The Investment Challenge:
Remaining Relevant through Compelling Value

Written by:
James Ware, CFA
Keith Robinson
Michael Falk, CFA

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Investment Leaders react to “The Investment Challenge”

“The guys at FCG really ‘get it.’ And this new paper on ‘The Investment Challenge’ just reinforces that.”
– Scott Powers, President, SSgA

“Focus Consulting Group are undoubtedly one of the great thought leaders of our industry. Their new paper not only examines the complexity and rapid change within the investment world but also includes a clearly defined list of measures that can help with these challenges. A ‘must read’ document for all those seeking to remain, or become, an excellent asset management firm.”
– Karen Yerburgh, CEO, Genesis Investment Management, LLP

“A very thought provoking analysis on what it will take to be a successful investment management firm in the future”.
– Bill Quinn - Chairman - American Beacon Advisors

“For over a decade FCG has been on the forefront of the movement to improve the effectiveness of investment managers. Year in and year out, they have been tireless in their quest to challenge each and every one of us to do better by our clients. With this latest white paper, FCG has clarified and raised the bar. I’m so grateful for their persistence and seminal insights.”
– Fred Martin, CEO, Disciplined Growth Investors

“Great paper and I love not only the observations, but the timeliness of the advice. Your guidance of leadership in the New Era is spot on. Firms that do not adapt to this New Era in asset management will not be around much longer.”

“Other than saying ‘don’t steal money,’ ethics in finance is notoriously hard to write about. Ware, Robinson, and Falk have put together a very thoughtful and provocative essay on ethics-related issues. I wish they didn’t have to do it.”
– Laurence B. Siegel, Gary P. Brinson Director of Research, CFA Institute Research Foundation

Cover art
The Road Less Traveled
### Executive Summary

This paper explores challenges and solutions for investment firms in what we call “The New Era.” Specifically, the main industry challenges are:

1. Fee pressure/margin compression
2. Alpha is scarce
3. Trust. Clients have lost trust in asset managers and in the integrity of the markets

The Solution: We summarize the solutions as being a firm’s ability to deliver “compelling value” to the clients. This is not what the investment manager thinks it is (i.e. beating a benchmark), it is what the client determines it to be.

In the summary statements below, we contrast traditional investment industry practices vs. what we see as required in the New Era.

### Traditional vs. New Era

<table>
<thead>
<tr>
<th>Traditional</th>
<th>New Era</th>
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<tbody>
<tr>
<td><strong>Leadership</strong></td>
<td>Leadership</td>
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<tr>
<td>Investment experts are bright, driven and capable of doing the strategic planning for the firm. Technical expertise trumps team leadership. Firmly rooted in the Founder’s syndrome: “I founded this firm and I can run it by myself.”</td>
<td>Drive vision, culture, strategy, talent acquisition and development, and compensation. Skills needed in the New Era go well beyond technical investment expertise. Most investment leaders show strength in: intelligence, driven, client-focused, technical skills, and problem solving. But, lack the skills of: reading and motivating people, and self-awareness. Talent in the New Era is demanding development in the form of coaching, mentoring, career pathing, and challenging growth opportunities. Failure will come from a lack of willingness to develop and grow talent. Founder’s syndrome won’t fly as strong executive teams are crucial. FCG has seen that strong exco’s drive strong culture and great results.</td>
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<tr>
<td><strong>Culture</strong></td>
<td>Culture</td>
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<tr>
<td>What has worked in the past will continue to work in the future.</td>
<td>While it is true that the core of good cultures – purpose, trust and values – doesn’t change, there are significant differences in New Era cultures. Best practices will include acknowledging the mindsets and values of younger generation workers. New Era leaders will respond to the most important values emerging in investment firms: more emphasis on Integrity, Excellence and Leadership Development/Mentoring.</td>
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<td><strong>Strategy</strong></td>
<td>Strategy</td>
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<tr>
<td>Investment leaders are smart, tend to think long term and so they can anticipate and plan strategically for future challenges.</td>
<td>Strategy is an unacknowledged weakness for many investment leaders. Planning and communicating the firm’s strategy is essential. Traditional asset managers will lose ground if they don’t retool themselves to deliver compelling value. Three “alpha” levers discussed in Casey Quirk’s “Life After Benchmarks” are used as triggers for thinking about new ways to deliver value. New Era strategy considers all aspects of firm delivery to the client: investments, sales/service and operations.</td>
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<tr>
<td><strong>Talent</strong></td>
<td>Talent</td>
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<tr>
<td>Money is the key to attracting and keeping top talent. As long as we have an attractive comp package, we’ll maintain our talent advantage.</td>
<td>Over 95% of investment leaders acknowledge that culture is important to their firm’s success because good culture attracts and retains top talent. The core of any successful firm is acquiring and developing strong talent. The evidence is compelling that investing in talent pays off in improved performance and growth in AUM. The younger generation of workers is especially tuned into development, mentoring, career paths, work/life balance, and autonomy. Leaders must respond to these new values or lose talent.</td>
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<tr>
<td><strong>Compensation</strong></td>
<td>Compensation</td>
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<tr>
<td>Comp work is about using market data to determine relative fairness in the market and then matching those amounts so that you can defend your comp package. Management determines and defends their solution.</td>
<td>Leaders must shift their thinking from comp to rewards. The keys to designing good reward systems are: fairness, transparency, and simplicity. And a broader definition of compensation. Smart leaders understand that intangibles like autonomy and culture are huge attractors and retainers of talent. There are countless examples of talented professionals who moved to new firms for less money for better quality of life. Key motivators for knowledge workers are: mastery of their skills, autonomy of work life, and meaningful careers.</td>
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<tr>
<td><strong>Succession</strong></td>
<td>Succession</td>
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<tr>
<td>Four tenets of succession: 1. We will get around to succession planning when the time is right. 2. I have a pretty good idea of who can fill my role. 3. There is NO one here who can fill my role. We’ll have to go to search. 4. Only the top positions are important.</td>
<td>Less than 20% of investment firms have good succession practices. Blindspots abound, such as the founder syndrome: “no one here could fill my shoes.” This encourages leaders to look outside the firm for successors, despite all the evidence that internal candidates are far better choices. Succession is successful when a collaborative approach is taken and driven by principles of fairness, transparency, and simplicity. Succession is no longer limited to the CEO or CIO. Successful firms realize that key position planning aligned with the firm’s strategic plan sets them up for long term success.</td>
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<tr>
<td><strong>Selling</strong></td>
<td>Selling</td>
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<tr>
<td>Sales is a relationship activity. Build a strong relationship by being friendly, available and responsive and you will become a trusted advisor to the client.</td>
<td>Ample evidence exists to suggest that selling in the New Era must shift from the “trusted advisor” to the “challenger.” The former tries to make the client feel comfortable; the latter challenges the client and introduces healthy tension into the buying decision. Three keys to challenger sales: teaching, tailoring and taking control.</td>
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The Investment Challenge:
Remaining Relevant through Compelling Value

by Jim Ware, Keith Robinson, Michael Falk

“*The models for success in the investment management industry are broken.*”
— Suzanne Duncan, SSgA

“*Legacy managers that refuse to change will, over time, see their business erode.*”
— Casey Quirk

These two dire quotes from long-time industry observers set the tone for this paper: real changes are occurring in the investment world which require real strategic responses. The question we put to investment managers is: How will you lead in the new investment environment? (In this paper we call it the “New Era.”) In what follows, we explore that question and provide recommendations based on our research and client experience.

The Challenges

First, let’s define the challenges for the industry. We use material from industry experts to inform our view, as well as our own hands-on experience. We worked with over 50 clients in 2014 which allowed us to compare what we read with what we saw. Plus, we also draw upon the experience of our “Focus Elite” firms, as they represent best practices for the New Era.

So, how do we define the challenges today? The main ones we see are:

1. Fee pressure/margin compression
2. Alpha is scarce
3. Trust. Clients have lost trust in asset managers and in the integrity of the markets

Fee pressure/margin compression

We list the challenges in this order because they spell out the acronym, FAT. Indeed, it’s understandable why some firms may have fallen into the fat camp. The returns in the investment industry are among the highest of all industries according to strategy guru Michael Porter. The top five ROIC industries for the period 1992-2006 are as follows:

<table>
<thead>
<tr>
<th>Rank</th>
<th>Industry</th>
<th>ROIC</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Investments</td>
<td>40.9%</td>
</tr>
<tr>
<td>2</td>
<td>Soft drinks</td>
<td>37.6%</td>
</tr>
<tr>
<td>3</td>
<td>Prepackaged software</td>
<td>37.6%</td>
</tr>
<tr>
<td>4</td>
<td>Pharmaceuticals</td>
<td>31.7%</td>
</tr>
<tr>
<td>5</td>
<td>Perfume, cosmetics</td>
<td>28.6%</td>
</tr>
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</table>

Note the average industry ROIC was 14.9%. How can the investment industry be so wildly profitable? Especially when studies argue that it is not adding value to clients in aggregate! Is such profitability sustainable?

Evidently not. In 2008 the industry got a nasty wake up call. One client used an addiction analogy to describe it:

“It’s as if the industry hit bottom after a long period of being drunk on profits and growth. The bull market created a drug
high, which finally wore off. The industry woke up with a hang over, and now faces the challenge of getting clean and sober."

This analogy holds some truth. Clean and sober for the investment industry looks like realistic profitability expectations for the value delivered. McKinsey reports that operating profits for asset management firms reached a high in 2007 – 33%, and then fell sharply to 22% in 2009. Since then, profitability has improved but not to peak levels and "prices for most institutional products continue to decline." Our experience with firms squares with McKinsey’s data: fees are under pressure. Clients are savvier about value. They are less likely to pay active fees for passive-like products or underperforming products. The Center for Applied Research found that "46 percent of institutional investors believe the fees they pay are not commensurate with the value that is delivered."

**Alpha is scarce**
The industry still "spends 60% of its capital on the pursuit of alpha…even though alpha opportunities are becoming increasingly rare." How rare?

"According to researchers at the University of Maryland, prior to 1990, 14 percent of US domestic equity mutual funds were delivering "true" alpha. "True" alpha in this case was identified by using statistical methods to single out funds where performance above their respective benchmarks couldn’t be explained by probability alone. By 2006, however, the percentage of funds delivering “true” alpha had shrunk to only 0.6 percent, while the total number of actively managed funds had increased 5x. This isn’t just a US phenomenon. Alpha production net of fees is difficult across the globe."

