October 7, 2015

LOL Journal - Highlights from FCG's Leadership Conference

FCG just hosted its 8th annual leadership forum. We define the purpose of the conference as three-fold:

1. Connect
2. Learn
3. Lead

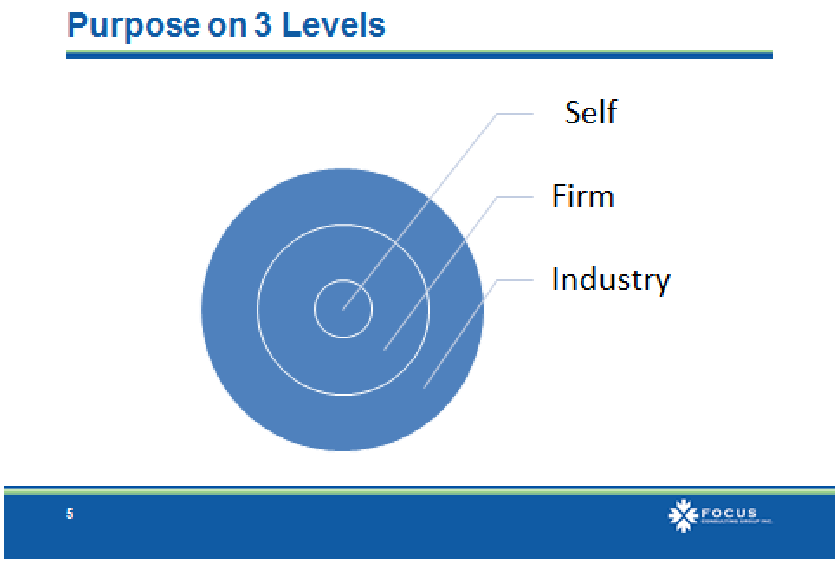
I referenced Dr. Ed Hallowell's book **Connect** as a study about the importance of connection—to family, friends, colleagues, and firm mission—and how it contributes to health and longevity. Even more recently, Michael Lee Stallard (former Charles Schwab employee) has written a book, **Connection Culture,** which addresses the importance of connection at work. Stallard identifies six needs, which line up exactly with FCG's culture recommendations:

1. **Respect**: choosing to treat all employees with respect
2. **Appreciation**: recognition for work
3. **Belonging**: the need to be included and to be heard
4. **Autonomy**: freedom to work as one chooses, not micromanaging
5. **Mastery:** the desire to use one's talents ("genius abilities") and to continually improve and learn
6. **Purpose:** connecting work to a larger purpose

The "learning" piece of our agenda was achieved through TED Talks (i.e. short, meaty presentations) given by the FCG team and our strategic partners. Topics included: State of the Industry, Comp, Compliance, Talent and Succession, Investment Philosophy and Process, and Purpose.

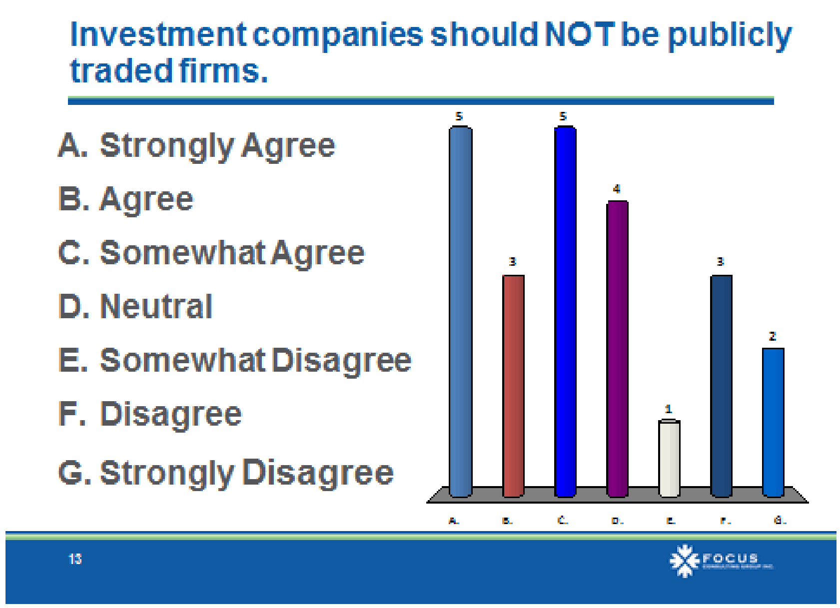
Leading, the final aspect of the conference purpose, is the natural outcome of all our work: helping investment leaders improve their leadership effectiveness.

We started the discussion with our twenty guests by teeing up a dialogue about purpose: the white-hot why. We had sent around my earlier blog with this title as pre-reading. We also sent a draft of FCG's thinking on "A Vision Statement for the Investment Industry" (included at the end of this LOL). And we asked each guest to bring a photo/image of their own personal mission. Almost immediately the conversation got animated. I commented that I was not the appropriate host for this exchange: we needed Jerry Springer! We used the following diagram to help frame the conversation:



The dialogue about the industry's purpose was spirited and many faceted. The takeaways for me were twofold:

1. People in our industry are thirsty for meaning in their work. They believe the investment industry does serve a noble purpose. But the ongoing debate (Ellis, Bogle, et al) about the industry as profession vs. a business is alive and well. We put this voting slide in front of our audiences and had a rip-roaring debate ourselves!



