FOCUS CONSULTING GROUP

THE LEADERSHIP EDGE
Winning Through Superior Culture

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Executive Summary

1. *Leadership shapes culture, which in turn drives performance.*
2. *Evidence: Surveys indicate that the top factors leading to investment employee satisfaction and commitment to a firm are:*
   a. *Leadership credibility and trust*
   b. *Organizational culture and purpose*
   c. *Opportunity for growth and development*
3. *Model for culture (causality): Experience -> Values>Actions (Behaviors)>Results*
4. *Six key success factors for building a strong culture:*
   a. *The company has identified and articulated its core values and vision and uses them as a source of guidance.*
   b. *Evidence that the values and vision described have undergone little change since inception.*
   c. *Significant evidence that vision and values are "alive" in the company.*
   d. *Strong evidence that the culture is well-defined and "binary;" that is, some people love it and others hate it.*
   e. *Significant evidence of a formal indoctrination process.*
   f. *Significant evidence that the company has a history of careful succession planning and formal leadership grooming.*

Introduction

This paper presents evidence that leadership and culture are key success factors in the investment world. Although we at Focus Consulting Group have been convinced of this for many years, it seems that only recently there are more leaders coming around to this view – but they are increasingly doing so. Statements such as "Culture is our only competitive advantage," by well-respected industry leaders like David Fisher of Capital Group, make it harder to argue against the idea. Still, questions remain: What exactly is culture? How do you measure it and manage it to produce competitive advantages? In this paper we look at these questions and provide some answers.

To begin, what is culture? We use the following working definition:

> *Culture: The beliefs, values, and behaviors that differentiate one organization from another.*

Because leaders have the most influence over beliefs, values, and behaviors in a firm, they have the most influence over culture. Anyone who has recently changed investment firms can appreciate this difference. From the physical layout of the firm's offices, to the way decisions are made, to the beliefs about how markets work, firms are different. Gary Brinson used to compare investment cultures to world religions: Each may be valid in its own way or sphere, but they are very different from one another. We agree that there are many ways to "skin" the investment culture "cat," but we have found some guiding principles that are common to the best firms.

First, let's examine some evidence that highlights the importance of leadership and culture in the industry. The table that follows shows which factors contribute most to investment employee satisfaction and commitment. In the war for talent, this information is critical. The best firms attract, retain, and motivate top talent. How do they do it? Here are the key factors: [1]

Leadership credibility and trust	84.8%
Organizational culture and purpose	69.6%
Opportunity for growth and development	50.0%
Challenging, meaningful work	50.0%
Total compensation	50.0%
Relationships with coworkers, customers	39.1%
Work recognition	39.1%
Quality of life/work balance	28.3%
Ownership	24.4%

Notice that leadership and culture are the top two factors. Our way of viewing this data is based on three important connections that top investment firms establish.

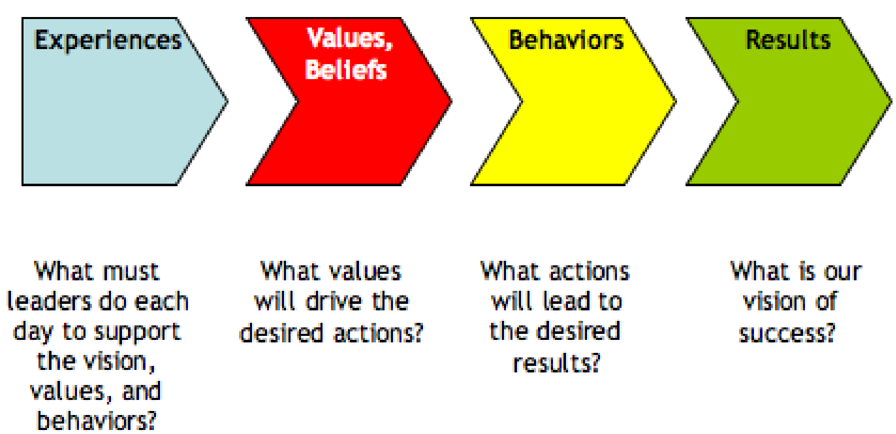
First, they establish a connection of trust among leaders, professionals, and clients. When trust and respect exist in a culture, individuals make deeper connections with one another because fear is largely absent.