In his FAJ article "The Rise and Fall of Performance Investing" Charles Ellis makes the same point, citing various studies, including one from Vanguard that examined mutual fund returns: "Results do not appear to be significantly different from random." In that same article, Ellis quotes Eugene Fama: "Active management in aggregate is a zero-sum game – before costs...After costs, only the top 3% of managers produce a return that indicates they have sufficient skill to just cover their costs, which means that going forward, and despite extraordinary past returns, even the top performers are expected to be only about as good as a low-cost passive index fund. The other 97% can be expected to do worse."

Yet another study conducted on US actively managed open-ended domestic equity mutual funds from 1975-2006 concluded: "after risk adjustment, well under 1 percent of funds achieve superior results after costs." Clearly, long-only legacy firms face a daunting reality. Hello, New Era.

Nevertheless, we believe there will always be a place for alpha-seeking firms, but they will have to produce sustainable alpha! For example, FCG worked with a firm in 2014 which had a six person US equities team. When we asked the team, "What is your edge? How do you expect to outperform?" The candid response – using our real-time voting devices – was "we don’t have one." Wow. So think about this. A firm that is investing large amounts of client money in US equities – and charging active fees – cannot state their winning philosophy. Really? Leaving ethics aside, we wonder what is the likelihood that this team will outperform? Slim to none, right! And indeed that is the case. Their track record for the last five years is exactly in line with the S&P 500. No added value. And this is not an isolated case. FCG has worked with many underperforming managers who do NOT have a plan in place for improving future performance. Remember: hope is not a strategy! Managers like this should surely disappear.

Conversely, FCG works with firms that have carefully developed winning strategies and are executing on them, thus creating value for their clients. For example, one such firm has developed expertise in finding companies that have "moats" around them, i.e. significant barriers to entry. The twenty year track record for this long-only equity firm supports the view that they have created an edge for themselves. But these firms are the exception. Alpha is very hard to find.

Why has it become so hard to find alpha? Suzanne Duncan writes, "There are two significant drivers behind this increased difficulty: information efficiency and competition. Ninety percent of the world’s data has been produced in the past two years, and investment professionals and investors alike have ready and easy access to it. The ability to have an information “edge” has eroded, and with it the arbitrage and mispricing opportunities that made alpha attainable in the past.

The second factor inhibiting alpha production, ironically, is the increased expertise of investment professionals. Absolute skill has gone up, the standard deviation of skill has gone down."
In other words, all the poker players around the table have upped their game, so the odds of any one player walking away as a winner – consistently – have evaporated.

Duncan concludes that “despite overwhelming evidence that alpha is increasingly difficult to obtain, the investment management industry continues to hold alpha as its primary measure of success – to its peril.”16

**Trust**

Finally, there is the all-important issue of trust. Financial services is the least trusted industry, as reported by Edelman Group, with a record low 50% of respondents trusting its practitioners.17 Separately, Duncan’s team of researchers found that only 49% of clients feel that their provider is acting in the client’s best interest.18 Ouch.

Rebuilding trust in the investment industry involves a true understanding of “fiduciary.” Two definitions from Merriam-Webster and Investopedia are offered below:

1. A person legally appointed and authorized to hold assets in trust for another person. The **fiduciary** manages the assets for the **benefit of the other person rather than for his or her own profit.**
2. Of or relating to a duty of acting in **good faith with regard to the interests of another**: a company’s **fiduciary responsibility to investors**

We’ve highlighted the important concept: placing the client’s interests ahead of one’s own. In theory, we all understand what this means. But in practice, we see very different behavior. The CFA Institute found this distinction important enough to title a guest editorial for the FAJ, “A New Era of Fiduciary Capitalism? Let’s Hope So.” In it, they contrast Fiduciary Capitalism with Financial Capitalism. The former will place the clients firmly at the top of the priority list: “investors must place the needs of their beneficiaries [clients] above all other considerations… The future of finance needs to be less about leverage, financial engineering, and stratospheric bonuses and more about efficiently and clearly connecting capital with ideas, long-term investing for the good of society, and delivering on promises to future generations.”19

How do these high aspirations for fiduciary capitalism translate into reality? Duncan reports that “investment professionals” greatest fear is for their careers. In fact, 54 percent of institutional investors who manage money believe that their job safety would be at risk if they underperformed their peers.20 For most investment professionals the conflict is very real: I know what is in the clients’ best interest, but I may lose my job if I act on it.” An example? We know firms that refuse to close their funds even though the CIOs have told us that the fund is way too large to create consistent alpha. How can CIOs fail to understand their fiduciary duty? We love this quote from Upton Sinclair because it rings so true:

“**It is difficult to get a man to understand something when his salary depends upon him not understanding it.**”

Trust involves understanding the asymmetry of knowledge in the investment world. Professional investors understand the game much better than clients. Scott Adams sums it up nicely in this comic:

When Greg Smith left Goldman Sachs, he wrote a letter that highlighted the trust concerns for the financial industry. He said: “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.’”21

FCG has had similar experiences while facilitating strategy sessions for investment firms. Once during a session, we pulled an empty chair into the center of the room and pointedly said, “How would you feel about the last hour of conversation
if one of your clients had been sitting in this chair?” The room went quiet and there was very little eye contact. Their entire discussion had been aimed at raising the firm’s margins largely at the expense of the client.

Trust will never be restored as long as the me-first mindset operates. A fiduciary relationship requires us to put the interests of the client first. Period. Full stop.

In summary, then, the challenges around fee compression, stiff competition, scarce alpha, and low trust are formidable. But the future is not hopeless. There is a way out of the darkness. The path forward lies in fully embracing two things: 1) the fiduciary role and 2) the True North of compelling value. Before we turn to strategies for achieving compelling value, let’s define the term a bit more carefully.

**Compelling Value: The Solution**

The basic idea behind compelling value as a solution is to focus the investment firm’s attention where it should have been all along: the client. The person/s whose funds are entrusted to you. This shift involves a change of mindset: from competitive – how do we gain market share, beat the competition, raise AUM, etc. – to service-minded – how do we understand and meet the needs of our clients? Investment managers must retool themselves to provide real value to their clients: retail and institutional. To many readers, this will seem like a “duh” statement. Of course, you say, all firms have to provide their customers with value or they will perish. Duh! In theory, yes. But in the investment world there are some notable nuances. Ellis states it well: “most clients do not seem to realize what is really going on.” And therefore, the clients are not ABLE to assess value. Remember the Dilbert comic above. In simple terms, Joe Public can determine the kind of car he wants to buy and a fair price. But can Joe Public determine if his fees are reasonable? Financial literacy surveys suggest not by a long shot! (Hell, forget Joe Public, in many cases investment PMs can’t determine it.) For years the industry has been selling “hope” and there are lots of underfunded institutions and individuals who are eager to buy hope! (Bernie Madoff preyed on these people.)

So, what is value in the eyes of the client? The Center for Applied Research asked thousands of investment clients – retail and institutional – which investment capabilities will become increasingly important to them over the next 10 years. The top five value drivers were as follows:

<table>
<thead>
<tr>
<th>Top Five Value Drivers (10 year outlook)</th>
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<tbody>
<tr>
<td>1. Performance 40%</td>
</tr>
<tr>
<td>2. Unbiased high-quality advice 28%</td>
</tr>
<tr>
<td>3. Client service excellence 25%</td>
</tr>
<tr>
<td>4. Transparency 25%</td>
</tr>
<tr>
<td>5. Reputation and Integrity 21%</td>
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</table>

Note that performance is still on the top of clients’ minds. They still want good results, presumably defined as alpha in some form. But also note that the next four value drivers add up to nearly 100% and are NOT performance factors. For this reason, Duncan says the compelling value for investors is holistic: including market components (alpha seeking/beta generation and downside protection) plus client components (liability management and income management). Greenwich Associates agrees with Duncan: “In order to deepen an understanding of client goals and objectives, managers ought to position themselves as the client’s partner to address their holistic challenges.” In a study, Greenwich found that “once the relationship is established, quality perceptions are driven primarily by relationship management factors rather than investment factors.” FCG would agree with these larger definitions of value, which includes the common associations with performance but also the less tangible ones like client service excellence. In fact, based on Duncan’s research, investment firms would be wise to carefully review their value proposition to clients, as many are unhappy with the current offering:

<table>
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<tr>
<th>Largest Weaknesses of Investment Providers</th>
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</thead>
<tbody>
<tr>
<td>1. Performance 24%</td>
</tr>
<tr>
<td>2. Transparency 21%</td>
</tr>
<tr>
<td>3. Unbiased high-quality advice 20%</td>
</tr>
<tr>
<td>4. Tailored solutions 19%</td>
</tr>
<tr>
<td>5. Client service excellence 17%</td>
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</tbody>
</table>
In FCG’s view the successful asset management firms in the New Era will be completely devoted to providing compelling value to their clients. Firm leaders will understand that the client is the benchmark and that tailored solutions are paramount. Firms that can provide alpha – despite the difficulty – will earn a place. We will discuss that challenge in the strategy section below. Most firms would be wise to retool themselves so that they are providing solutions to clients, not simply competing with benchmarks. (We will draw from Casey Quirk’s piece “Life After Benchmarks” in our comments.)

Thus, we’ve tried to scare everyone straight and sober in this opening section. Indeed, the game is tougher. Alpha is vanishing, fees are narrowing, clients are skeptical at best, cynical at worst, and smarter than they used to be, profit margins are under pressure. Let’s turn then to solutions. The overall solution that FCG is presenting is found in the phrase, “compelling value.” What must the best firms do to create compelling value for the clients? The rising tide cannot be counted on to lift all boats, as it did during the pro-longed boom from 1982 to the new century. Firm leaders must have a good answer to the question what is our value proposition? In what way do we provide “compelling value” to our clients?

Let’s start discussing solutions by exploring the role of leaders in the New Era.

**Leadership in the New Era**

We start with leadership because leaders drive vision, culture and strategy. In the future, leaders will have to be more than just excellent investment professionals. In fact, FCG has seen so many examples of excellent investment leaders who did NOT come from the portfolio management side of the business that we no longer subscribe to the myth that CEO’s must have investment pedigrees. Yes, they must understand the business, but they do NOT need to have managed money.

In our work with leaders, we assess them on three levels: leading the firm, leading the team, and leading themselves. We have 360 assessment results for hundreds of investment leaders, so we are in a position to analyze their collective strengths and weaknesses. The table below shows some of the competencies that fit into each category: leading the firm, team, and self. The top rated competencies are in green, the lowest rated in orange.