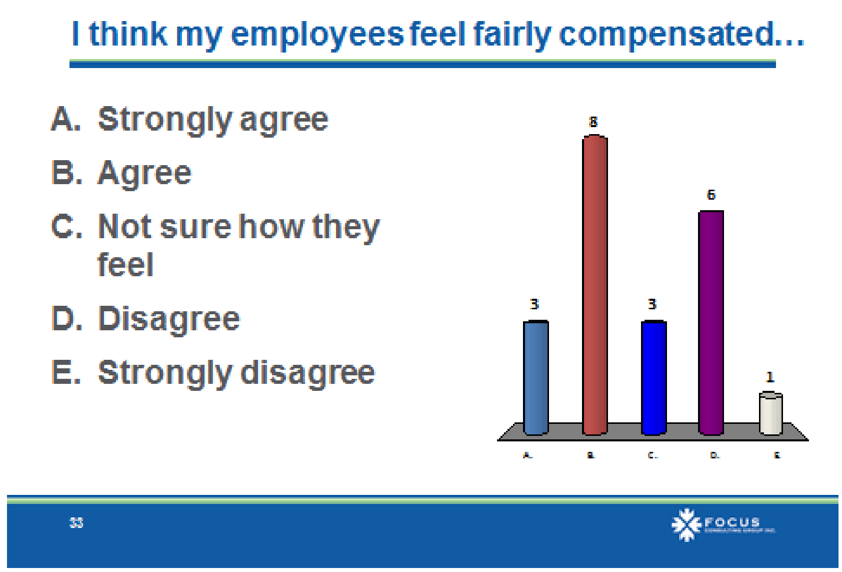
Clearly, we did not reach consensus. Although, the question was reframed nicely as "what should the optimal structure be?" And most agreed that investment firms should be their own masters. They should be free to determine their own destiny.

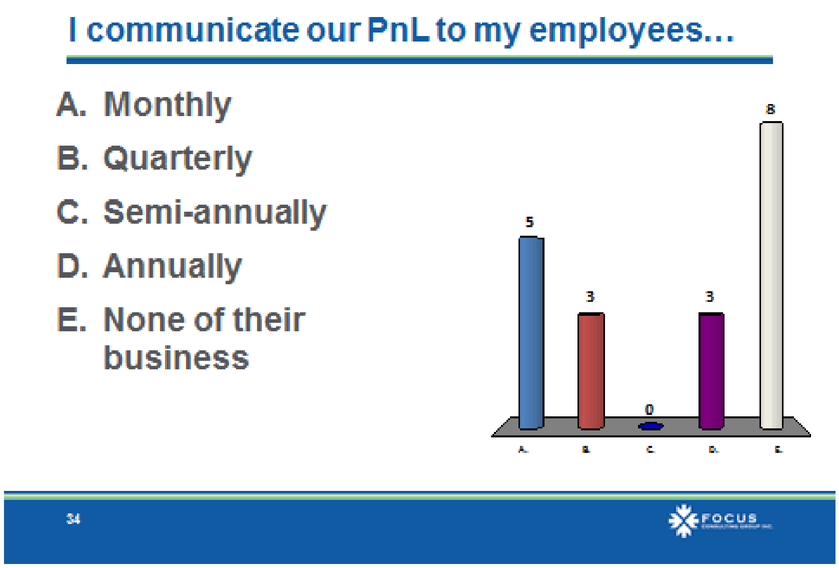
2. The second takeaway, related to the first, is that the strongest rallying cry for investment professionals is found in words like "honorable" and "noble." They want to be part of a profession that is seen in this way. Again, read the Vision statement at the end and please provide us with feedback. We are working away at creating a Vision statement that centers on that notion: an honorable profession.

Keith Robinson, FCG's Managing Partner, presented Ted Talks on two important topics: comp and succession. Both stimulated good discussion. (The format at our conference is small tables in which our guests can engage in dialogue after a topic is presented.) FCG's view of compensation is radically different from traditional approaches. FCG practices three guiding principles:

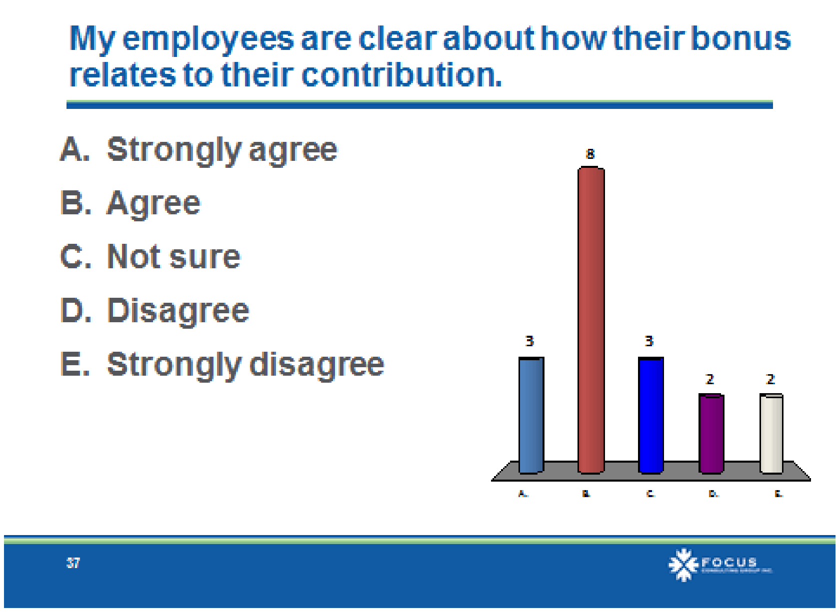
1. **<u>Fair</u>**: in the eyes of the employees
2. **<u>Transparent</u>**: so that there are no secrets
3. **<u>Simple</u>**: so that all can understand why they are paid a certain amount