[1] *Capital Resource Advisors*, July 21, 2002

The second source is connection with the firm's purpose. Top firms make it clear that they are driven by a purpose beyond making money. This higher purpose allows employees to connect with a mission that feels meaningful, such as "providing financial security for people" or "helping people realize their financial dreams." Notice that, in the preceding table, money is important but not a top factor in creating employee satisfaction and commitment.

The third important connection that top leaders foster is between the employee and his/her unique talents. Factors three and four above relate to this connection. People feel – and perform – best when they feel they are using the special gifts that they were given. In short, these three connections can be thought of as "above" (mission and higher purpose), "around" (with trusting relationships), and "inside" (with their own unique talents). Good leaders create cultures in which a healthy dose of each occurs.

So, how does one think about culture in a practical way? What model is helpful in understanding how to measure and shape it? We use the following causative model to understand the key elements:



We start with results. The word is carefully chosen: not vision or mission, but results. Why? Because some firms may quibble over whether they even have a vision or mission or goal statement or whatever. But all firms, every day, are producing results. The word "results" eliminates any hiding place. The question becomes, "Are you producing the results you want?" Therefore, we start by investigating what success looks like and how we would know if we achieved it. In short, what results are we shooting for? In the process, we encourage leaders to be as inclusive as possible in creating a document that describes the successful future state. The range of possible inclusion levels goes from the CEO crafting it personally and telling everyone what it is, to the leadership team starting with a blank sheet of paper and creating it with the entire staff. (Obviously, this is harder to do for UBS than for Turner Investments…)

Backing up a step from results, we would then discuss what actions lead to the desired results. A good approach here involves some storytelling about what actions in the firm have led to favorable outcomes in the past. For example, one firm we know of has seen open communication lead to improved teamwork and client satisfaction among its financial advisors. Therefore, the firm has continued to recognize, reward, and train financial advisors in communication techniques, such as giving and receiving feedback. The value that this firm has embraced is teamwork. The belief is that teamwork will produce better results than silos and individual heroism. To repeat, the causal chain is that beliefs underlie values, which drive behaviors, which in turn create results.

So what does the term experience mean? Underlying values, behaviors, and results is the need for leaders – and employees – to constantly reinforce key experiences so that employees clearly see that "walking the talk" matters. When discussing these cultural issues with investment leaders, I always ask for an example of when a top performer was dismissed because he/she didn't fit with the culture. From the top firms, I invariably get concrete examples of just that – and an admission that those decisions are some of the toughest they ever have to make. Leaders at top firms are clear about vision, values, and behaviors and are relentless about reinforcing them by creating experiences that recognize and reward them. American Century in Kansas City devotes an entire day to celebrating the five employees who best exemplify its five values.

With all this emphasis on vision and values, what other evidence exists – aside from the fact that employees seem to like good leaders and strong cultures – that values and vision contribute to superior results? After all, there is still a gap between happy employees and great investment performance. So how do we link our culture work to the bottom line? We offer the work of Collins and Porras in Built to Last as strong evidence that firms that pay careful attention to culture outperform over the long term.[2] In fact, the 18 firms that Collins and Porras identified as superior companies outperformed the 18 comparison companies by a wide margin: $1 invested in the former during the period 1926-1990 grew to $6,356, versus $415 for the comparison companies. (Just for the record, the superior companies were not chosen based on stock appreciation, but rather factors such as reputation and quality of products and services.) With this huge difference in stock performance, though, it makes excellent sense to ask if there were consistent differences between the two groups of companies. Collins and Porras found 21 factors that explained the difference between "great" and "good." Six of the most telling factors involved leadership and culture. We've extended Collins's and Porras's work into the investment community and measured these same factors.