<table>
<thead>
<tr>
<th>Firm Competencies</th>
<th>Team Competencies</th>
<th>Self Competencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drive to win</td>
<td>Business processes</td>
<td>Perseverance</td>
</tr>
<tr>
<td>Critical thinking</td>
<td>Problem solving</td>
<td>Integrity and trust</td>
</tr>
<tr>
<td>Client focus</td>
<td>Continuous improvement</td>
<td>Functional/technical skills</td>
</tr>
<tr>
<td>Ethical/values centered</td>
<td>Planning effectively</td>
<td>Action oriented</td>
</tr>
<tr>
<td>Drives firm vision</td>
<td>Conflict resolution</td>
<td>Comfort with higher managers</td>
</tr>
<tr>
<td>Asset management expertise</td>
<td>Work/life balance</td>
<td>Time management</td>
</tr>
<tr>
<td>Effective decision making</td>
<td>Delegates work to others</td>
<td>Self-motivated</td>
</tr>
<tr>
<td>Builds firm talent</td>
<td>Reading people</td>
<td>Candor</td>
</tr>
<tr>
<td>Strategic thinking</td>
<td>Builds effective collaboration</td>
<td>Listens actively</td>
</tr>
<tr>
<td>Servant leadership</td>
<td>Developing others</td>
<td>Self-awareness</td>
</tr>
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</table>

In our leadership assessment process, we allow the firms to customize the 360 surveys so the competencies in each version are never exactly the same, but the ones listed above are most commonly chosen. So, what strengths and weaknesses emerge from the 360 results?

**Leading the Firm**

Investment leaders overall are very strong in these competencies relating to firm leadership:

1. Drive to win
2. Critical thinking
3. Client focus (actual clients might differ with this view from peers!)
4. Ethical/value centered

These results square with our experience, coaching many investment leaders. Specifically, they are type A, bright, focused on the client and trying to do the right things. These last two competencies will become increasingly important in the quest for “compelling value.” Investment firms must be true fiduciaries, placing the client at the center of all that they do. And they must provide value in an ethical and fair way.

Investment leaders have two pronounced weaknesses:

1. Servant leadership
2. Strategic thinking

The definition of “servant leadership” (provided to feedback raters as they fill out the 360 survey) is as follows: Uses emotional intelligence to understand how investment firm
professionals prioritize work, team and personal life. Makes subordinates feel cared for and valued. Monitors workload and considers non-work lives of subordinates.

Servant leadership could be contrasted with “command and control” leadership, in which bosses simply bark orders to the “troops” and expect them to be executed. Servant leadership has become increasingly important as more Gen Yers enter the work force and Gen Xers ascend into leadership roles. We will say more on this later in the paper.

Strategic thinking may surprise some readers as a weakness for investment leaders. After all, these are smart and driven people, why wouldn’t they be good at strategy? FCG facilitates many strategy sessions for investment firms and this result aligns with our experience. Most investment leaders are very tactical in their work. They are “head down, mush-dog-mush.” Their personality types are much more “closers” than “openers” when it comes to dialogue and discussion. Good strategy requires a tolerance for the unknown. It requires a willingness to incubate on ideas. And to slow down enough to wonder about the various different scenarios that are possible. FCG’s work in this area of strategy is highly important because leaders are over-confident about their abilities. Strategy is a leadership blindspot. The investment leaders of the future must upgrade their strategy skills, as the New Era requires it. Business as usual won’t work.

Leading the Team

Moving to the team competencies, investment leaders are assessed as strong in these areas:
1. Business processes
2. Problem solving
3. Continuous improvement
4. Planning effectively

Again, these strengths align with our experience. These are “thinking” skills and investment leaders are good thinkers.

The problems (weaknesses) appear on the other side of the team development competencies, managing people:
1. Delegates work to others
2. Reading people
3. Builds effective collaboration
4. Developing others

Leading the Self

Finally, turning to the “self” competencies, leaders have clear strengths. In fact, this grouping of competencies – self – is the highest average, followed by firm and then team. (The weaknesses discussed above for team – around leading people – brings that average way down.) Here are the top rated competencies for leaders relating to leading themselves, as independent contributors:
1. Perseverance
2. Ethical
3. Functional/technical skills
4. Action oriented

No surprises here. Leaders are seen by their raters as hard working, skilled at their individual functions, ethical and hands on. The biggest weakness by far for leaders is:
1. Self-awareness

To paraphrase Rumsfeld, “we don’t know what we don’t know.” To be fair, investment leaders must have a certain amount of bravado to sign up for the game. It’s a difficult challenge with plenty of humbling experiences. But overconfidence – or simple blindness – about their abilities is often their undoing. Despite their innate intelligence, leaders in our industry can be some of the least reflective about their own behavior. It’s rare that we encounter investment leaders who are genuinely curious about themselves. (Note: it is NOT rare to find leaders who are genuinely enamored with themselves...@) One data point in this regard involves journaling. Less than 10% of investment decision makers record their
decisions and the reasons for them. In the future, successful leaders will become more thoughtful about their decisions and the reasons behind them. And they will begin to understand the power and effectiveness that “mindfulness” brings to their work and leadership.

To summarize the strengths of investment leaders, they are formidable. Leaders in this industry are bright, driven, client focused, and highly skilled at their particular function. The areas that they will need to improve are: strategic thinking, self-awareness and the people skills, like reading others and developing talent.

From cynic to evangelist
As you can imagine, 360 assessments are often threatening to senior leaders. One COO in particular resisted FCG’s assessment process vehemently. He explained to us in great detail how our process was flawed and that he had seen the damage these exercises can do at his former employer. If the COO’s boss (the CEO) had not insisted that he go through the process, surely the COO would have dropped out entirely.

When the COO got his results, he was shocked. Indeed, he is bright, integrous, and driven, with his highest scores in these competencies:

1 Critical Thinking (Firm) – I critically examine information and identify inconsistencies.
2 Critical Thinking (Firm) – I evaluate tradeoffs, costs, benefits and risks to optimize outcomes.
3 Effective Decision Making (Firm) – I collect all necessary information and appropriately analyze it before making a decision.
4 Self-Motivated (Self) – I value opportunities to perform and produce high level results.
5 Self-Motivated (Self) – I have a personal desire to get things done and accomplish high levels of success.
6 Integrity and Trust (Self) – I am seen as honest and truthful.

But this same professional received some of the lowest scores we had ever seen in these competencies:

1 Developing Others (Team) – I give direct reports the authority and responsibility for making independent decisions.
2 Ambiguity Responsiveness (Firm) – I am able to make decisions and act despite not having the “whole” picture.
3 Developing Others (Team) – I invest time to personally teach or train junior or less experienced employees.
4 Self-Awareness (Self) – I seek feedback and attempt to always learn and improve myself.
5 Reading People (Team) – I am keenly aware of my social environment and those in it.

He was seriously out of touch with the way his immediate team viewed him. True to form, his self-awareness – like many in the investment industry – was very low. As was his ability to read people, another important element of Emotional Intelligence. The COO was shocked to see these results.

But the real turning point for this COO came when he shared the results with his wife. She looked at the results, including the comments, such as: “He uses fear to motivate people, and frequently calls people out publicly. He does not listen well, and has to have his own way. Often is sarcastic and demeaning. Very rarely does he appreciate his people” and responded calmly: “yeah, that’s you.”

To his credit, the COO made a commitment to change. He told us, “I don’t want to be that guy!” In the months that followed, he made significant strides in changing both his attitude and behavior. And he has become the biggest proponent of FCG’s work around leadership development. (Comically, he has reversed his position on coaching to the point where every problem – regardless of what it is – can be fixed through coaching! If you’re laptop doesn’t work, get a coach for it!)

Senior Leadership Teams: Crucial to Success
FCG recommends that CEO’s form strong and effective executive committees (exco’s). The firms that enjoy ongoing success routinely have highly functioning excos. The strong exco serves several important functions. First, it allows senior team members to get feedback from their peers. Often when leaders reach the level of the exco, they stop getting good feedback from their direct reports. These leaders – especially the CEO – need to have a safe place to get honest, direct feedback. The exco is the place for that.
Second, the most effective way to build strong culture is to model it at the exco level. If we were to give one piece of advice to leaders about improving their culture, that’s it! Live the values and behaviors of the firm at the exco level. Practice what you preach and the troops will fall in line. Conversely, if the exco is dysfunctional, the troops will know it and culture will suffer.

So, how do you build a strong exco? Limit the number of people to 6 or less. All the research indicates that good team dynamics for a decision making body erode beyond 6. Typically, the members include CEO, CIO, COO, Chief marketing/sales officer, and then two additional people who bring wisdom and maturity to the senior team. The exco members should understand that they have an important role to play outside of “leading their team” and “leading themselves,” they also must “lead the firm.” And this involves being good communicators, culture carriers, and strategic thinkers.

In addition to the right people and clarity of roles, good exco’s are significantly better at these five factors vs. the industry:

<table>
<thead>
<tr>
<th>Success Factors for Top ExCos</th>
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</thead>
<tbody>
<tr>
<td>Team Factors</td>
</tr>
<tr>
<td>I feel fairly compensated for my contributions</td>
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<tr>
<td>We have the right team members to accomplish our goals</td>
</tr>
<tr>
<td>There is a high level of trust among team members</td>
</tr>
<tr>
<td>Our team openly debates issues</td>
</tr>
<tr>
<td>As a team we value and appreciate one another</td>
</tr>
</tbody>
</table>

7 point scale: 7 = strongly agree, 1 = strongly disagree

Immediately after the comp issue, the key factor is “right team members.” And this is crucial. We have seen many situations where an otherwise first rate exco is debilitated by one “misfit” member. (The person in question may or may not be dysfunctional. Sometimes it really is a matter of poor fit. The individual in question could perform wonderfully on a different exco.) And when the tough decision is made to move that person off the exco, everything changes. There is an important element of chemistry in choosing an exco. And it can require some trial and error to get it right. But it is well worth the effort. High functioning excos are crucial to success. Some of the most dysfunctional investment firms that we’ve worked with suffer from the founder syndrome. The CEO/founder simply cannot trust others to help him/her run the firm, so they micromanage everything. While CEOs have a unique role to play in setting vision, holding and shaping it over time, describing and modeling the values of the firm, enforcing accountability and good governance, they should not be trying to run the entire firm. Good leaders trust, delegate, and empower others.

This brings us to the third factor, trust. Trust is the important platform on which so many other behaviors exist. For example, trust precedes candor. Without a good level of trust, staff members simply won’t feel safe enough to be candid with their views. And without candor, good debate won’t happen. Investment firms are in the business of decision making, and if the thinking process is hampered by low trust, then the quality of decisions will suffer.

