fairly. And the way to make sure this happens is to include them in the process. All of FCG's comp work is participatory: the people being rewarded are part of the design. The logic here is so simple: if you let the staff help design the reward system, then they can't complain about it afterwards! When we explain our process to CEOs, we sometimes hear, "hey wait a minute, you're letting the inmates run the prison!" And our response: if that's how you view your talented staff, then you have a more fundamental problem than comp! If you've hired the right people—mature and trustworthy—then there should be no problem in including them in the design of their comp. For more on FCG's approach, see Keith's paper on comp: Comp: Getting it right

So, there you have it. Initial data on the state of firms in the New Era. And it's not pretty. Investment firms will need to re-tool not only some of their products and solutions, but also the way they lead, develop talent and promote, build strategy and culture, and reward their people. In this regard, FCG has initiated an HR offsite for the purpose of discussing these issues more fully with the talent experts in each firm. On May 7-8, FCG will meet with HR leaders in Chicago so be sure to inform your talent officer.

Curiously yours,

JW