The culture of sustainable investment performance

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Introduction

Peter Drucker famously said: "Culture eats strategy for breakfast."

In the investment world, while investment strategy delivers performance it is the people and the culture that shape the investment strategy. It follows that culture is integral to the quality of investment performance and sustainability of investment organisations. Yet this little-understood 'secret sauce' of investment organisations is all too often under emphasised to the detriment of the organisation itself and those who trust it to manage their money.

The following analysis, derived from extensive discussions with investment leaders in the recent past and over time, suggests a much greater focus is needed on this critical element of successful investment management.

1. What is culture?

Culture is the collective influence from shared values and beliefs on the way an organisation thinks and behaves. In a strong culture, it aligns the values and beliefs of the individuals within the organisation and establishes a common set of expectations and trust.

Without doubt, the most important element of good culture is strong leadership. Culture is a reflection of leadership past and present. For culture to be influential, leadership must both be active in living its values and putting them into action.

Culture has uniqueness to it. Investment processes and strategies can look alike but culture is always distinctive. But this carries a big challenge to develop a culture that is effective in drawing focused and cohesive effort from talented individuals.

The reality is that many parts of culture result from the particular history of organisations, and are very often unplanned. Such results may not be optimal to sustainable investment organisations or their performance.

There are understandable problems of managing these unseen forces. The investment industry has not mastered the language of culture or the mechanisms to manage something that is clearly everywhere, but nowhere to be seen. The industry has to come to terms with assessing culture and developing it into a strong and distinct component of how firms are structured.

This has been difficult to accomplish through a period of increased complexity, which has also seen significant growth in the scale of most investment organisations. Complexity breeds specialisation and silos, which, all else being equal, damages culture. Growth generally has the same effect.

As a firm grows, for example, the dispersion between the three typical silos of front office, back office and sales, will also grow as the values of the teams associated with each silo tend to differ. This problem can quickly become worse if it is not addressed by the leadership.

Strong culture tends to revert towards the mean in the absence of highly focused actions to maintain it. So the fast-changing nature of the industry makes the development of culture a management imperative.

2. When team and talent align; or when they don't

Culture is multi-faceted. There are many factors that contribute to this unique blend of forces that drive an organisation towards its performance, for better or worse. Among the most notable, and visible features of organisational culture, that has a particularly important impact in defining the investment organisation's DNA, is that of team versus talent.

In the on-going war for talent, the winner is talent. There simply isn't enough investment talent to go around. Inevitably this leaves all of the investment organisations searching for top managers so talent is in a very strong negotiating position. All too often this can result in an unbalanced culture where the danger of a 'winner takes all' attitude is high.

If we think first of hiring extreme talent there is the danger of corrosive impacts on culture. Extremely talented individuals tend to have strong and distinctive personalities, which can materially change the culture within a team and organisation, for better or worse.

By contrast, where a star is home-grown, they will more likely be a strong fit to the culture that already exists, making it more sustainable, but even in these cases, that talent must be embedded in the team to avoid the dangers caused by that talent leaving the firm.

In a highly competitive industry, some high fliers are always needed and how organisations manage and bring out that talent is increasingly critical to success. The talent and team culture must fit in a mix with the strategy. But how is this best done?

First, incentives can help to point the right way in how talent can be used. To be effective and sustainable, talent has to play its part in a team. It would not be sustainable without team elements to it. After all, organisations are inherently team structures. They are made up of a series of interlinked teams that ultimately become a company's total offering.

All talent needs a particular infrastructure of front and back office support to excel. If that talent moves to another organisation then often the edge will be lost. Talent must, therefore be embedded in a team structure to be successful and sustainable.

Finally, the question of retaining talent is linked heavily to the sustainability issue. In essence, for an investment organisation with extreme talent to remain consistent and sustainable the whole team must become the embodiment of that talent. That requires a culture of personal and collective development, appropriate freedoms and collaborations, respect and recognition. Without these being in place the talent edge in culture runs a considerable risk.

3. Creating optimal culture through the team

In most investment organisations the employee value proposition is not dominated by compensation. Associates are most influenced by motivations from more intrinsic sources derived from cultural forces.

There are several essential features of a people culture: respecting personal development wishes, encouraging maximum creativity, facilitating collaboration opportunities and giving personal recognition. Consider, for example, the power of 'well-done' or 'freedom to perform'; also consider how many of our greatest achievements were genuinely a one-person effort. Others were generally involved and the achievement was the sweeter for that collaboration.

One of the most influential cultural attributes is the passion to help associates develop. But this requires considerable front-line time and resources to provide the necessary training, mentoring, and performance management. Few organisations have developed the assiduousness to do all that is needed in this regard. However, where companies don't spend enough time and resources on this, more turnover inevitably follows, which degrades the culture that is so essential to corporate sustainability and success.

Retention of talented individuals will often reflect flexibility with career advancement. One of the most critical test questions of an investment firm's culture is 'do your top people stay with you for their entire career?' It is important to be able to differentiate on the pace at which people progress through the levels. This is also evident when firms have given individuals a variety of roles and tours of duty.

Culture is deeply embedded and so responds weakly to ad hoc attempts to change it. That said, culture can be changed successfully in these people culture areas. Leaders are critical to this both in managing the process of change and as agents of that change.

Creating cultural change can take different forms: change processes, particularly by using organisational transformational methods; rework the organisational design, including the layout of where power is distributed; and in some cases it is necessary to redesign compensation to align the extrinsic incentives to the desired behaviours.

Conclusion

There are certain well understood results in this research.

- culture is a unique ingredient in the struggle for competitive advantage among institutional investment organisations
- the first step in developing good culture is a deep understanding of the current organisational culture;
- with regulators taking an increasingly keen focus on this aspect of the financial industry, firms would do well to address this fundamentally important issue sooner rather than later.

There are some less well understood results

- in a world of more complexity, specialisation and urgency, culture matters a lot more than it did before
- good culture regresses without direct action to maintain it
- there are short-term business incentives that create headwinds to improving culture.

There are ways for culture to be managed and developed over time, but it will take focus, patience, leadership and process. Having a clearer description of company culture without recourse to stereotypes is the best starting point to that journey. Only that way, can a firm identify the necessary steps to address their culture when they don't like what they see in the mirror.

One final tangible thought: making culture a strategic KPI (a key performance indicator that is tracked over time) is a desirable step. Without a measured focus on this core ingredient, the other elements in the organisation's strategy will be vulnerable.

The 300 Club

The 300 Club is a group of leading investment professionals from across the globe who have joined together to respond to an urgent need to raise uncomfortable and fundamental questions about the very foundations of the investment industry and investing. The mission of the 300 Club is to raise awareness about the potential impact of current market thinking and behaviours, and to call for immediate action.

Current economic and investment trends will change the investing landscape over the next two decades and we are at a crisis point which presents huge risks to investors, according to the 300 Club. Moreover, the 300 Club believes that current financial and investment theory and practice run the risk of failing investors at their time of greatest need.

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