The final factor, appreciation, may surprise some readers. Indeed we joke about the industry suffering from ADD: appreciation deficit disorder. When we ask investment leaders – especially CIOs – why they are so reluctant to give out praise, they answer in these two ways:

1. If we praise them, they will want more money!
2. If we praise them, they will stop working so hard!

These views are simply wrong. Leaders who genuinely show appreciation for their staff members get more effort for less money! Given the importance of talent retention in the industry, leaders can’t afford NOT to praise their good performers. The body of research about “positive” work environments is growing larger showing that leaders should create a positive culture to get the most out of their talent. Negativity harms good thinking. Blame hinders performance.
We started our discussion about solutions for the New Era with leadership because firm leaders are responsible for key hires – talent acquisition – and culture. As Ray Dalio is fond of saying, “You have to make two things great – the culture and the people. If these two things are great your organization can navigate the twists and turns to get you where you want to go.” And that is what we are discussing in this paper: how do you navigate this New Era? Let’s turn now to culture.

**Culture: the mindset of the organization, the values and beliefs that define it.**

The platform on which strong cultures are built will always be:

A. **Purpose:** employees must feel like their work matters. That the firm they work for is providing a useful service, doing something positive in the world.

B. **Trust:** team members must feel they can trust one another and their leaders.

C. **Values:** a select set of values and behaviors that all employees must understand and practice creates a strong culture.

Given point “C” above, the top three culture challenges are well documented from our survey work in the industry:

1. **Integrity,** as Fiduciary Capital becomes a reality
2. **Excellence/continuous improvement,** as the challenges become tougher
3. **Leadership development/mentoring,** as more Gen Yers enter the workforce

Taking them in order, Integrity is a core industry value.

*FCG’s strategic partner Laura Pollock (from Third Street Partners) said that in her recruiting practice she regularly has to tell clients that a candidate is not right, even though he or she has every thing the client wants in terms of investment or sales skills. What that candidate is usually missing is something that could be defined broadly as integrity. In one case, a sought-after candidate repeatedly played cute with his past compensation until she asked for his W2s. It turned out he had had one high-earning year after many years of earning less than he claimed. She recommended the offer be rescinded because he lacked good judgment. “How could he possibly be trusted to advise on high-level financial decisions when he couldn’t state a simple fact: his compensation,” she said. The irony was if he had been honest he would have been hired and paid the higher salary.*

Our research on investment firms shows that employees understand the importance of embracing and practicing integrity. But interestingly – and somewhat shockingly to many firm CEO’s – less than half of a firm's employees state that “integrity is a value that we experience at our firm.” After seeing this result (and waiting until their blood pressure returns to normal), the CEOs ask us to explain why only half of the employees vote for integrity as a current value of the firm. Answers from interviews with employees vary from:

- “We just assume that everyone practices integrity. It’s a given. So, I didn’t write it on the survey.”

To

- “I’ve seen some questionable behavior. I don’t think the leaders here are completely ethical.”

Both of these responses are teachable moments for leaders. In the first case, leaders need to reinforce the idea that integrity (and ethical conduct) is far too important to take for granted. Research shows that ethical behavior is similar to physical exercise: if you don’t work out, you get flabby. If you don’t continue to think about integrity and remind yourself of what it means to be ethical, you are likely to stray. In one experiment, a control group that read the “Ten Commandments” before a planned exercise behaved significantly more ethically than the one that did not. Simply reading a famous set of ethical principles helped shape moral behavior. It would probably be a good exercise for all employees to read a one page statement of the firm’s values each day before starting their work!

In the second case of “questionable behavior,” leaders need to get curious (not defensive) and inquire about the behavior. The demise of Arthur Andersen is a powerful example of what can happen to a firm when leaders punish the challengers (i.e. the auditors at Enron). Instead, ethical leaders must reward employees who have the courage to ask hard questions. To keep them honest.

So, if you are a leader serious about promoting integrity in your firm, what can you do? We strongly recommend spending time with a paper by Erhard and Jensen (Harvard), “Putting Integrity into Finance.” The authors’ approach is purely practical in the sense that they argue integrity leads to high functionality, or “workability” in their words. In this piece, the authors define very clearly what it means to be a person of your word. (Like the old, “My word is my bond.”)
Ok, so what is integrity? Beyond just “doing the right thing” how do we carefully define it? Here is their definition:
1. The person’s or other human entity’s (i.e. firm’s) word must be whole, complete, unbroken, sound, in perfect condition.
2. For the word of a person or other human entity (i.e. a firm) to be whole, complete, unbroken, sound, in perfect condition, they must keep their word, or when they will not be keeping their word, they must maintain their word as a whole, complete, etc. by honoring their word.

This definition hinges heavily on clarifying and understanding one’s “word.” Erhard and Jensen go into great detail about what exactly it means to honor one’s word, which is important because they say early on that integrity for a person/firm “is a matter of that person/firm’s WORD – nothing more and nothing less.” And, here is what they mean by “word” which is the gist of their model:

“Honoring your word means that you are honest and straightforward: This means nothing is hidden, no deception, no untruths, no violation of contracts or property rights, etc. And (as explained above) because your word also includes conforming to the rules of the games you are in (for example, ethical standards of the profession or organization you are in [like the CFA Code of Ethics], and the moral standards of the society and legal standards of the government entity you are in). If you refuse to play by any of the rules of the games you are in, integrity requires you to make this refusal clear to all others and to willingly bear the costs of doing so. (Gandhi is an example.)”

Integrity is the backbone of the firm in the New Era. With all the bad lessons about “profit maximization” floating in our psyches, leaders need to get clear with themselves and their teams that they are in a service role, providing value to their clients. Integrity is the spinal column that keeps leaders and their teams on the straight and narrow.

Second, leaders need to embrace and teach excellence/continuous improvement. The new era will be tough. More competition and more demanding clients. Leaders need to understand what it means to have a growth mindset. Carol Dweck coined this term and describes it as a willingness to be open to new challenges, and receptive to feedback. In FCG lingo, Dweck is talking about curiosity: a willingness to learn even when the ego gets bruised. Research from K. Anders Ericsson shows that even the best performers start to level off after 10 years. Consequently, we must all be ready to set new standards and reach for them through activities like deliberate practice. (In Ericsson’s studies he found that it was not the quantity of practice but the quality of practice that differentiated masters from average performers.) Deliberate practice in equity research would look like keeping journals and checklists and regularly doing post-mortems to learn from past experience. Only about 10% of the analysts and PMs we know do this deliberate practice. Do you?

Third, leaders need to be aware that the younger generations are shouting out for development and mentoring. When asked what they mean, the Gen Yers respond with answers like these:

Integrity is the backbone of the firm in the New Era. With all the bad lessons about “profit maximization” floating in our psyches, leaders need to get clear with themselves and their teams that they are in a service role, providing value to their clients. Integrity is the spinal column that keeps leaders and their teams on the straight and narrow.
Having talked about leadership and culture – two sides of the same coin – our attention now turns to strategy. So, how do we think about strategy in the New Era? What must 21st century investment firms do to provide real value for their clients?

**Strategy in the New Era**

Strategy is the process of getting from here to there. FCG is suggesting that “there” is delivering compelling value. In our view, the mission of every asset manager should be to deliver compelling value to the client. One obvious benefit from this mission is to rebuild trust. So, how does a firm move from its current state to the preferred state: delivering compelling value?

We stated earlier in the paper that a weakness of leaders is strategic thinking. FCG has found in its strategy work that a big benefit is definition of terms. Specifically, we suggest the following definitions to clarify the strategy discussions:

1. **Goal:** The general category about which you are strategizing, i.e. AUM growth or client satisfaction. Example: “Our goal is to achieve a high level of client satisfaction.”
2. **Objective:** The specific outcome that measures your success or failure at the goal. In the example above, “Our goal is to achieve 95% client satisfaction.”
3. **Strategy:** In general, how will we achieve our goal? Continuing the example above, “we’ll achieve our goal by providing our clients with compelling value.”
4. **Tactics:** Specifically, “we will move from being a style box manager to being unconstrained. Additionally, we will provide excellent client service and valuable advice for our clients.”

This language spells out a nice acronym of GOST™ and has been extremely useful in making strategy sessions productive. We recommend that you introduce this language and get agreement from your strategy team before diving into a strategy session. (Actually, we recommend that you hire FCG to facilitate your session, but that’s just shameless self-promotion…)

Another tip. Make sure you have the right people in your strategy session. Many excellent team members are great at execution, but they will hinder the strategic thinking. Good strategic thinkers have the capacity to see the big picture,
connect seemingly unrelated dots, and create various scenarios for how the future may play out. A good strategy session should include key opinion leaders – and good strategic thinkers – from each major function: investments, sales/marketing, operations, legal, etc. And, of course, avoid the Dilbert approach:

As a context for strategic thinking, we like Casey Quirk’s (CQ) piece, “Life After Benchmarks.” It details the erosion of the traditional asset management business and suggests that legacy firms will have to change in order to survive. Business as usual is no longer a valid strategy. We would largely agree with Casey Quirk’s forecast:

*Benchmark-oriented active strategies will struggle for share within a large but slowly shrinking global pool of assets, while “new active” strategies will benefit from sustained inflows from organic growth and turnover.*

*New active products will capture more than $3 trillion of cumulative inflows from 2014 to 2018, much of that coming from $1.8 trillion of outflows from traditional active strategies. In terms of revenue opportunity, turnover within the large embedded base of traditional active assets – driven by investors who remain wedded to benchmarks – will remain significant.*

It’s important to understand that both CQ and FCG are aligned that there is a place for active-management. However, it must bring value. Let’s consider, CQ’s three implications:

1. **Investment** strategies tied to narrow benchmarks (such as style boxes) will give way to broader mandates centered on key risk factors and risk-return profiles.
2. **Investors** will spend more time determining desired outcomes and designing a dynamic asset allocation framework, and less time selecting individual managers.
3. **Asset managers** must differentiate themselves less on product features and more on the direct application of their strategies within a prospective client’s asset allocation strategy and desired outcomes.

FCG likes the three implications that CQ stated, and would add these thoughts 1) broader mandates, 2) risk factors, and 3) dynamic asset allocation.

- **Broader mandates** – For those who have managed in a style “box” their whole career, freedom may not be all that freeing. Most investment professionals have been trained as hedgehogs – to do one thing very well – NOT foxes, who are multi-talented. Broader mandates suggest the need for foxes, but let’s be clear: foxes are rare. They are hugely valuable in this New Era because they are hard to find. FCG likes broader mandates, but it’s a tough order. Broader mandates do allow for greater freedom. For example, if you’re a value equity manager and there’s little value to be found, then you could:
  1. hold cash,
  2. hold a different asset class that offers value or
  3. return client money until an opportunity existed again (Yes, really. You could do this.)

Of course, if firms were executing well on broader mandate(s), then how many investment products would be necessary? Maybe just one – an all-weather product. An all-weather fund has profound implications for the industry. If one fund provides consistent performance, why do you need anything else?

Traditional style boxes allow for better comparisons, measurement and decisions about hiring/firing managers. So how would less constrained managers get reviewed?