In what follows, we describe the six key factors and present the data for the original Collins and Porras superior and comparison companies. We also include our data from 35 well-known investment firms. The range of scores is from +1 to -1, with zero being a middle rating. In each case, Built to Last (BTL) companies score higher than the comparison companies. Investment firms (average of 35 well-known firms) tend to score in between these two groups. This makes intuitive sense, as the investment firm sample combines top companies – such as Capital Group – with firms that fit the description of comparison companies (that is, average performers). In our experience, top investment firms do score well on these six factors.

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[2] Collins, J. & Porras, J. (1994). *Built to Last.* New York: HarperBusiness

Culture Success Factor #1: Clarity of Values and Vision

The company has identified and articulated core values and a vision and uses them as a source of guidance.

Scores for CLARITY OF VALUES AND VISION		
Built to Last Companies	Comparison Companies	35 Investment Firms
.78	-.11	.42

Top-performing companies worship at the altar of clarity. They have carefully identified and defined what results they are shooting for and what values, beliefs, and behaviors will help them achieve those results. The very best firms make this process as inclusive as possible. They invite in all the key stakeholders so that each person's voice will be recognized. In this way, they build a high degree of ownership in the firm's vision and values. Given the data presented earlier on investment employee satisfaction and commitment, it should come as no surprise that top firms emphasize vision and values. Investment professionals want to work with organizations that have strong cultures and purpose. A necessary ingredient in such a culture is clarity of values and vision.

In the data above, notice that the average investment firm rates itself significantly behind the BTL companies. Note that the sample of 35 investment firms includes stellar performers such as Capital Group, as well as companies that are currently struggling, by their own admission. The message we take away is clear: There is great opportunity for most investment firms to improve on this score.

Why don't they?

One obvious answer is that they don't buy the thesis that leadership drives culture which drives results. Our experience talking with leaders from around the globe is that this viewpoint is shifting. Increasingly, leaders are acknowledging the role of culture in performance.
In practical terms, the biggest obstacle that investment firms face with regard to vision and values is taking the time to do it. Investment professionals are hands-on types and rarely get enthusiastic about our suggestion to go offsite for two days. ("TWO days?!" is the usual response.) Leaders must understand the difference between working "in" the business (blocking and tackling on the field) and working "on" the business (going up to the skybox and observing). A relatively small investment of time – say, two or three days – can translate into enormous competitive advantages.

Culture Success Factor #2: Consistency of Values and Vision

Evidence that the values and vision described have undergone little change since inception.

Scores for CONSISTENCY OF VALUES AND VISION		
Built to Last Companies	Comparison Companies	35 Investment Firms
.67	-.89	.34

So your firm has established values and vision – good! The question then becomes: Have the vision and values been in place for a while, or do they change like the latest fashion fad? Consider two extreme cases. First is the building of the Sears Financial Network. Remember the so-called "socks and stocks" experiment? The leaders of Sears put forth a vision to build a financial network, allowing consumers to take care of all their financial needs under one roof; a financial supermarket, if you will. Almost a decade in the making during the 1980s, the whole enterprise had been dismantled by the early 1990s. Hence, a poor score for consistency of values and vision.

Consider the opposite example, just down the street from the Sears Tower. John Rogers started Ariel Capital in the mid-1980s with a laser-like focus on becoming the premier name in small and mid-cap value investing. Over the next 20 years, Rogers grew the company from a few hundred million under management to the $16-billion, top-rated manager that it is today. The firm's mascot is the turtle and its motto is "slow and steady wins the race." Everything in the firm screams "focus!" Ariel is vivid testimony to the power of consistency and focus.

Given that the factors we've identified as critical to successful organizations build on one another, we would expect that the score for factor #2 – consistency – would be lower than the first score for identifying values and vision. In other words, firms that have not performed step 1 could not rate themselves highly on step 2. Accordingly, the scores for all three groups of companies are lower for this second factor.

Our recommendation concerning this factor of consistency is simple: Do it right the first time. Most visions and values shift because the original process was not thorough. By taking the process seriously and digging deep, you won't need to revisit the vision and values a year later to redo the process. The old carpenter's rule of "measure twice, cut once" applies here.