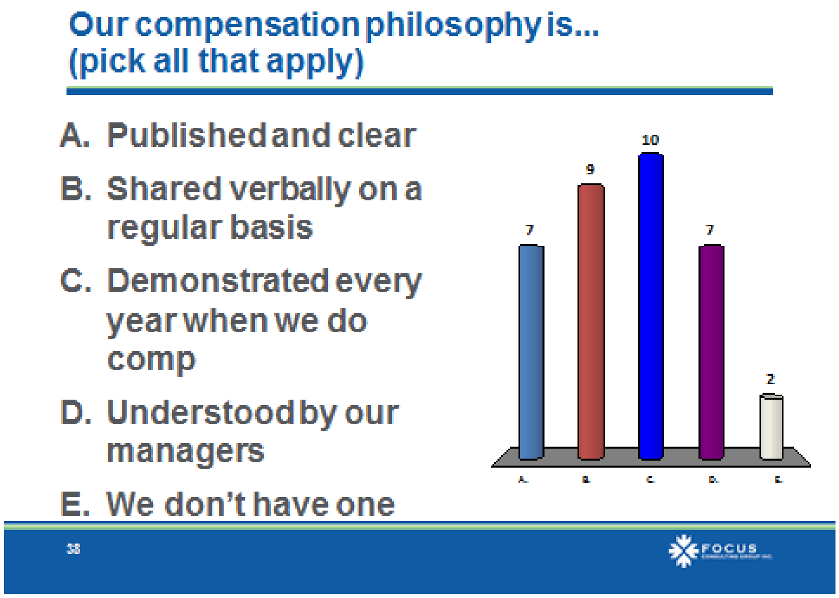
In presenting this topic, Keith teed up a number of very interesting voting slides, which we provide below:





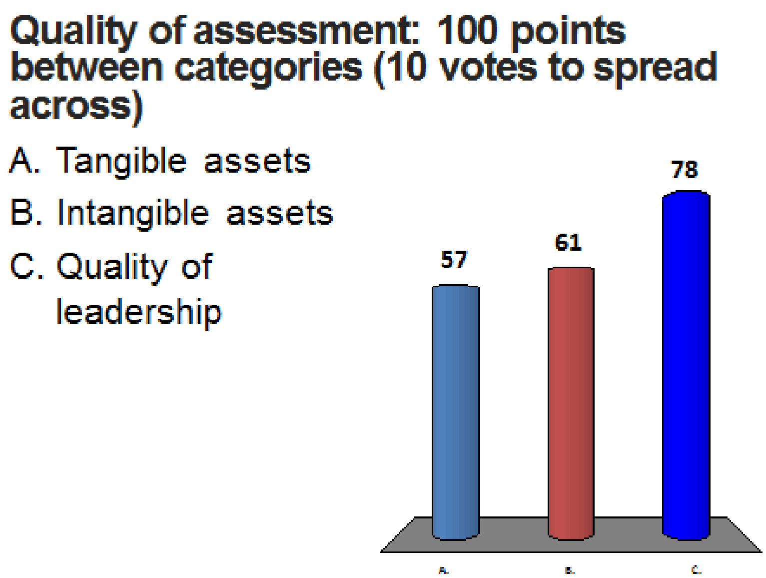
PnL = profit and loss statement





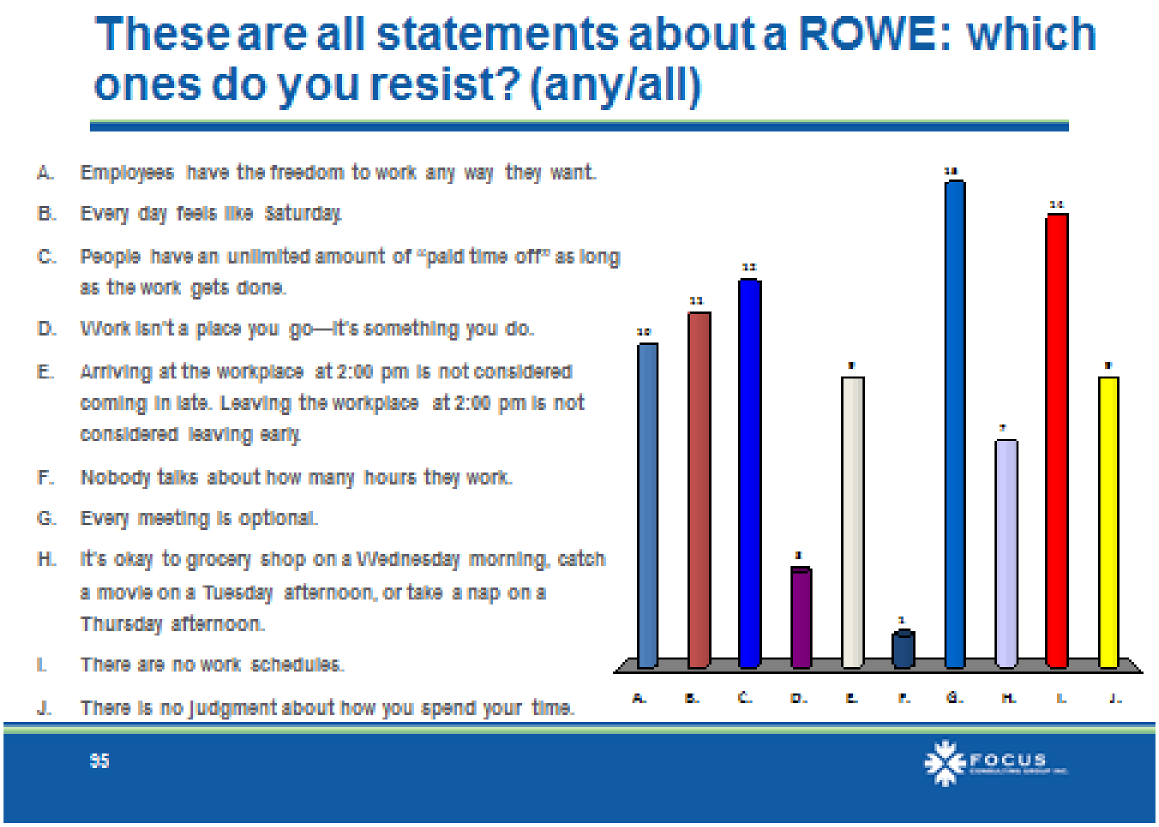
The takeaway from the lively discussion of compensation is that FCG has developed a radically different approach. As one guest said, "It's really good, but the firm that uses it has to have very mature staff members." Possibly. But FCG has used this radical approach with many firms and it has NEVER failed. For more on this approach, read Keith's white paper:
http://www.focuscgroup.com/files/6113/8757/9547/Compensation_-_Getting_it_Right.pdf

Justin Allen presented on behalf of Dave Ulrich, author of **The Leadership Capital Index.** The big idea behind the book is that evaluating leadership of companies is hugely important to valuing publicly and privately held firms. In fact, our guests placed these weights on three key factors which are considered important criteria for evaluating the worth of a firm:



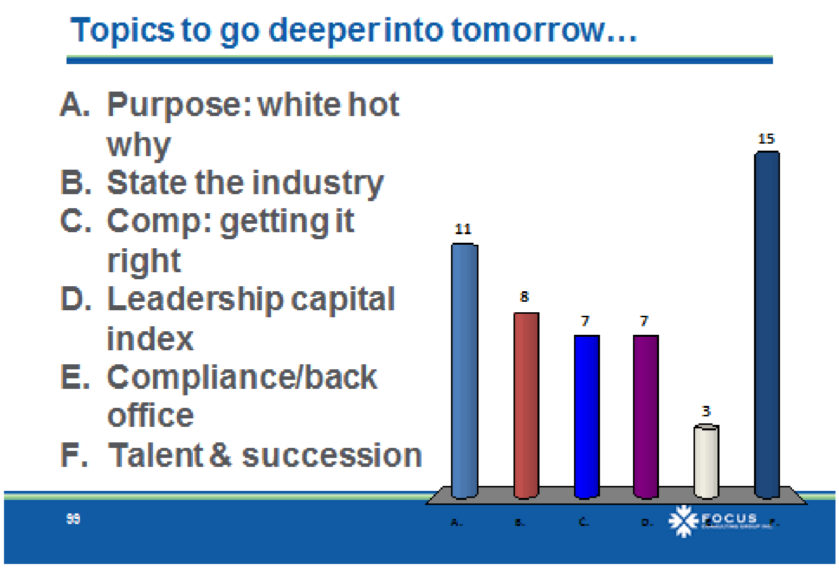
Our guests said that quality of leadership is MORE important than either tangible assets (cash flows, assets, etc.) or intangible assets (brand name, patents, etc.) FCG highly recommends this book for anyone who is actively managing portfolios. Dave Ulrich presented a Webcast for FCG recently. A recording, titled *Realizing the Market Value of Leadership*, is available on our website at www.focusCgroup.com under the "videos" tab.

