Focus on Organisational Culture

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The broader topic of culture within financial organisations has moved up to the top of the industry agenda in the last couple of years. Although regulation of the financial sector, and specifically the asset management industry, has been increasing since the great financial crisis in volume, breadth and detail, many policy makers realise the limitations of prescriptive, rule-based regulation. As a result, the main financial regulators are putting a greater emphasis on culture as the key effective control mechanism against unwelcome behaviour towards the industry's customers - savers and investors. Some of the worst examples of investor treatment during the last financial crisis is often directly blamed on poor, aggressive or misaligned culture.

Within our industry, the demonstrable commercial and investment success of companies like Bridgewater provides strong appeal for culture. For many rather pragmatic and non-altruistic reasons, senior management often views culture as a tool to improve key business performance indicators – and ultimately profitability. The logic here is that a better culture should lead to an increased productivity, wider engagement and improved retention of talent.

In our organisation the culture is a specialist topic; one that is subject to continuous development through debate amongst our colleagues, clients and their advisors. We often refer to our organisational culture as an integral part of our business model and a key aspect of our differentiation. We therefore very much welcome the industry and regulators' renewed interest in this subject. Press coverage, however, too often appears centred on the theoretical end of the argument and so, we believe, rarely digs deep enough into the subject.

However much we all talk about the importance of culture in a financial organisation, there seems to be some disparity between what the industry agrees is right, and reality. A quick review of websites of major banks and asset management companies reveals how all those companies pay tribute to corporate culture; talking at length about their philosophies and principles. But often these are the same companies that we hear of as involved in yet another scandal. So it seems that we, as an industry, are clearly not suffering from a lack of understanding of the importance of getting organisational culture right. There is also plenty of external guidance at hand, as the subject of organisational culture and leadership has been extensively studied by the management science for at least several decades. So do we practice what we preach?

Let's make it clear: we are not sceptical enough to imply that most of the companies in the financial industry actively mislead their customers. This gap between the widely-held belief in good corporate culture and the persistent evidence of poor culture in many firms confirms one of our strongest beliefs. Despite its somewhat ephemeral nature, the corporate culture cannot be simply a theoretical or aspirational matter and requires certain conditions and continuous, dedicated hard work. To use a gardening analogy, wishing for a strong green tree is not the same as nurturing and growing one. There are in our view a number of important conditions and ingredients that are required to turn those aspirations into reality. Similarly to the tree in our analogy, these also require both time and discipline.

Let us start our conversation by looking at what we think is the most important ingredient for an effective and positive corporate culture. We believe this is the long-term stability of an organisation. The importance of this point is not simply limited to its desired nature from a company management perspective, as we would expect most, if not all, companies to be better if they are run as sustainable long-term businesses. The majority of the asset management industry's end clients have long term horizons. This could be due to the length of investment horizon (pension funds, endowments, pension savings, wealth managers, etc.) or sometimes due to more practical constraints of those asset owners. An example of the latter would be the often limited resources of some of the asset owners that act as an effective constraint on their ability to review and change their external appointments.

It is therefore perfectly logical for asset owners to look for service providers, external investment managers, with a business horizon to match their own. That explains why we often hear references to asset owners and clients trying to build long-term partnerships. Also, any due diligence done on an asset manager these days normally covers issues such as business structure and corporate governance, financial strength, ownership and incentive structures - all ultimately trying to assess the long-term stability and sustainability of the business within which an investment manager operates.

So why is it that the investment management industry as a whole often struggles to match its customers' horizons? In our view there are a number of challenges that a typical asset management company faces when trying to align its business horizon with that of its long-term clients. As you will see below, some of those challenges are simply a reflection of industry norms and structure. The others often result from the choices of investment and/or business managers.

1. Need to compete for talent. This is a good example of how the industry norm of remuneration for shorter term performance has a clear implication on shortening the horizon of asset management firms. It is a real challenge to build a sustainable organisation aligned with investors where most of the talent expects to be paid on their performance over a calendar year. The growth of hedge funds in the last 10-20 years actually made this problem worse, with many long-only houses struggling to hold onto their talent.

2. Need to reinvest as you go. The investment landscape and the nature of the challenges that a typical investment manager faces are constantly evolving. There is therefore a clear need for some of the financial reward to be collected as you go so the quality of investment proposition (skill set, systems and technology, broader resources etc.) can be maintained and improved.