Culture Success Factor #3: Alignment with Values and Vision

Significant evidence that vision and values are "alive" in the company.

Scores for ALIGNMENT WITH VALUES AND VISION		
Built to Last Companies	Comparison Companies	35 Investment Firms
.72	-.20	.22

Factor #3 could be called the “walk the talk” factor. Do the leaders and staff really embody the values and embrace the vision? We worked with a $60-billion, buy-side organization that had completed steps 1 and 2. Values and vision were identified and printed on wall hangings and paperweights, and they had been in place for at least six years. The problem came in walking the talk. We made it a practice, every day while we were on site, to ask several employees: “What are the guiding vision and core values of this firm?” Of the 280 employees, exactly one could answer the question with conviction and accuracy. She was the director of human resources, whom I later found out had crafted the statements.

Built to Last companies score very high on this factor. Employees know the core values and vision and show it in their actions. The average score for investment firms (.22) suggests that there are great opportunities for them to “tighten” their cultures. There are several effective ways to do this. When leaders re-clarify and recommit to the vision and values, it can have a quick and powerful impact on the staff. Employees watch leaders like Fed watchers eye Alan Greenspan. Every single word and gesture is analyzed and critiqued. Smart leaders understand this human tendency and make sure that signals from the senior team are clear and aligned.
A second technique involves recognizing and rewarding staff who walk the talk. At American Century in Kansas City, there is a recognition day celebrating staff members who have shown exemplary behavior involving values. For example, each year one employee is nominated by colleagues for being the most innovative. He or she receives money and public recognition for this contribution.

Firms that have clearly identified their values and vision and are successfully walking the talk are well on their way to success factor #4, a strong culture.

Culture Success Factor #4: Strong Culture

Strong evidence that the culture is well defined and “binary;” that is, some people love it and others hate it.

Scores for STRONG CULTURE		
Built to Last Companies	Comparison Companies	35 Investment Firms
.44	-.33	.21

Even the best of the best, the Built to Last companies, only muster a score of .44 on this factor. It’s tough to build a very strong culture. Firms that rate highly here are characterized by great pride in their products and services, elitism (“we’re the best”), and a binary nature. Binary means that some people would love it and some would hate it. In the investment world, Vanguard is an excellent example. Founded by Jack Bogle, Vanguard has a strong nautical theme running through its culture. The name itself comes from the winning ship in a naval battle between Lord Nelson and Napoleon’s forces; the French surrendered to the HMS Vanguard in 1798. The buildings at the headquarters are named after sailing vessels. There are paintings of ships on the walls. The employees are called the "crew." The cafeteria is called the "galley." The bathrooms are the "head." If a crew member is missing, one almost expects to hear, "Man overboard!" The director of corporate communications told me once that his neighbors tease him about working for the "cult company." The comments neither surprise nor upset him. He acknowledges the cult-like nature of Vanguard, that is, its strong culture. He is proud of the firm.

So what's to be done to achieve strong culture? Steps 1 through 3 are critical and cannot be skipped over. No shortcuts here. But assuming that leaders are serious about establishing strong culture, the critical step for factor #4 is aligning incentives with values and vision. Staff members must see evidence that employees are hired, promoted, recognized, and rewarded based on their conformity with the firm's cultural norms. (ATB Financial in Calgary is so serious about hiring a good fit that they actually have a page of recruiting material that lists the characteristics of people who shouldn't work for the company!) Firms that take culture seriously can all offer up a story in which a top performer was dismissed from the firm because s/he wasn't a cultural fit. Nothing sends a clearer message to the troops that culture matters than the dismissal of a top producer. Firing a "star player" sends the message that leaders care not only about results, but also about how they are achieved.

Culture Success Factor #5: Cultural Indoctrination

Informing and educating new hires about the culture of the company.