How would you benchmark an all-weather manager? Would the benchmarking complexity further drive investors towards passive management? Then again, in an outcome-oriented approach the benchmark is determined by the client. For example, if they need a 7% return to send their kids to college, then that becomes the benchmark. Clearly, in the New Era, client goals become paramount.
- **Risk factors** – these factors – such as momentum, value, interest rates – are essentially forms of DNA behind risk premiums versus the mashed-up baskets of factors which exist in asset classes or securities at all times. So, baskets of stocks or bonds contain these strands of DNA. The implication, however, is that PMs may not fully understand what they own. So, managers who struggle to select asset classes and securities successfully likely will have an even harder time with the underlying DNA. And, by creating various risk-return versions (i.e., low- to high-risk balanced funds) how will anyone know when to be in the “best” risk-level fund for the coming months/years? In short, the suggestion to bet on risk factors in the New Era will be difficult. Not to mention risky.

- **Dynamic asset allocation** – CQ suggests that dynamic asset allocation will become more common in the New Era. Pick your betas (bonds or stocks) vs. picking your managers or individual securities. Indeed, FCG agrees that managers who can do this well will win. Finding them is the trick!

Does the industry need to deliver more “outcome-oriented” versus “investment-oriented” solutions? Yes, there is no better way to regain trust than to serve the client, specifically.

The term “outcome-oriented” hides the real story. The broader mandates, risk factors and dynamic asset allocation are all a function of a simpler story from FCG. Michael Falk coined the phrase: “immunize before you optimize.” Clients should immunize their needs before they (even try to) optimize for their wants. Granted, immunizing needs in today’s interest rate environment is really hard. So clients would have to increase savings or change their goals, i.e. later retirement...and, of course, they do NOT like to hear this. So, they instead hire the investment manager who tells them what they want to hear, “sure, we can earn 12% per year for you.” Thanks, Bernie. The move into risky assets was always a “Hail Mary” strategy as a surrogate for proper savings (or goal planning.) But, haven’t we learned by now that hope is NOT a strategy?

Given that the Global Financial Crisis dashed hopes and damaged trust, the outcome-oriented approach finally moved front and center, as it should. However, this is not what investment firms have classically provided; they managed volatile assets and clients accepted the volatility until 2008. CQ’s dynamic asset allocation et al is largely being discussed because of that story. So, due to today’s low rates jacking the cost up for immunization, the management of volatile assets is no longer just for client’s wants but also for their needs. The risk has gone up, and clients better understand the high cost of sub-par results. So CQ has given investment managers levers to pull to compete in the New Era. Will your firm effectively move to these new levers?

The three levers are captured in the following chart:

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**1 Risk Lever**
- **Definition**: Extend existing investment approach by reducing risk guardrails, increasing conviction
- **Focus**: Risk-Oriented Capabilities
- **Lever Dimensions**
  - Tracking Error
  - High
  - Low
- **Asset Class/Sector**
  - All-Cap/Multi-Sector
  - Local Global

**2 Universe Lever**
- **Definition**: Extend existing investment approach to expanded investment universe
- **Focus**: Universe-Oriented Capabilities
- **Lever Dimensions**
  - All-Cap/Multi-Sector
  - Single Cap/Sector
  - Local Global

**3 New Skill Set Lever**
- **Definition**: Develop (or acquire) skill set for entirely new investment approach
- **Focus**: Tool-Oriented Capabilities
- **Lever Dimensions**
  - Specialist Capabilities (e.g, loan workouts, merger arb)
  - Overlay Strategies (derivatives)
  - Leverage
  - Asset Allocation
  - Macro/Relative Value
  - Short-Selling
  - FX/Commodities
  - Quantitative Risk Modeling

**Note**: Each capability lever may not apply for every New Active operating model.

Source: Casey Quirk
schedule that is a win/win? Investment managers who beat
an agreed upon bogey (index, hurdle rate, client liability target?)
get paid handsomely as a percentage of their added value;
however, if they fall short of their bogey, then they get paid
beta-like fees. Perhaps, you could even maintain a high-water
mark to maintain allegiance to the client’s gains. Or, active
managers could just lower their fees, simpler still! McNabb at
Vanguard voiced this same opinion: “High-cost active is dead.
There can be a place for active portfolio management in people’s
portfolios, but if you’re a high-cost manager, it’s going to be
very difficult to compete.”

FCG’s fifth Lever – for the few managers who have winning
or adequate performance records, then the strategy could be:
continuous improvement. No deep changes. Stick with what
is working. Duncan cites Bridgewater as an example: “With
the goal of improving alpha production, they have instituted
procedures aimed at creating a ‘learning culture.’” Keep in
mind, if enough active managers fail, then the level of competition
eases. So, there may be a payoff for surviving!

And, of course, innovation can simply be the combination of
old “things.” Do you dare (can you) offer to your clients talented,
unconstrained managers who are willing to be benchmarked
against their client’s goals with fees aligned based on the
client’s progress towards their goal? Strategy be damned,
who wouldn’t buy that?

The future for smaller shops may be positive. If more conviction
(fewer holdings), unconstrained (more trading?) and specialists
(smaller opportunity sets) all have capacity constraints, then
we seem to need smaller, skilled, skinnier managers. Hello,
“baby” boutique firms. Assets are not evaporating or even
being drained overall, but they are moving. The reality is that
it is comparatively easier to avoid capacity constraints, have
conviction and exploit a niche when you are smaller rather
than when you are a large firm. Do you have the courage of a
boutique conviction? And, how will the bigger firms respond
to the challenge from boutiques in the New Era? Especially
the possible talent drain: many professionals at larger firms
have opted for smaller firms so they can be masters of their
own fate.

The quick review of their levers indicates that managers must
become truly active, essentially demonstrate the courage of
their convictions. Closet indexers will be “outed” and sent off
to do something useful!

CQ’s Risk Lever – This lever is about conviction: are you
willing to make bets? More conviction raises the risk; it raises
the challenge. But it’s the right challenge! Some very highly
respected managers over time have held many securities, and
some highly convicted (not a pun) managers have vanished.
Case in point, the Litman Gregory Masters Funds have hired
some top managers over time and blended their best ideas
into single, multi-manager portfolios. Over the years, many
highly-respected managers were fired; their own fund results
seemingly couldn’t be improved upon or matched solely by
their highest conviction ideas.

Let’s re-think conviction primarily as not fearing tracking error,
and only secondarily about the number of positions. However,
time for investment professionals is precious and to really know
what you own is important. Don’t own more positions than you
or your team can look at each/every morning before trading
opens and answer confidently “I want to hold, add, trim or sell
‘that’ at ‘this’ price.”

CQ’s Universe Lever – This lever is about broader
mandates. Can you maintain your philosophy and process in
the unconstrained space? Foxes – PMs with lots of tools in
their kit – tend to win in this space. And, if you don’t have
pre-existing foxlike skills, then either build them or buy them.
These skills can be used either in an unconstrained format
or as macro tools for fundamental portfolios.

CQ’s New Skill Sets Lever – This lever involves new
investment approaches driven by new skill sets. Effectively
CQ is suggesting new and better style boxes, which is
appropriate given “adaptive markets” that are learning and
equilibrating. These new and better boxes would be run by
specialists who can exploit niches. The challenges will be:
how many exist, how can you find them, how much capacity
do they have and the high risk inherent in niche strategies?

FCG’s fourth Lever – in lieu of new products, what if you
just offer client-aligned fees? The days of heads the industry
wins/tails the investor loses are ending. How about a fee
Retooling for the New Era

So, how does strategy play out in reality? FCG consulted with a firm that had limited products, with its premier product being a high-quality small cap product that is capacity constrained. They wanted to grow firm AUM from around $2B to $5B. Their strategy, as suggested by CQ’s second lever, “Universe Lever,” was to find a foxlike, unconstrained PM who could manage an all-cap portfolio. FCG knew of a PM who fit this description and was a good culture fit for the firm. We introduced the two parties and suggested a 3-month trial run, in which the new PM wrote a position paper on how he would manage and grow an unconstrained portfolio in the all-cap space. Meantime, both parties got to know each other’s strengths, weaknesses, and values. After three months of “courtship”, the parties decided it was a good fit. This firm is now on track to add a “New Era” product to their lineup, and have the opportunity to hit their AUM growth goals.

The Talent Challenge

Now let’s turn to a core interest of FCG: talent. The prior sections on leadership, culture and strategy are necessary to provide the right setting for talented professionals to do their best work. We know from our research that over 95% of investment leaders believe culture is important to firm success. And when asked “why?” these same leaders respond, “Because culture allows us to attract and retain talent.” Attracting, retaining and developing top talent is NOT about money, it’s about leadership and culture. As Frederick Herzberg showed in his famous motivation-hygiene theory (one of top ten articles in the Harvard Business Review’s history, “One more time: How do you motivate employees?”45), money is a disatisfier, not a motivator. Yes, you can make people unhappy with bad comp practices (and we see it all the time!), but you won’t motivate them to do their best work and be happy through money. It’s necessary, not sufficient. In the New Era, intrinsic rewards such as development opportunities, career paths, mentoring and work/life balance will drive attraction and retention of talent. How does FCG know this? We talk weekly with the people who are leaving jobs NOT because of pay but because of better working opportunities. We also know from our culture research that the biggest gap between current and aspirational cultures is leadership development and mentoring. Leaders in the New Era must become knowledgeable and skillful in creating opportunities for their staffs.

A good resource in this regard is Dan Pink’s book, Drive.46 He makes a strong case for three big motivators of knowledge workers:

1. **Mastery**: the internal desire for investment professionals to master their craft. In a changing world requiring new skills this will be paramount in the design of talent development approaches and rewards. Knowledge workers want to continuously improve their skills. Leaders need to provide those opportunities for them.

2. **Autonomy**: the ability to take control of how you work. This will become an important new currency for asset managers in the future to attract and retain talent, especially as compensation dollars get reduced through fee compression and shrinking margins. (Note, this is an increasingly important form of “currency” for Gen X and Gen Y employees.) One investment leader told us that the autonomy he gave a top manager was worth half his salary. (That is, a competitor would need to pay 50% more to tempt this manager to move.) An important resource for autonomy is the work by Thompson and Ressler, who coined the term Results Only Work Environment (ROWE). In their view, “work is something you do, not a place you go.” As a virtual firm, FCG can completely support their ideas about ROWE. (And those of you who are clients, you can tell us if it’s working!)

3. **Purpose**: the clear understanding that our work is meaningful. There are five big factors that come into play for this one. We routinely ask investment staffs to tell us what is meaningful to them at work. Here is the actual voting slide from a roomful of 60 investment professionals (PMs and analysts):

Which are most meaningful to me? (pick 2) My work...