Another culture topic of great interest these days is autonomy. How much freedom do you give your employees? The radical approach is called R.O.W.E. (Results-only work environment). We work with the two ladies who wrote the books on this approach and founded a firm called Culture Rx. (Jody Thompson, Cali Ressler) We discussed their approach with our guests and asked them to vote on these statements from Jody/Cali's book on ROWE:



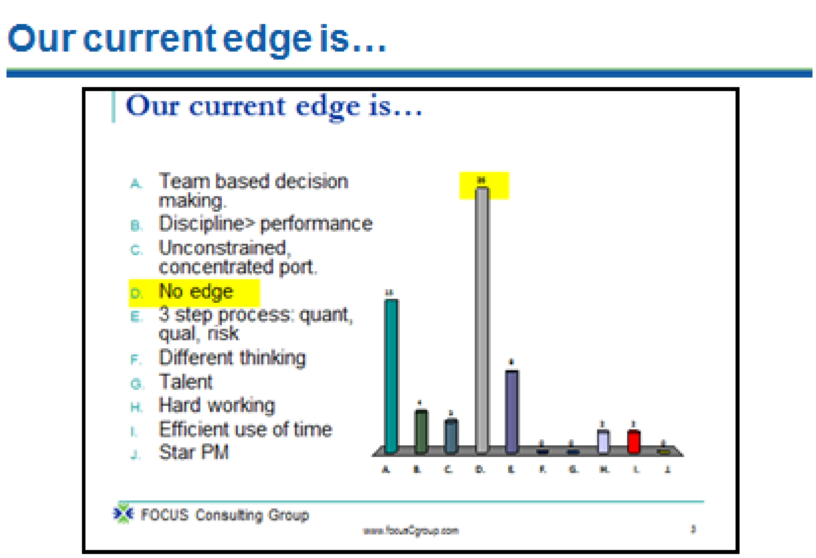
The biggest resistance from our group involved the policy that every meeting is optional. The logic behind this policy is that a ROWE is based on results. So, as long as people deliver results it does NOT matter if they go to any or all of the scheduled meetings. FCG has adopted this policy. So far it has not caused any problems! And our team members appreciate the respect that goes with it: YOU decide if this meeting is valuable and if you need to attend. FCG recommends ROWE to our clients. We know it works because we practice it! But, again, it requires a mature and trustworthy staff. Which luckily we have. ☺

At the end of the first day, we polled our guests about which topics they wanted more on for the second day. Overwhelmingly, they wanted more of Keith on succession and talent:



In response to this vote, Keith pulled together a case study from a recent talent and succession assignment and presented it on the second day. Keith's case study combined with Michael Falk's presentation that he did at the CFA Annual in Frankfurt provided a strong finish to the conference.

The real shocker from Michael's presentation was this slide, in which an actual active manager confessed to NOT having an edge in their approach to equity investing!



This slide caused one of our guests to exclaim, “What, are you kidding?!” No, sadly, there are many active managers who cannot articulate a bona fide edge in their philosophy. Michael works with these firms to help them articulate and build process around a real edge.

Also, on the second day our guests shared with us images of what a personal mission/purpose looked like to them. A couple of the images are presented below:

We want our clients to experience “goosebumps.”

Clear and transparent leadership is our goal.

Many of our repeat guests said this was the best conference yet. That is gratifying to know that we are following our own prescription for continuous improvement! I think we succeeded in our goal of connect, learn and lead. And we are energized by the positive spirit of our guests who traveled long distances to share their leadership journey with us.

And now this installment of LOL is finished…but if you wish to read the draft of our Vision for the Industry, we've included it below.

Curiously, Jim Ware

A Vision for Investment Leadership: Wealth Care Providers

By Jim Ware, CFA; Michael Falk, CFA, CRC[1]; and Keith Robinson, Focus Consulting Group (FCG)[2]

Where there is no vision, the people perish. Proverbs 29:18

The purpose of this essay is to expand the thinking of investment leaders. What is possible for the industry, if we step back from the frenzy of markets and think bigger and broader? Jim Collins gives us this advice, when thinking about mission and vision:

> It has to be something that could be as valid 100 years from now as it is today. It should help you think expansively about what you *could* do but aren't doing.[3]

Unfortunately, in over 15 years of work with investment leaders, FCG has heard only a handful of "expansive," compelling visions. One very successful investment CEO stated his vision as, "to have fun and make money…in THAT order!" Indeed, he has succeeded. He is very rich and he seems to be having fun. But this vision falls way short of what FCG would call a compelling and expansive view of what is possible. The shortage of compelling visions may result from the competitiveness of the investment industry. Indeed, it is a competitive industry which attracts very competitive people. And when people are in a competitive mindset, they tend to be very focused, very practical, and very much "what's next?" This mindset does not lend itself to coming up with expansive thinking about "what is possible?"

So, let us say at the outset, the vision we are putting forth is a 100 year vision. It won't happen next week or next month or next quarter, Wall Street friends! It won't necessarily answer the question: what do I do differently on Monday? Although it might, if you include "mindset" as something you can do differently. The mindset shift is from a "me" or even "my firm" mindset to an "all of us" mindset. It requires investment leaders to think about the collective. And by collective we mean, all the people who are seeking financial well-being. (Which we imagine is all people! ☺) In the same sense that all people seek physical well-being—good health—we can assume that all people seek financial well-being—good wealth. (And don't ignore the connection between the two: poor wealth often creates poor health.)

