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**LOL Journal - Competition: Healthy vs. Toxic**

Are you competitive? Of COURSE you are! ☺ Any serious professional in the investment world is. Investment firms are competitive places. As one CEO told us recently, "I encourage collaboration at our firm, but personally I am so competitive that my family has barred me from playing parlor games on holidays!" (Note: this same CEO is viewed by his team as hugely compassionate and generous, which he is.) Nevertheless, competitive energy is palpable in his firm and in the industry in general.
There are many reasons for this. The industry…

- …attracts alpha people who are "type A" high achievers
- …is mostly males, who tend to compete more than collaborate. (The neuroscience of this is explained by males having more testosterone.)
- …is mostly "thinkers" vs. "feelers" (T vs. F on the Myers Briggs personality assessment. T's are more task oriented, F's are more relationship oriented.)
- …has been framed as a competitive battle, in which there are winners and losers (in the daily publication of results, if not every trade)

Healthy competition is fine and leads to better results. The Beatles' McCartney and Lennon used to compete for writing the best songs. (They had 27 #1 hits.) Ned Johnson at Fidelity inscribed over the firm's main entrance: "Competition breeds excellence." Fidelity's success—AUM and brand recognition-- speaks for itself. There are countless examples of the benefits of healthy competition.

Unhealthy competition is different. It's toxic. It occurs when the healthy drive to compete goes too far and winning becomes everything. Vince Lombardi uttered the now-famous quote, "Winning is not everything, it's the ONLY thing."[1] People use this quote, and Lombardi's success as Green Bay's coach, to defend the position that it is ok to win at any cost. Winning is all that matters. Look at all the examples of competitors who do just that:

- Lance Armstrong (and others athletes) using performance enhancing drugs
- Tom Brady deflating footballs, Belichick stealing opponents signals
- New Orleans Saints paying "bounties" for injuring key opponents
- Woody Hayes punching a player, Bobby Knight throwing a chair, etc. etc.

A recent example of toxic competition came from Steve Kerr, coach of the NBA champions, the Golden State Warriors. He admitted to lying about his starting lineup. His comment about the incident:[2]

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[1] Actually, this quote originated with college football coach Red Saunders, though Lombardi did say it as well. https://www.psychologytoday.com/blog/ethics-everyone/201007/winning-isnt-everything
[2] http://espn.go.com/nba/playoffs/2015/story/_/id/13063006/2015-nba-finals-golden-state-warriors-coach-admits-lying-plans-game-4-starting-lineup

’Sorry, but I don't think they hand you the trophy based on morality,’ Kerr said. ‘They give it to you if you win.’”

The Chicago Tribune recently had this quote in the sports section:

“Appearances don’t matter. Winning does. Winning, period. Winning at whatever cost.”

Really? This is what we should teach our children? Don’t worry about morality, just win. At any cost.

Interestingly, the “father” of all this win-at-any-cost attitude, Vince Lombardi, had this to say later in life about his famous quote:

"I wished I'd never said the thing...I meant the effort. I meant having a goal. I sure didn't mean for people to crush human values and morality."[3]

Phew. From everything I’ve read about Vince Lombardi, he was essentially a good man, and I’m so glad he redeemed himself in the statement above. My guess is that Steve Kerr is also a good man and would do the same, under the right circumstances. No evil people here, just ordinary humans pushing competition too far. Losing perspective.

## Defining Healthy and Toxic Competition

So, what is “too far?” In FCG’s experience with many investment firms, we’ve developed some guidelines for healthy vs. toxic competition.

| Competition:<br>Underlying Beliefs: | Healthy | Toxic |
|---|---|---|
| Effort v. Outcome | Competing and improving are enjoyable in and of themselves, regardless of outcome. Doing my very best and learning are worthy goals. | Winning is the only acceptable outcome, all else is failure and defeat. Winning at all costs is the goal. No excuses, no forgiveness. |
| Feeling: fun vs. fear | Fun, excitement, enjoyable<br>“I love to compete.” | Fear, life-or-death, serious<br>“I’d better win…or else.” |
| Abundance vs. Scarcity | Abundance, there’s plenty to go around, the pie is ever-expanding. Learn and grow. | Scarcity, zero sum game, I’d better grab my piece before it’s all gone. Now or never. |
| Mutuality (We) vs. Separate (me/you) | Even when competing, there is a sense of connection or mutuality. “I respect/honor my opponent. May the best man win.” (or woman, ☺) | When competing, it is me against you. You are the enemy. “I hate my opponent. I want to crush them.” |

[3] See #1 above for the quote.

We've found you can boil down the table into a simple question, "Are you having fun?" When competition becomes serious, a life-or-death struggle, then the odds are it's become toxic. We worked with a PM who continually described the industry as "brutally competitive." He used this as an excuse to justify poor behavior with his team of analysts. No surprise, the turnover of analysts at this firm is about 50% per year. Many leave without a new job. They just want to escape the toxic environment.

**Competition in the Investment World**

What does all this have to do with the investment world? We could create a similar list of wrong-doers for our industry. Names like Bernie Madoff, Steven A. Cohen, Dick Strong, Pilgrim and Baxter, and many more. Arguably, it is the same drive to win at any cost—toxic competition—that drove these men and others over the edge.