3. Need to manage the expectations of shareholders. Any investment management company is ultimately a business with its pressures of profitability and growth. Here, the short-term pressures from shareholders, whose time horizons and expectations could be different from those of company's clients, is often a concern. Listed asset management firms, as a narrow case of the whole market of public companies, are often criticised for allowing external shareholder pressure to impact their strategic choices to favour shorter term smaller gains at the expense of investing in a greater profitability and sustainability in the long term. Although this dilemma is most evident among listed asset management firms, it is clearly not limited to that group. The misaligned interests of shareholders of a private investment management company could have the same impact. There are a few examples one can draw from in the last few years, where a private equity or a single family/individual shareholder's actions have acted as a material impediment to building a sustainable investment organisation.

4. The negative impact of the behaviour of other investors. This is something that is not really getting much airtime in the industry, but the short termism of some of the investor groups often acts as an effective reinforcer of short-term pressures in the investment industry. Many investors make a judgement of their active manager on the basis of short-term performance and are quick to disinvest as performance fortunes change. The recent growth of thematic allocation and active tactical asset allocation models in the broader industry further increases these short-term pressures. This client behaviour often exaggerates internal (within an investment management firm) preference for 'consistency' of good performance and need to urgently 'deal with' underperforming strategies.

5. Limited understanding (among some investors) of investment challenges and inability to stick with an investment strategy through a cycle. Often a correct investment call made early is impossible to distinguish from a wrong decision. Also, where an investment process is characterised by certain style, such as value or small capitalisation, at least some of the superior long-term return to investors is a compensation for a greater volatility or uncomfortable pattern of those returns. It is still often the case that many investors invest on the basis of historic analysis without due appreciation of the longevity and patience required to actually capture the excess returns. Many absolute return strategies' investors suffer from the 'name on the tin' syndrome where they rely on labels like "Absolute" or "Defensive" too much and appear willing to forget that any investment strategy is a form of risk taking in which periods of underperformance are to be expected. Similarly to the general short termism we mentioned above, this sort of behaviour penalises an investment manager and the asset management company he or she operates within for taking a longer term perspective, and punishes those investment managers for a desired degree of stubbornness needed to succeed.

6. Unintended consequences of industry regulation and initiatives. All additional regulation that we see in the investment management industry is clearly meant to protect the interests of individual investors and to build trust within in the financial system – an aspiration we clearly support and encourage. However, we often feel that where the new rules come with overly descriptive frameworks or a pre-set calculation, unintended consequences can negatively impact the same investors they are meant to protect. The recent wave of 'value for money' assessment is clearly an attempt to improve the link between the positive investment outcome and reward. Great! However, if the framework that investors are going to use is too simple (i.e. does not take into account nuances and idiosyncrasies of investment approaches) and is applied to a short time window, then it simply adds the same short-termist pressure. The other related example is an industry-wide drive for lower fees. We often see that those investment managers who are more sensitive to short term falls in profitability and AUM (those who have to report to their shareholders and investors on a quarterly basis) are most willing to undercut their fees and bound to the client pressure. When those are cut to the level below the cost of managing the strategy, the long-term consequences to investors (i.e. expected degree of outperformance) and sustainability of the business itself is likely to suffer.

So what can be done? As the discussion above shows, any improvements in longer term stability and sustainability of asset management firms, at the industry level, requires a greater awareness of rather complex implications of some of the actions and choices that we all make as investment firms, asset owners, clients and regulators. In our own organisation we look at long-term stability as a key foundation of the culture we are trying to develop for the benefit of our clients, people who work with us and our shareholders (which is often the same people who work with us). We deal with those challenges every day and try to factor in this understanding into a wide range of daily challenges we have to address. This drive informs our hiring policy, the way we structure remuneration, the investment autonomy that we are so keen to preserve for our individual investment teams, the nature of internal support and governance that we have for our investment strategies, and our approach to client service and new business.

1. Credit Suisse – The Incredible Shrinking Universe of Stocks, Michael J. Mauboussin, 2017

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Arthur is Head of Investment Strategy. He joined RWC Partners in early 2017 and focuses on a wide range of investment, strategy and management issues.

Arthur started his investment career at the Central Bank of Turkmenistan where he spent five years developing and managing the bank's foreign exchange reserves. He then joined Mercer Investment Consulting in London to focus on advising large UK pension schemes. Prior to joining RWC Partners, Arthur spent twelve years with Stonehage Fleming as a Head of Investments and most recently as a joint CIO. He managed a range of multi asset and global equity strategies and had an overall responsibility for the firm's investment proposition.

Arthur has a BSc in Mechanical Engineering from the State University of Turkmenistan and an MSc in Investment Analysis from the University of Stirling. He is a CFA Charterholder and a member of the CFA Institute.

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