Scores for CULTURAL INDOCTRINATION		
Built to Last Companies	Comparison Companies	35 Investment Firms
.61	-.39	-.17

Built to Last firms far outscore comparison companies and the average investment firm in the area of indoctrination. Obviously, indoctrination can happen only in firms with fairly strong cultures. After all, how would you indoctrinate someone into an amorphous culture? There would be no clear guidelines or norms in such an environment. Hence, all the steps 1 through 4 must be tended to before a firm can tackle this step. Firms commonly make the error of ignoring this step, despite having done the hard work of creating a strong culture. Rather than carefully manage the process of training new hires, leaders may incorrectly assume that rookies will learn by osmosis. Top investment firms don't take this chance. They establish formal and effective training programs that quickly get the newbies acculturated. A key consideration for any new hire is, "How do I succeed in this organization?" The orientation program should address this issue. What is expected from employees? What factors translate into promotions, pay increases, and bonuses?

Ariel Capital takes the indoctrination process seriously. Their "ambassador" program concentrates on the new recruits' first 100 days. In that time, the new hire will learn the firm's values, vision, product offerings, performance results, strategies, investment philosophies, and so on. At the end of 100 days, the new hire will know enough to be considered an "ambassador of the company."

Culture Success Factor #6: Succession of Leadership

Significant evidence that the company has a history of careful succession planning and formal leadership grooming.

Scores for SUCCESSION OF LEADERSHIP		
Built to Last Companies	Comparison Companies	35 Investment Firms
.33	-.39	-.06

Leadership drives culture, so the development of leaders is critical to building a winning culture. How could a new leader brought in from the outside hope to quickly understand the nuances of an established culture? Even the sharpest, most willing learners still require months to get the feel of a new culture. Worse yet, many new leaders don't even try to understand what they've inherited. Rather, they go about bringing in people from their prior firm in an effort to reproduce their old culture. This move can work if the cultures happen to be very similar, but most aren't. The evidence is clear: Outside leaders are disastrous and statistics indicate that most mergers, acquisitions, and new regimes fail.

Several years ago I watched as a buy-side investment firm brought in a new outside CIO. For the next several years, relatively high turnover occurred. Significant time and money were lost as people tried to figure out the new way of doing things. Key players left when they eventually got frustrated. After a few years the firm stabilized at a mediocre level of performance. Then, amazingly enough, the whole cycle repeated. Even with six years' time, the CIO didn't find a replacement for himself. So when he was tapped for another assignment in the parent company, they brought in yet another new CIO from the outside. The same turmoil ensued, but to an even greater extent. The most notable example of the talent drain occurred when a derivatives trader left with two weeks until year-end. All his colleagues reminded him that if he could just "gut it out" until December 31st, he would be entitled to a sizeable bonus. His response? "It's not worth it." And he left…with his bonus still on the table. Basically, he left a Mercedes on the table because the environment was so bad that he couldn't take it one more day. (A very personal note here: This sort of leadership is inexcusably bad. Leaders can and do make legitimate mistakes, where bets are placed and prove to be wrong. But this mistake – of bringing in an outside CIO because in six years the predecessor didn't do his job of developing an internal replacement – is a "whippable" offense…as in woodshed and willow switches.)

Investment firms, for the most part, follow the tribal method of leadership. Each tribe – fixed income, equities, real estate, privates, etc. – establishes its own rituals and ways of doing things. Then, at some midnight secret ceremony, these rituals are passed down to the next generation, along with secret handshakes and magic chants. We recommend a more formal approach. With culture in mind, design a leadership development program based on the unique vision, values, strategies, and investment philosophy of the particular company. In other industries, this idea elicits a response of, "Well, duh!" But in our work with investment firms, we are continually amazed at the lack of any formal leadership training that exists at even the best firms. We have helped firms develop leadership programs that include "soft" skills such as:

- Interviewing/hiring
- Performance management
- Conflict resolution
- Giving/receiving feedback
- Accountability/integrity
- Coaching/mentoring
- Trust building
- Teamwork
- Emotional intelligence

The last skill, emotional intelligence, was made famous by Daniel Goleman in his book by the same title.[3] This skill has been identified by reputable organizations – including the Center for Creative Leadership – as the key leadership skill yielding success, even ahead of IQ or experience. So what is it? Emotional intelligence has four basic elements:

1. The ability to identify one's feelings and behaviors (self-awareness)
2. The ability to manage one's internal states (self-control)
3. The ability to recognize and understand others' emotional states (empathy)
4. The ability to manage skillfully one's relationships with others (rapport)

To recap, the six culture factors discussed above are powerful and effective steps that the best investment firms have taken to provide a competitive advantage. As noted earlier, David Fisher of the highly respected Capital Group says, "Culture is our only competitive advantage." The formula is simple, but not easy to implement. For one thing, success requires a deep commitment at all levels of an organization. For this reason, we've developed a "Readiness Survey" that we use with all firms considering a culture change. Typically we will discuss leadership and culture with the key opinion leaders and then distribute a survey that asks questions such as:

- Does the process make sense to you?
- Do the facilitators seem capable?
- Is the level of urgency in your organization high enough?
- Are trust levels sufficient to make real progress?
- Is senior leadership committed to the change process?
- Is senior leadership capable of leading us through the change?

If the responses to these questions are lukewarm, then typically the level of commitment from participants is also lukewarm. In these cases, we recommend postponing the process and dealing with the obstacles.

[3] Goleman, D. (1995). *Emotional Intelligence.* New York: Bantam

Practical Applications

For the more "hands-on-oriented" readers, let me give a few illustrations of how we've applied these concepts with clients.

A large money manager on the East coast with a very strong performance record is planning to double assets under management in the next three years. Their concern is keeping the successful culture pure. They obviously don't want to wreck their winning formula. They asked us to analyze their current organization and design training on "how to hire an excellent fit for their culture." This work involved clarifying the outstanding features of their current culture and developing an interview process that specifically incorporated these features into questions for candidates. The outcome of this customized and "tighter" interview process is objective rankings for each candidate as to how well they will fit with the existing culture.

Another practical application of leadership and culture work is designing a customized leadership development program. Recognizing that they were heavily dependent on the "tribal" approach to leadership development, one firm we work with asked us to design a more formal program that would fit with their current environment. The process again starts with analyzing the culture, defining it, and leveraging the talents and strengths of leaders who are excelling in the environment. The practical outcome of this assignment is a definition of what it means to be an effective leader at their firm. Formal training and executive coaching (including 360° feedback) is used to drive home the desired attitudes and behaviors. The upshot is a good fit between leadership and culture. Leaders reinforce the appropriate beliefs, values, and behaviors. When done skillfully, this process also addresses the succession issue: internal leaders are prepared to take over when senior people leave. The evidence – and our experience – clearly supports the case for home-grown leadership.

A third application addresses mergers and acquisitions. A large global investment firm asked us to help define and integrate the cultures of four different firms that they had acquired. This process involves facilitating a discussion between key opinion leaders of the newly-formed entity and gaining agreement on the new vision and values. The strategy of the acquirer was to capture best practices of each separate firm and leverage them into the new entity. A separate strategy, employed by parent companies like AMG and UAM (now Old Mutual), is to acquire asset management firms and leave the existing cultures intact. A blend of the two strategies is employed by NatCan in Montreal, where three distinct asset management groups have defined their own separate cultures but collectively agree on "meta-values" at the parent company level.

Conclusion

Leadership drives culture which in turn drives investment performance. Building a strong culture requires leaders to work "on" the business, as opposed to their normal task of working "in" the business. Leaders must step away long enough to deeply consider and identify a clear vision and strong values. They must then "walk the talk" and reward staff members who do the same.

Our research shows that a huge opportunity exists for investment firms to differentiate themselves from the pack by strengthening their culture. Specific areas of focus are:

- Clearly define vision and values
- Communicate the vision and values and reward behaviors that reflect and promote them
- Hire for fit
- Indoctrinate new hires carefully and thoughtfully
- Promote and compensate based on cultural factors approach
- Develop strong leaders from within the firm via formal training

Please consider this paper an invitation to dialogue with us about the competitive advantages of culture. We welcome your thoughts and insights.