Health and Wealth

Let's play with this analogy: health and wealth. The U.S. and many developed countries have good health care systems.[4] If people take reasonable care of themselves and see their doctors regularly, they

[1] Certified Retirement Counselor
[2] FCG is a consulting firm, operating solely in the investment world with a mission of: helping investment leaders to leverage their talent.
[3] Jim Collins, **Built to Last**
[4] The care is very high quality but it is very costly and possibly not sustainable.

can hope to remain healthy and live a long life.[5] We all know that doctors make a good living in exchange for the collective good of providing health care. The medical community gets rewarded for the services they deliver, which serves the collective group of citizens.[6]

Let's look at the wealth part of "health and wealth." People aspire to have financial well-being so that they can pay for the necessities of life and possibly some luxuries as well. Additionally, people would like to have sufficient wealth to allow for retirement, if they wish. In the same sense that physical health creates peace of mind, so does financial wealth. Most of us would agree, we imagine, that peace of mind is a fine end goal. Health care professionals and wealth care professionals would be in the business of providing peace of mind for their clients. That is the bigger picture and it is a good one. Quite possibly a "noble" one. We imagine that CEO's in the investment industry would take pride in telling their children that they provide financial peace of mind for people.

Continuing with our analogy, wealth care providers also enjoy very good financial returns from their chosen profession. But--and this is a big "but"--how are the clients doing? What is the collective value delivered to clients? Can we argue that wealth care providers—like their brethren in the health care profession—are succeeding in providing good solutions for the collective of citizens? We think not. There seems to be a gross disconnect between the financial well-being of the investment professionals and their clients in aggregate. Specifically, only 22% of U.S. citizens are "very confident" they will have enough money to retire. More importantly, when we unpack the assumptions in that very confident group, we find:[7]

- 11% of them were not saving at all!
- 40% of them had less than $50,000 in savings.
- 30% had never estimated how much they need.

Shocking, right? And this group was VERY confident. This picture would be the medical equivalent of nearly all of us suffering various forms of cancer, but being VERY confident about our long-term health.

Despite this over-optimistic assessment of their financial well-being, the informed public has lost trust in the wealth care providers. The 2015 Edelman Trust Barometer[8] paints a dire picture of trust in the financial services industry. Highlights, or rather "lowlights", of the survey are as follows:

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[5] Of course, good genes and good luck are factors as well! ☺
[6] Admittedly, the whole question of fair value for the services delivered is THE question.
[7] Michael Falk, from his CFA retirement lecture based on 2015 EBRI data, delivered to CFA audiences around the world. Mr. Falk is the author of a forthcoming book from the Research Foundation of the CFA Institute on entitlements and their impact on the sustainability of long term growth. The working title is **Let's All Learn How to Fish…to sustain long-term economic growth**, due out in January of 2016.
[8] See full report, http://www.edelman.com/2015-edelman-trust-barometer/trust-across-industries/financial-services-path-to-building-trust/

- Of 15 industries measured globally, financial services and banks rank at the bottom[9], only beating one industry, Media. (Insert Brian Williams joke here)
- For those of you taking refuge in the fact that financial services and banks are giant industries, we're sorry to inform you that the breakouts don't improve the picture. Financial Advisory/ Asset Management ranks worse than banks or credit cards. (Insurance ranks worst of all.)
- The informed public believes that "Greed/Money" ranks higher as a motivator than "Improve People's Lives" or "Make the World a Better Place." (54% vs. 30% and 24%, respectively)
- Worse yet, as a result of the deep distrust of financial service firms, the informed public believes that much more regulation is needed for financial service firms. (54% say that government needs to regulate financial services MORE. Ouch.)
- When asked what behaviors are important to building trust, these behaviors were top rated:
  - Ensures quality control
  - Keeps me and my family safe
  - Embraces sustainable business practices
  - Is transparent in reporting progress on company's social responsibilities
- For the above factors, the informed public does NOT believe that financial services companies are performing well on them. (The gap between "Importance of behavior" and "Performance on behavior" was over 25% for each.)

In short, the industry has blown it. Trust is at the core of a fiduciary service and Edelman tells us that we have lost it.[10]

Surely "up" is the only direction from here.

To be clear, we understand that many wealth care providers are working hard on behalf of their clients and have earned their trust. FCG knows this from our experience with these firms and their leaders. So, we know that it is possible to succeed at building trust and creating "peace of mind" for your clients. The larger vision for wealth care leaders would be to shift their mindset from "my firm" to "the industry." By making this shift, investment leaders would start to play at a bigger game. The new goal becomes: How do we as an industry provide financial peace of mind for all citizens? This is a tall order, but that's a vision: an ambitious goal. Collins calls it a BHAG: a Big Hairy Audacious Goal. Reminiscent of Martin Luther Kings' "I have a dream," a BHAG is something we can be proud of as an industry. As wealth care providers we want to see ALL people enjoy financial peace of mind. (Note: for many this simply means a modest life style. As Thoreau said, "I make myself rich by making my wants few."[11])

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[9] The question put to the "informed public" was: "how much do you trust each of the following industries?"
[10] And, it declined further from 2014 to 2015. After showing some improvement after the Global Financial Crisis.
[11] http://www.goodreads.com/quotes/231800-i-make-myself-rich-by-making-my-wants-few

Higher Needs

So, what might motivate investment leaders to shift from "my firm" to "our industry?" Is there any reason for hope? We think the answer lies in the natural desire of people to move up Maslow's hierarchy of needs. Maslow stated that when our basic needs are taken care of, such as safety, food, clothing, companionship, and finances, then we naturally aspire to what he called "self-actualization." Maslow defined this as:

> 'What a man can be, he must be.'[12] This quotation forms the basis of the perceived need for self-actualization. This level of need refers to what a person's full potential is and the realization of that potential. Maslow describes this level as the desire to accomplish everything that one can, to become the most that one can be. Individuals may perceive or focus on this need very specifically. For example, one individual may have the strong desire to become an ideal parent. In another, the desire may be expressed athletically. For others, it may be expressed in paintings, pictures, or inventions. As previously mentioned, Maslow believed that to understand this level of need, the person must not only achieve the previous needs, but master them.[13]

Interestingly, as Maslow aged he added another level to his hierarchy, which he called Self-transcendence. He described it this way:

> The self only finds its actualization in giving itself to some higher goal outside oneself, in altruism and spirituality.[14]

In this definition, Maslow is moving to the collective. As we fulfill all our basic needs, we naturally move to more generous and altruistic thinking. We want to give back. We become less ego driven and more "higher self" driven. As wealth care providers we begin to think, "How can our industry provide financial peace of mind for all citizens? How can we contribute to the common good?" This is not fantasy. FCG has met many investment leaders who share this Self-transcendent goal of generosity, altruism and giving back.[15]

There is a lot of research to support this idea that people are highly motivated by serving a larger purpose. Dan Pink, author of **Drive**, states that:

> Those who do so in the service of some greater objective can achieve even more. The most deeply motivated people—not to mention those who are most productive and satisfied—hitch their desires to a cause larger than themselves.

[12] Apologies to readers. Maslow was writing in a time before the equality of genders.
[13] https://en.wikipedia.org/wiki/Maslow%27s_hierarchy_of_needs#Self-actualization
[14] Ibid.
[15] For the names and firms of such individuals, see FCG's paper, "Linking Culture to Long Term Success" at our website: www.focuscgroup.com

Another researcher, Csikszentmihalyi (author of **Flow**), states:

> One cannot lead a life that is truly excellent without feeling that one belongs to something greater and more permanent than oneself.

FCG has found in its work with many investment leaders that they do indeed aspire to this higher calling of serving a larger purpose, a common good. And yet, the data from our investment industry surveys show that the mindset of investment professionals is primarily focused on their daily work:

Motivation: What has most meaning in daily experience?

N=968, from 6 firms. 3 US, 2 European, 1 Canadian

The work serves a larger purpose, doing something positive in the world (such as allocating capital properly in the markets.)	8%
The work contributes to a sound and sustainable financial future for our firm.	15%
The work benefits our clients, and I enjoy happy clients most of all about my job.	23%
The work allows me to spend time with bright and engaging colleagues. I like these team interactions best of all.	22%
The work is interesting, challenging and intellectually stimulating.	32%

QUESTION: Please choose TWO (2) factors that are the most meaningful in your daily experience.

Wealth care providers think primarily of their daily work, their clients, and their colleagues in that order. They have NOT tied their work to a larger purpose. Less than one person in ten feels that their work as a wealth care provider serves a larger purpose, the common good. This essay explores ways to expand that vision.

Casinos and Markets

We all know that the only benefactor of a casino is the "house." If you were interested in the long term wealth of the casino patrons, you would advise them, "Don't spend your hard earned money in there, only the house wins!" Again, thinking of the collective, all the casino patrons taken as a whole are financial losers after visiting Las Vegas. In a similar sense, all the citizens who are working with financial advisors or investing in mutual funds or pension plans are financial losers! (Relatively speaking when compared with a proper benchmark.) The winner is the "house," that is, all the wealth care providers who are managing the money. Indeed, many citizens do increase their assets over time because compound interest is working in their favor and markets go up over time. (Einstein understood this: "Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it."[16]) The correct mindset of wealth care providers should be "how do we harness the

[16] http://www.goodreads.com/quotes/76863-compound-interest-is-the-eighth-wonder-of-the-world-he

power of compound interest to make all the citizens better off?" Unlike the casino owners who make good profits because people enjoy playing games of chance, most citizens do not enjoy betting in the markets. Wealth care providers should NOT be paid for providing an entertainment service! Rather, they should be paid for actually helping the average citizen to achieve financial peace of mind. (Again, NOT beating a benchmark but achieving their goal.)

In short, the mindset of wealth care providers must shift from one of competition to one of service. True, there is a limited role in the financial world for competition, such as price discovery and efficient allocation of capital.[17] But the much larger mission is to help clients achieve financial peace of mind. The way the industry works now is that the "house" (wealth care providers) makes huge returns from competing with one another for scarce alpha. For every winner, there is a loser. Firm A's clients did well, while Firm B's client did poorly. Zero sum. But overall, the house took its cut.

In practice, a first step towards this vision would be a serious re-think about value. Each investment leader would commit to providing genuine value for the clients. They would still be focused on their firm and their clients, but they would be doing so in an honorable fashion. An example is Bailee Gifford in Scotland. The 40 partners in this firm gave the clients fee reductions simply because it seemed the right thing to do. (The clients in turn were very suspicious: what's the catch?) There wasn't one. It was simply an acknowledgment that fees were too high relative to the value delivered. Contrast this example with another one in which the CEO of a firm told their sales leader, "Your job is to continue getting 100 basis points for our active products even though the market level is moving to 50 basis points." The sales leader, showing a high level of integrity, left that firm. His explanation: "I can't feel good about my mission being to over-charge clients for as long as I can."