- allows me to use my talents and abilities and to challenge myself. 61
- allows me to spend time with bright and engaging colleagues. I like these team interactions. 33
- benefits our clients, and I enjoy happy clients most of all. 15
- serves a larger purpose, doing something positive in the world (such as allocating capital properly in the markets). 14
- contributes to a sound and sustainable financial future for our firm. 5
Notice that the choice which relates to money is the lowest vote getter. By far the greatest source of meaning is the challenge of the work, followed by the camaraderie of bright, engaging colleagues. In the New Era, where talent rules, leaders must become aware of these drivers.

More evidence of the importance of developing talent comes from Citi Prime Finance in their report called, “People Alpha.” The authors studied 24 hedge funds to see how they developed their talent and if it mattered to performance. The results were definitive: the hedge funds that developed their people had better performance and better AUM growth, as seen in the chart below:

For each of these practices, Citi Prime identified the “Standard Practices” that were used by hedge funds and also the “Leading Practices.” For example, in the area above called Performance Management, the practices were as follows:

**Performance Management:**

**Standard Practices:**
- Annual or semi-annual goal setting discussion with manager offering both qualitative and quantitative measures dependent on role
- Annual self-evaluation
- Annual or semi-annual performance review with a sign-off from the employee and manager
- Performance related compensation assessment

**Leading Practices:**
- Collection of feedback from peers (360 assessment)
- Separate review and compensation conversation
- Qualitative and Quantitative Measurement of Trading Personnel
- Measuring adherence to values within performance evaluation
- Defined path to partnership

Given that FCG’s culture research has revealed the strong need for talent development within investment firms, the report from Citi Prime should not come as a surprise. Linking talent development to improved performance and AUM growth cements the case that motivating and developing your people is not simply a “nice to have” but a “must have” in the New Era.

As profitability shrinks, ideas about rewards and motivation must broaden. Fee compression and lower margins mean smaller bonus pools. Successful managers will use other intrinsic rewards such as career progression, development and mentoring, community engagement, etc. Autonomy (read: ROWE mindset) will become even more critical as investment professionals will be looking for more balanced lifestyles and the ability to plan how, when and where they work.

**From “Comp” to Rewards in the New Era**

The New Era will modify our vocabulary: “rewards” as opposed to “compensation.” As a factor to address satisfaction, cash will still be king, but over a smaller country. The more effective
their full potential in their careers. This will require leaders to master the competencies of Servant Leadership and creating an organization that will develop others. (A firm that we work with was experiencing analyst turnover as a result of a lack of transparency on how to move between levels and what it meant to be a career analyst. The leaders defined a road map for their analysts to follow over the course of a career with milestones, competencies, knowledge and experiences needed to grow a career. The result was increased satisfaction and reduced turnover.)

**3 Purpose** – measured not only in the firm’s purpose, but how well aligned it is with the individual’s. (For example, one of the Focus Elite firms has a value of community service. They demonstrate their integrity in this value by giving staff member’s time to contribute within their community. It is a significant reason they retain talent.)

Specific approaches to rewards will vary by firm, but there will be some common themes addressed for each tribe (Investment, Sales/Marketing and Operations). The “Simple” principle for rewards suggests that some approaches can be spread over all three tribes:

1 **Reward for skill acquisition:** if the premise is that new skills will be required for success in the New Era, all three tribes will need to develop them. Leaders that provide developmental opportunities for their teams will increase employee satisfaction and retention. Those that are really serious may also tie other forms of extrinsic rewards to skill acquisition in the form of cash, stock or time.

2 **Rewarding for the firm’s core values:** many firms claim that this is part of their discretionary bonus, but our experience is that this is “all bark and no bite.” Being more explicit about what the core values look like and how much compensation will be tied to them will be critical. Firms that are really serious will use tools to measure an individual’s contribution to the firm’s culture. (FCG has developed survey tools for this purpose.)

3 **Serving the client collaboratively:** FCG’s research shows that tribal friction has been a long standing problem that cripples value delivery. In the New Era tribes will need to work collaboratively to create compelling value. Strategies will be developed with all three tribes participating in the planning and execution. Again, serious firms will measure the internal success of collaboration across the tribes. (Several FCG clients are doing that already.)

If the pie is shrinking, a leader’s role will now need to focus on how to make each piece more satisfying. Leveraging Dan Pink’s work will become more important:

1 **Autonomy** – measured in personal decision rights about time, location and how work gets accomplished. The younger generation in particular equates free time with money. As leaders become comfortable with ROWE environments, they can leverage the flexible time and flexible location to attract talent. One leader that FCG worked with realized that the number one annoyance for employees was commute time. By allowing workers to avoid the commute he gained huge goodwill.

2 **Mastery** – measured by resources for the employees to develop personally and provide more value to the client. Also measured in the firm’s ability to help employees realize
4 **Rewarding for risk-taking:** firms that are serious about creating learning environments will experiment with ways to reward sensible risk-taking. One leader said it well: “I don’t want to create an environment where all my people play it safe. We need to take appropriate risks. I need to appreciate people who have the courage to try new approaches.”

Firms that want to take compensation off the table completely will use a two-step approach to rewards. First, for extrinsic rewards (cash), all employees will be on a simple revenue share model and receive a percentage of the profit. No muss, no fuss. Each contributor is rewarded based on their position’s value to the firm. (FCG calls this, “criticality factor.”) The second step will be identifying other intrinsic rewards that will attract and retain top talent. This shift is more challenging and will require some creativity, but on a broader scale will include career paths, development opportunities, empowerment, responsibility and autonomy (to name a few).

FCG’s experience with clients indicates that rewards for the different tribes – investments, sales, and operations – will become more sophisticated. For example, in the investment tribe leaders will need to get clear on the question, “what are we really paying for?” The information edge has diminished and less than half (42%) of clients believe that skill is the primary driver of performance. Matching pay with institutional time frames will become more common: rewarding 1 and 3 year performance when institutional goals are longer is a disconnect.

Other shifts that we’ve seen in the investment rewards:

1. **Process:** recognize that process is key to good, sustainable results. Recognize inputs over outputs. The former is controllable by the analyst, the latter is not and often represents luck, not skill.
2. **Team vs. star:** in the New Era, firms recognize that co-PMs and teams produce results. The new best practice will allow teams to determine how the pie gets divided fairly. And transparently. FCG uses this process with great success.
3. **Alignment:** investment professionals should eat their own cooking via a large portion of their own LTIP in the funds they manage. Additional incentives should be given when client targets are met. Eliminate LTIPs that vest and cash out.

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**Sales and marketing incentives**

Reward behaviors that benefit the client! Stop paying for product proliferation. Stop using AUM growth as a primary metric of success; stop charging higher fees that don’t align with client value, and benchmarks that don’t really measure success. Current pay models often reinforce this behavior. Leaders should design reward packages that encourage better product creation. Pay for actionable insights from clients that address their needs and for getting the design right. Make the overriding mission of salespeople to rebuild trust with clients by offering compelling value to them. Change the perception that “only 49% of clients feel their provider is acting in their best interest.”

**Sales and Marketing Success Story**

FCG worked with a firm that revamped their sales model to encourage cross-selling of products. The client service team pushed back indicating that their number one goal was to build trust and act as fiduciaries. The client service team did not want to be seen as product pushers. To the leadership teams’ credit, they listened and discussed this issue until the client service people were satisfied that they would NOT be asked to push unnecessary products. (But they would be asked to honestly assess the client’s needs and recommend broader solutions when appropriate.) This level of honest dialogue between sales and investment leaders should become common in the New Era. Rather than simply, “push, push, push!”

**Operation tribe incentives**

Often the comp design for operations (support staff) is the trickiest. The reward system is highly subjective. To overcome this problem, move away from subjectivity and pay for:

1. Alignment of projects and work with GOST (the metrics in the strategic plan)
2. Efficiency and accuracy
3. Internal service satisfaction (surveys are good metrics)
4. Quality decision making
In summary, Duncan has a chart in her paper “Folklore of Finance” that nicely captures the old vs. the new in terms of what is rewarded in the investment firm:

- Past reward metrics (the sinking ship):
  - Past performance
  - Traditional benchmarks
  - External sources
- Future reward metrics (sophisticated and effective):
  - Effective decision making process
  - Realistic self-assessment
  - Tolerance for pain
  - Empathetic communication

As Stephen Levitt argued in Freakonomics, people do respond to incentives, so make them the RIGHT incentives: ones that encourage compelling value to the client. Incentive systems will need to reflect this fiduciary goal.

**Leadership Succession in the New Era**

Succession is a blindspot for most investment firms. Less than 20% of firms have good succession plans in place for senior leaders. FCG’s experience with firms confirms the survey data. We have worked with firms that expect us to start and finish succession work for the CEO and CIO positions in less than 6 months. (background music: “beautiful dreamer…”)

FCG recommends a runway of at least three years for senior positions. Why? Because seamless transitions, which appeal to both employees and clients, require that the successors are properly trained for the new roles. Successors should take on the new role with the skill sets that enable to do the new role. The only scenario in which a candidate can seamlessly move into a CEO or CIO role in six months is if that person is internal and fully ready to ascend into the new role. The likelihood of this scenario is less than 10%.

Assuming that a firm has the wisdom to start the succession process early, there are still blindspots to overcome. A big one is the “prophet in his own town” syndrome. All too often CEOs say, “My successor is NOT currently employed at my firm.” That is a major leadership failure of the current CEO. His/her successor SHOULD be employed at the firm. This is a CEOs first job: start looking for your successor! Conversely, a good CEO says to us, “there are several viable candidates for my role. Here’s the list. I plan to retire in three years.” Wonderful. FCG can begin its succession process by designing – with the help of the executive committee and Board – the job description for the new CEO and creating a talent assessment to see which candidates are best suited. As with our compensation work, this process follows the principles of fair, transparent and simple. FCG includes all the senior team members as well as the candidates in the process. When the successors are named, the ideal response from the firm’s senior staff is: great choice, makes perfect sense. Or as one leader, who did NOT get the promotion, said, “I have to admit, this is an elegant solution.”

A successful succession assignment means that **NO talent is lost from the firm.** All the senior team members understand the process and the result and react with a view that “it’s rational. It’s what is best for the firm.”

Far too often promotions in firms are announced by email and staff members react with, “I didn’t even know we were looking for a new CIO. Was I even considered for the role?” Or worse yet, “What the hell?! THAT guy/!”

Another benefit of a thoughtful succession process is leadership development opportunities, which will be crucial for successful firms in the New Era. When FCG conducts succession assessments, we do thorough 360 reviews of the candidates which include debriefs of strengths and weaknesses and a development plan for each person. Often, the candidates choose to get follow up coaching from FCG on how to use the information from their assessment. The result of the process is to get the right leaders in the right roles at the right time, and to upgrade the skillsets of the entire leadership team. All of this is aligned with the firm’s strategic plan.