Investment leaders would be wise to think about competition and how it can be directed in a healthy fashion in their firms. Healthy competition is constructive and productive, toxic competition is destructive. There is certainly a place for healthy competition in active management. Talented PMs and their teams come together to build winning portfolios and in doing so create more efficient markets. Proper allocation of capital in the markets is a win for society. Alpha is a win for clients. Healthy competition serves a useful end. Investment firms should compete so that clients are better served. We are, after all, a service industry, with a fiduciary standard. Healthy competition in the service of clients is fine. Let me give two examples: one toxic, the other healthy.

**Toxic Competition**

Arguably, Goldman Sachs—once a partnership, now a public company--lost its way. I'll simply offer Greg Smith's resignation letter from Goldman as a glaring example of competition gone awry:
"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.'"

**Healthy Competition**

On the other hand, Baillee Gifford in Scotland seems to have found a healthy approach to competition. They use their competitive juices to create alpha, which serves their clients. In addition to producing solid investment results for their clients, they are also reducing fees. Good for the clients, right? Yes, but clients view this action suspiciously, asking "what's the catch?" Andrew Telfer, the firm's joint senior partner, smiled when he told us this story because there is NO catch. He and his 40 partners simply decided it was the right thing to do for clients. And because the firm is a partnership they can make these client-friendly decisions, indicating a true service mentality.

For FCG, the solution lies in harnessing the healthy competitive energies. I like to use an analogy of nuclear energy. When nuclear energy is safely contained, it can produce powerful benefits for society. It is a force for good. When the process is not properly contained, however, there are massive toxic consequences. Three Mile Island or Chernobyl come to mind.

FCG believes there is a role for active managers in the investment world. We don't believe alpha is dead or irrelevant. Two points to be made here:

1. There seem to be way too many firms trying to produce alpha. Only a small percentage (probably less than 20%) are true alpha producers. The other 80% represent a kind of tax on society.
2. The firms that do produce alpha are often the intensely competitive, dedicated teams. These firms are the "nuclear energy" facilities. They are fine, if safely contained, which in part means that the leaders promote healthy competition described above.

As stated earlier, there is a role for these high intensity firms: to set accurate prices in markets and to create alpha for clients: defined as relative to an indices or more appropriately relative to their goal achievement(s).

The place where the investment industry has gone wrong is in forgetting its ultimate role as a service industry. Unlike professional sports, we don't get paid for entertaining the audience with bad behavior. (Remember how entertaining it was to watch John McEnroe's tennis matches?) The investment industry exists to serve the clients, to help them with their financial lives. It may have been entertaining to watch the recent antics at PIMCO, but no one benefitted from them. And they certainly spoke to the toxic, ego-driven, and largely dysfunctional culture. (FCG collects "PIMCO Stories" from alumni and they **are** entertaining…although somewhat hair-raising.)

The proper mindset for investment professionals is service. Charley Ellis in his recent FAJ piece gets it exactly right when he says,

"To the extent investment experts continue to do the important work of advising clients on investment policies to achieve their true objectives and values and sustain their commitments through various markets, our profession will be appropriately admired and well rewarded."[4]

I see this role, described by Ellis, as much more collaborative than competitive. Sitting around a table with clients and thinking through their financial scenarios is much more a partnering exercise than a competitive one. Yes, there is a role for the competitive alpha producers, but it is relatively small

[4] FAJ, August, 2015 pg. 7

compared to this huge undertaking of providing good advice to thousands of institutions and individuals. Our industry has it just backwards, according to Suzanne Duncan (SSgA), who makes this point in her piece, "The Influential Investor." (Specifically, she says that too much time and resources are spent on price discovery and not nearly enough on providing sound financial advice.)

**Solutions for Toxic Competition**

Here are some suggestions for fostering healthy competition in your firm.[5]

1. As a leader, check in with yourself: are you having fun? Are you enjoying the challenges of the job? Or has the work become serious, do-or-die?
2. Have you stated your firm's mission and values clearly? Is it clear that client interests come first? Are values like collaboration, respect, trust, and balance highlighted? (Are you creating safe "nuclear power?")
3. Have you separated process from outcomes? The former you can control, the latter you can't. FCG advocates for showing process and execution notes, journals, and post-mortem analysis to clients and prospects.[6]
4. Do you have a measure for healthy culture, such as employee or customer turnover? Or an independent culture survey? (FCG has a fine one…☺)
5. Do you set an absolute vs. relative investment performance standard?
6. Do you set investment bonuses against the standard and not against one another?

On the distribution side, sales teams present an interesting challenge. Are they also in a competitive game? The best-selling book these days for sales people is called, "The Challenger Sale." As the name implies, it is an aggressive approach to selling. Is that appropriate for a service industry? Would you want your doctor to be aggressively selling you services? ("Yes, you do need this appendectomy. You might even need two." ☺)

In FCG's view, if the investment industry is to reclaim the high ground of being a noble profession, then the proper balance between healthy competition and collaboration (partnering with clients) must be struck. Otherwise, we'll continue to have our fair share of "Three Mile Island" disasters, like Goldman and PIMCO, which only hurt the reputation of our industry.

The takeaway? Remember to ask yourself: Am I having fun? If I'm not enjoying competition, it has probably become toxic.

Curiously,

JW

[5] Thanks to Fred Martin, CEO at DGI, for these good suggestions. DGI has a great culture.
[6] Partner Michael Falk, CFA at FCG elaborated on these process points in his presentation at CFA Annual in Germany. Slides are available from us if you wish.