Unfortunately, too many wealth care providers have been raised on the misguided advice of Milton Friedman—Nobel Prize winner—who said,

> There is one and only one social responsibility of business–to use it resources and engage in activities designed to increase its profits.[18]

Wrong. This toxic statement has caused no end of troubles for the industry. As a fiduciary business it is our privilege and duty to protect and care for the clients, NOT to invoke "buyer beware" and sell them products they don't understand and don't need at inflated prices. (It's been said, "Hedge funds are a pricing scheme (2-and-20), not an investment strategy.") Instead, we should all be committed to financial literacy which would help average citizens understand what a reasonable financial plan looks like and how to use the power of compound interest and rising markets to achieve it over time. It's frightening to see the numerous accounts of greed in the industry, in which empathy for others is

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[17] In both fields—health and wealth—FCG recognizes the need for specialists who are largely unconcerned with the common good and much more focused on the skill of their work: brain surgeons and hedge fund managers.
[18] http://www.goodreads.com/quotes/240845-there-is-one-and-only-one-social-responsibility-of-business-to

completely lacking. Characters like Bernie Madoff top the list, but even high profile firms like Goldman Sachs have embraced this level of greed:

> To put the problem in the simplest terms, the interest of the client continue to be sidelined in the way the firm operates and thinks about making money….I attend derivatives sales meetings where not one single minute is spent asking questions about how we can help clients. It's purely about how we can make the most possible money off of them….it makes me ill how callously people talk about ripping their clients off. Over the last 12 months I have seen five different managing directors refer to their own clients as 'Muppets.'[19]

You can see why the vision that FCG is putting forth is a BHAG. It is a long journey from the greed and ego driven behavior described above to the selfless and service-driven behavior of a noble and honorable profession. But it is possible. Most investment leaders have met their basic Maslow needs long ago. They are in a position to ask themselves the higher order questions: How does my firm provide genuine value to the clients? And, how do I and my firm contribute to the larger good of financial well-being? Can we raise the number of citizens who feel good about their retirement plan? Can we rebuild trust in our industry? Can we establish a level of integrity for wealth care providers that rivals the health care professionals, and their Hippocratic Oath, part of which reads:

> May I always act so as to preserve the finest traditions of my calling and may I long experience the joy of healing those who seek my help.[20]

Can we proudly tell our children that we are members of a profession that skillfully stewards people's wealth? Can we shift the mindset from "me and mine" to "the financial well-being of all?"

The Vision

The first step in such a journey is an inspiring vision. And a willingness to shift our mindsets. Things do change, when minds change. Remember, there was a time when women were denied the vote, when apartheid was tolerated, and when the Berlin Wall would never come down. The investment industry would do well to think bigger about our mission. Think beyond making the rich even richer, or developing yet another arcane financial tool, to declaring that our purpose is improving the financial well-being of people on the planet. Long after the authors of this essay have passed on, it would be wonderful to imagine an assessment of our industry that reads like this:

The investment industry has now achieved a proud position in the world. Far from being the lowest ranked industry after the Global Financial Crisis, we are now viewed as the most trusted industry by Edelman. It has been a long journey, but our steadfast commitment to placing client interests first and to seriously embracing the meaning and practice of integrity, has won out over the greed and fear that once characterized our industry. As an industry that is filled with good-hearted, very bright people, we

[19] Greg Smith's letter printed in the Wall Street Journal.
[20] http://guides.library.jhu.edu/c.php?g=202502&p=1335759

have harnessed our skills to help many people achieve a level of financial well-being. And while a small portion of our professionals still compete rigorously to set fair prices and make markets efficient, a much larger percentage of our professionals see themselves as service-minded, genuinely devoted to the financial welfare of clients. We are proud that our industry has grown beyond the zero sum mindset that assumes some firm's clients will win but others will lose, to an abundance mentality that uses the power of compound interests and upwardly trending markets to make all investors better off over the long term. Additionally, investment professionals have outgrown the belief that the only purpose of a business is to make a profit. Instead they see the purpose of a firm is to provide goods and services that are valued. In short, to do something useful, for which others are happy to pay. Investors have also outgrown the short term focus that looks quarter to quarter and have embraced the long term perspective that allows firms to operate optimally. This focus on the long term, allows both clients and their investment firms to consider issues like sustainability, social welfare, and the common good as they choose where to allocate resources. Years ago, these notions would have been considered idealistic and even foolish, but the investment industry refuses to settle for simple wins, choosing instead the more challenging "double victory" that creates profit and increases well-being on the planet. The investment industry has matured and now balances growth and profit with integrity and sustainability.

The right question to ask as you read this vision is not,

Could this ever really happen?

but rather,

Is it a worthy vision?

Does it inspire pride in our work and our profession as we contemplate this future? We may not know all the steps to get from here to there, but the vision inspires us to try. At FCG, we simply don't see a downside from embracing this vision. If you feel similarly, please join us. Forward this vision to your colleagues. Either way, if you agree or disagree, let us know. We welcome the dialogue.

The FCG Partners, September 2015