FCG looks for internal candidates to fill key roles because those people know the culture and have been ”tested” in it. When internal candidates are vetted and the decision is that an outsider must be recruited, FCG turns to Third Street Partners (TSP). TSP, founded by Laura Pollock, understands our view of leadership and culture and works closely with us to find an outside candidate who will fit the firm’s culture. The output of this combined effort is a “talent map” which gives leaders a clear picture of the internal vs. external landscape.

**Talent Succession in the New Era**

In addition to leadership succession, firms in the New Era will need to plan for talent succession, or “key position bench strength.” While it’s important to know the plan for each
C-suite role, it’s equally important to have a talent strategy aligned with your firm’s strategic plan. Leaders must analyze their current and future needs and be vigilant in preparing for them.

**Right person, right job, right time.** These are the three keys to a successful talent succession and development. In our experience failure comes from not carefully understanding each of these factors in the context of: the strategic plan, career goals of the individual, and skills needed to do the job. Anticipating timing versus the plan is critical.

For example, we worked with a firm struggling to manage the time PMs spent seeing clients, doing pitches, sitting in on finals presentations, etc. Too much time was spent in unnecessary client travel (sound familiar?) and not enough time doing quality thinking. Right person: the firm had an analyst with a CFA and the ability to educate and present well. Right job: the firm developed a Client Portfolio Management position where this individual would be on the investment team but serve as a proxy for the PM in many client meetings. Right time: prior to making this move, the Analyst was thinking about leaving since his performance was mediocre and he was not passionate about doing the analyst work. The result was a huge success which benefited the firm at a time of growth.

For years talent planning has been elusive. Effective talent planning requires other processes, such as a well thought out strategic plan, are in place. It also requires a focus on professional development which we know is a critical aspirational value in the New Era. Finally, it requires a process that helps leaders evaluate their talent against consistent success factors aligned with the firm’s growth strategy and value proposition.

FCG’s talent planning process uses a three dimensional approach to viewing talent in the organization: Contribution (performance), Competency (skill) and Criticality (importance to the clients, firm, and team). The benefit of the three dimensional model is that leaders can compare talent across different areas of the firm to determine where they are strong or weak relative to the short and long term needs of the firm. The key differentiator from traditional talent reviews is “criticality.” Clients that have applied this model have learned to pay close attention to the risks associated when someone scores lower in Contribution and Competence but is in a highly critical role.

Once the strategy is in place and assessment is complete, the real work begins. The three dimensional map gives leaders a clear understanding of strengths and gaps that can now be addressed through development or hiring (we think development is the best option). Good talent development requires what we referred to as a “growth mindset.” In her book, Mindset, Carol Dweck examines why some organizations (and people) seem to develop talent and perform better than others. The key is a person’s mindset. The chart below summarizes the responses of people with a growth mindset vs. people with a fixed mindset. Growth mindset types embrace challenges and feedback and are not thrown by obstacles. Fixed mindsets (read: heavily ego driven) are reluctant to take risks or challenge themselves because they may fail, or look bad. The chart below summarizes the two mindsets:

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Obstacles</th>
<th>Effort</th>
<th>Criticism</th>
<th>Success of others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Embrace them</td>
<td>Persist in the face of setbacks</td>
<td>Path to master</td>
<td>Learn from criticism</td>
<td>Find lessons and inspiration in others’ success</td>
</tr>
<tr>
<td>Avoid them</td>
<td>Give up easily</td>
<td>Effort is fruitless</td>
<td>Get defensive and rebut</td>
<td>Feel threatened by others’ success</td>
</tr>
</tbody>
</table>

**New Era firms will create a cultural foundation of “growth mindset” in how they hire and develop talent.** With this in place, there are three things our experience tells us about the development component of successful talent succession:

1. **Firms that target the individual’s development toward future needs** (i.e. 3 -5 years out) will be able to more effectively address their strategic needs and reduce expenses. FCG refers to this as a “build not buy” strategy.

2. **Firms will create “pools” of talent that can be moved inside the organization and do different things.** Referring back to our discussion about “foxes” vs. “hedgehogs,” foxes are scarce and you may need to develop them yourself. This creates a more flexible and nimble environment, and establishes the foundation of a “growth mindset.”
Successful firms in the New Era will rely on clear and transparent career “options” aligned with their strategic plan. We have helped clients create these growth opportunities for their teams in a transparent and understandable way. This approach gives the next generation of talent a clear set of choices and a path to planning.

Our experience with the best firms highlights the following benefits: higher engagement and satisfaction from the next generation of talent, less recruiting costs since retention is higher, less compensation costs since satisfaction is higher, stronger culture since you are not replacing talent and better value to clients because those in your organization are aligned with your value proposition.

**Finally, a word about Selling in the New Era**

For a firm to be successful in the New Era, it must offer compelling value to its clients. In FCG’s experience, it must also have a superior selling/client service team. FCG has worked with many investment firms who deliver great value to their clients but experience little or no growth. Much as PMs would like to believe that a superior track record will sell itself, that has NOT been our observation. Too many investment PMs think like Dilbert (you could replace “engineers” with “Investment PMs” in this cartoon!):

```
You will need effective marketing and sales in the New Era.
So, what should that look like? Dixon and Adamson (DA), authors of “The Challenger Sale” have some useful ideas. Their research is on sales activity before and after the financial crisis of 2008. One of their most important findings is the “decline of relationship selling.” To quote the authors:

“It seems that the old advice, ‘build relationships first and then sales will follow,’ no longer holds true. That’s not to say that relationships are unimportant. I think a better explanation is that the relationship and the purchasing decision have become decoupled. Today you’ll often hear customers say,

“I have a great relationship with this sales rep but I buy from her competition because they provide better value.” (Note: the emphasis is on VALUE!)

The authors go so far as to say, “How you sell has become more important than what you sell.” FCG’s research in the investment world suggests that there is truth in this assertion. We find that many professional buyers believe investment products are sold, not bought. In other words, very few investment products can stand on their own merit. (“If you build it – i.e. a great track record – they will come” is not true) Rather, it is necessary to have a great process and track record just to be in the race. But the victory will go to the best sales organization.

In the New Era world described in this paper, the competition will be fierce and the sales effort more complex. DA state that “as sales become more complex, the gap between core and star performers widens dramatically. (200%)” In the simpler, transactional world of “pushing investment product” the gap between your top sales people and your core performers was not that wide. Now it is.

DA set about discovering what kind of sales person will win in this new environment. Their research is deep:

“We surveyed hundreds of frontline sales managers across ninety companies around the world, asking those managers to assess three reps each from their teams – two average performers and one star performer – along forty-four different attributes. And while the initial model was built on an analysis of the first 700 reps for whom we had data – representing every major industry, geography, and go-to-market model – we’ve since increased that number to well over 6,000 reps all over the world.”

One of the key findings from all this research was that there are five types of sales reps. DA discovered the five types by running factor analysis to discover attributes that tend to cluster together. (For example, if you were studying ecosystems, you would find certain ones that display all these attributes: intense heat, sand, scorpions, and cacti. You could name this cluster, “desert.”) From the sales data, there were clearly five distinct types of sales reps:
In our work with investment sales teams, FCG can verify that we have seen each type. Often the Lone Wolf is the “Red X” in the team. (The difficult but talented star.) FCG recently worked with a ten person sales /client service team that was largely composed of Relationship Builders and Reactive Problem Solvers (“Responders”). The framework that DA provides was very useful to them in wrestling with the question, “who do we need to be in the future to succeed?” Their investment team is well aware of the New Era, and is expecting the sales team to rise to the challenge of effectively representing their capabilities in the New Era.

This paper has explained the challenges of the New Era and the five sales types. The question to ask is, Which sales type does better in the high complexity world?” (Read: the New Era!) The DA research is very relevant on this point:

By way of comparison, look at the difference between the traditional “Relationship Builder” (i.e. Trusted Advisor) and the new “Challenger.” The following chart shows the core attributes for each.

<table>
<thead>
<tr>
<th>Sales Type</th>
<th>Low Complexity Sale</th>
<th>High Complexity Sale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relationship Builder</td>
<td>11%</td>
<td>4%</td>
</tr>
<tr>
<td>Problem Solver</td>
<td>18%</td>
<td>7%</td>
</tr>
<tr>
<td>Hard Worker</td>
<td>26%</td>
<td>25%</td>
</tr>
<tr>
<td>Lone Wolf</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Challenger</td>
<td>20%</td>
<td><strong>54%</strong></td>
</tr>
</tbody>
</table>

Note, that FCG has inserted at the top – in the dark boxes – our view that the relationship skills are useful and form a baseline, but that top sales people in the New Era will have additional skills as well. The most important difference being that once a sales person has built sufficient trust and “comfort” in the relationship, then the goal becomes constructive tension: educating the client and pushing them out of their comfort zone. (In the New Era, the remark by Henry Ford will become very relevant: “If I’d listened to my customers I would have built faster horses.” Challengers must help the clients understand the New Era and why the client must transition to it.)
Let’s review more closely what it means to be a “challenger” sales person. The three key skillsets are:

1. **Teaching for differentiation**
2. **Tailoring for resonance**
3. **Taking control of the sale**

**Teaching**

Teaching is all about offering clients unique perspectives about the New Era and communicating with passion and precision such that the client is drawn into the conversation. Importantly, its value add for THE CLIENT. For a typical legacy investment firm, this means retooling their offerings so that they are prepared to address and solve the problems of clients: institutions, retail or high net worth. The sales person must understand the industry, explain how it is changing, and demonstrate how his firm can add value to the client. Due to the technical nature of this conversation, the sales person is not expected to wing it, or come up with miraculous insights during the meeting, but rather to come carefully prepared with insights from her own firm’s marketing department and investment professionals.

The most important point about teaching is that it is different from the traditional model of listening carefully to the needs and wants of the client and then responding to them. In the New Era, a skillful conversation about why the client wants a car instead of faster horses will be paramount. Challengers must be able to reframe the investment discussion, based on the New Era realities.

**Tailoring**

While teaching is the defining skill of great challenger sales people, it must be combined with deep client and industry knowledge. For example, one sales person won a large mandate from a pension fund because he was the only person in the short list presentations that asked the client about “risk” as a key topic. The CIO of the pension fund was so relieved that at least one of the presenting firms understood that this was the most pressing issue for them, that she awarded his firm the mandate. Sometimes preparation for a short list presentation will involve additional homework about different hot buttons among the buyers.

**Taking Control**

Taking control does NOT mean being aggressive or worse yet annoying. But in this New Era, it is about standing one’s ground when clients push back. So, when the client asks for a 10 basis point reduction in fees, the Challenger brings the conversation back to the overall solution, pushing for agreement on value, rather than price.

In summary, the old trusted advisors strove to make the client feel comfortable, while the challenger in the New Era strives to educate the client even when it involves constructive tension in the dialogue.

**Conclusions and Checklist for Success**

Despite the nuances of this paper, the overall point is simple: winners must decide how to bring compelling value to their clients and then do so. Leadership, culture, strategy, rewards, succession, and selling will all factor into a firm’s success. FCG believes the solution is holistic: the pieces need to work well together. Leaders must be skilled at helping the whole organization think and act as one team. At the core of that challenge is talent. We’ve shared our views on how leaders can best assemble and motivate talent to deliver on the honorable mission of helping clients achieve their financial goals. For every reader of this paper, the job of winning back trust is in your hands. Let’s reclaim the high ground of a trusted fiduciary. If you think it will help: please forward this paper to friends and colleagues.
Scorecard

Now that you’ve read and mused about the challenges facing our industry and your firm, encourage your senior team members to read this piece, and then discuss your responses to the scorecard below:

(5 = Strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree)

☐ Our senior team members know their strengths, weaknesses and blindspots via feedback from peers. We have a feedback rich environment.
☐ We have an Exco of six or less qualified members that leads our firm well.
☐ Our culture is clearly defined. We can all communicate our stated values, and they are used to hire, coach and fire team members.
☐ Our culture attracts and retains top talent. Our turnover of “franchise players” is low.
☐ Our firm has a plan in place for assessing, coaching and developing talent in the New Era.

☐ Our investment team has a clearly defined edge and can execute on it.
☐ We have shifted our mindset from “comp” to “rewards.” Our rewards system is fair, transparent and simple.
☐ Each year we identify our “franchise players” and each has a development plan.
☐ We have a merit-based succession process for key positions.
☐ Our marketing and sales mindset has shifted from “friendly and responsive” to “challenging and teaching.”

Hopefully, you scored high on each of these important factors. In the event that you wish to better understand one or more of them, please reach out to us. We are very practical in our approach to helping investment leaders. And we’re easy to talk to. Liz will be happy to schedule a call. lseveryns@focusCgroup.com

Appendix

Competencies

Leads the Firm
- Servant Leadership
- Ethical and Value Centered Leadership
- Organizational Awareness and Understanding
- Challenges Assumptions
- Client Focus
- Builds Investment Firm Talent
- Inspires Investment Firm Professionals
- Strategic Thinking
- Asset Management Business Expertise
- Ambiguity Responsiveness
- Effective Decision Making
- Comprehensive Thinking
- Drives Firm Vision
- Informing Others

Leads Others
- Builds Effective Collaboration
- Reading People
- Provides Direction
- Develops Others
- Confrontation Management
- Work/Life Balance
- Resource Management
- Priority Setting
- Planning Effectively
- Asset Management Process
- Conflict Resolution
- Delegates Work to Others
- Negotiating
- Problem Solving

Leads the Self
- Candor
- Action Oriented
- Integrity and Trust
- Learning Agility
- Listens Actively
- Self Awareness
- Temperament
- Perseverance
- Impression Management
- Comfort with Higher Management
- Time Management
- Intellectual Complexity
- Written Communications
- Self Motivated
- Courage
- Functional/Technical Skills
Endnotes


3 “Life After Benchmarks”


4 See FCG website for the paper “Linking Culture to Success” which names the firms and describes them in detail. 


6 We use Securities Brokers and Dealers as a proxy for the Investment industry.

7 “Outcomes are the New Alpha”

8 Ibid

9 “Influential Investor* pg. 15

10 “Folklore of Finance” pg. 5

11 “Folklore of Finance” pg. 6

12 Ellis, Charles. “Rise and Fall” pg. 17

13 Ibid, pg. 18

14 “Influential investor” pg. 15

15 “Folklore of Finance” pg. 7

16 Ibid, pg. 9

17 Edelman Trust Barometer, 2013

18 “Folklore of Finance” pg. 11

19 Rogers, John. “Fiduciary Capitalism” pg. 11

20 “Folklore of Finance” pg. 18


22 As a sidenote, we believe much of the inappropriate mindset is the result of the “shareholder value maximizing” principle taught be business schools and advocated by Nobel prize winner, Milton Friedman: “there is one and only one social responsibility of business—to use its resources and engage in activities to increase its profits.” Oh, the damage this mindset has done. James Montier calls it the “World’s Dumbest Idea” and writes, “Shareholder Value Maximization has pretty well laid the kingdom to waste.”

23 Ellis, Charles. “Rise and Fall”

24 “Influential Investor* pg. 19.

25 Ibid, pg. 23


27 Ibid

28 Ibid. The question put to investors was, “Based on our investment providers’ current capabilities, which of the following areas represent the largest weaknesses?”

29 For a list of competencies, see the appendix.

30 See FCG white paper on “Linking Culture to Success” in which these factors are described in detail.


33 CEO of Bridgewater Capital, see the book ‘Learn or Die” for a discussion of their culture. Or visit FCG website and read the piece called, “Learn or Die.”

34 From hundreds of survey results in the FCG database of investment firms.

35 Available at www.papers.ssrn.com for a shorter summary, see Jim Ware’s blog.

36 Erhard, Werner and Michael Jensen. “Putting Integrity into Finance” pg. 35

37 See footnote 22 above on “shareholder value maximization”


41 “Life After Benchmarks”

42 Collins in his book, “Good to Great” uses this language. Hedgehogs have one approach and use it repeatedly. Foxes have many approaches and choose the one they think is most appropriate in a given situation.

43 Barron’s, February 7, 2015.

44 “Folklore of Finance” pg. 23. Again see “Learn or Die” for more on Bridgewater’s learning culture


46 Pink, Daniel. Drive.

47 “People Alpha”

48 The U.S. Institute is one of Institutional Investor’s prestigious membership organizations. Established in 2000, it serves the asset management industry as an international “think tank” and discussion forum for the leading Chief Executive Officers and their C-level team. The mission of the U.S. Institute is to provide a peer-group networking forum where members privately discuss key industry issues of common concern – within a collegial environment.

49 U.S. Institute survey of attendees, CIOs and CEOs

50 Firms like PIMCO or Fidelity should be embarrassed by their events, in which the CEO leaves with no successor named. That is complete irresponsibility on the part of the CEO and Board.

51 This comment came from the Director of Research, who was a candidate for the CIO role.

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OUR MISSION: To help investment leaders leverage their talent.

OUR APPROACH: Listen carefully to your goals, then help you develop leadership, culture, strategy, investment philosophy/process, incentive systems, and talent to achieve them.

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Leadership: develop the three hats of leadership: self, team, firm
- 360 Assessments for strengths, weaknesses, blindspots
- Development & coaching
- Onboarding of new leaders
- Personality typing & application
- Design and development of high performing teams

Succession: merit based process for putting the right people in the right roles at the right time
- Assessment of talent
- Interviews
- Facilitation of talent review
- Process for design and implementation of succession plan

Culture: build a learning culture that delivers high performance
- Analysis & management
- M&A analysis, integration, implementation
- Culture sustainability and process

Investment Philosophy & Process: define and operationalize your team's investment edge
- Assessment of P&P
- Embedding with teams to learn & improve daily practices
- Applied behavioral finance
- Effective journaling & post-mortems

Compensation & Incentive Plans: design plans that are fair, transparent, and simple
- Research on industry benchmarks
- Interviews and discovery of current and preferred philosophy for rewards
- Design & facilitation of comp and bonus plans

Strategy: design and facilitate sessions that move your firm to its preferred future
- Designing and facilitating offsites
- SWOT analysis
- Industry expertise
- Discussion and agreement on strategic plans

Mindfulness: training for sustainable high performance and better management
- Improve self-awareness, leading to better decision-making
- Learn neuroscience of investing and how to overcome habits through self-regulation
- Increase personal and team well-being
- Certified and highly experienced mindfulness teacher on FCG staff

Visit us and learn more: www.focusCgroup.com
Contact us: Liz Severyns (lseveryns@focusCgroup.com) or call (847) 989-5699
Focus Consulting Group

James Ware, CFA is the founder of Focus Consulting Group, a firm dedicated to helping investment leaders leverage their talent. James is also a highly acclaimed industry author and international speaker on the subjects of investment leadership, culture and building high performing teams. A frequent keynote speaker at CFA Institute, Mutual Fund Educational Alliance, Investment Adviser Association, U.S. Institute and other major industry conferences, James is recognized for his insightful, inspiring and entertaining presentations. His recent books, “Investment Leadership: Building a Winning Culture for Long-Term Success” (Wiley, 2003) and High Performing Investment Teams (Wiley, 2006) identify those elements of leadership and teamwork that lead to sustainable success for investment firms. James has 20 years of experience as a research analyst, portfolio manager, and director of buy-side investment operations. He has been a guest lecturer on the topic of investment firm management at the Kellogg Graduate School of Management at Northwestern University. His educational background includes a Masters in Business from the University of Chicago and a degree in philosophy from Williams College, where he graduated Phi Beta Kappa.

Keith Robinson is the Managing Partner of Focus Consulting Group and brings over 27 years of global investment experience to his consulting and coaching work at FCG. As an expert in human resource and talent management at Allstate Investments, UBS, and Marsh & McLennan, he was selected to develop a cutting edge leadership development program for Northern Illinois University. At NIU he taught masters level accounting students how to lead, effectively communicate and collaborate with others. His specialties include: Management and Leadership Development, Compensation, Succession and Talent Assessment, Organizational Design and Performance Management. He is the co-author of various FCG white papers, and was recently published in Smart Biz magazine for his work on “Managing the Human Portfolio.” Keith holds an MBA from University of Illinois and graduated Summa Cum Laude with a business degree from Western Connecticut.

Michael Falk, CFA is a partner with the Focus Consulting Group, and a partner and the chief strategist on a global macro hedge fund. Formerly, he was the CIO in charge of manager due diligence and asset allocation for a multi-billion dollar advisory. His background includes extensive asset allocation research and portfolio development expertise along with a multi-faceted understanding of behavioral finance and retirement issues. At FCG, Michael is the lead consultant on strategy and investment philosophy & process assignments. Additionally, Michael is part of the CFA Institute’s Approved Speaker List, a contributing member in the Financial Management Association’s (FMA) practitioner demand driven academic research initiative (PDDARI) group, and has taught for DePaul University in their Certified Financial Planner (CFP) Certificate Program as adjunct faculty as well as on behalf of the CFA Society of Chicago in their Claritas program. He is frequently published and quoted in the financial press. He graduated from the University of Illinois with a B.S in Finance. He holds the CFA and Certified Retirement Counselor (CRC) designations.