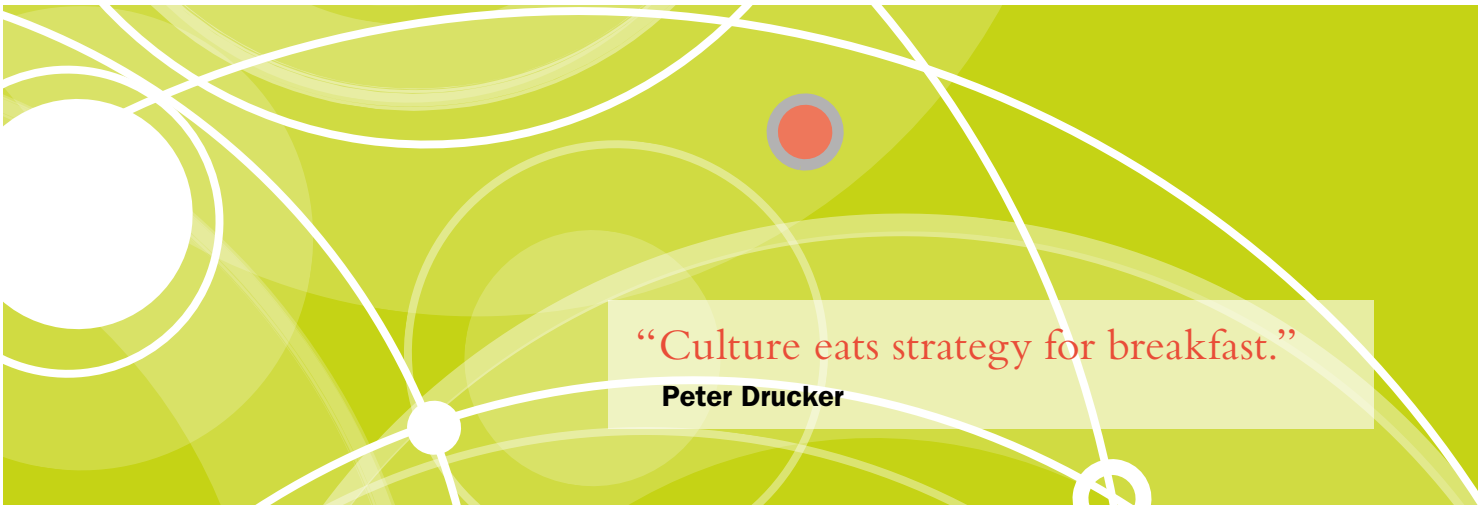
Thinking Ahead Institute

The impact of culture on institutional investors

Roger Urwin

August 2015

TOWERS WATSON



In brief

This paper sets out why culture is a unique ingredient in the struggle for competitive advantage among institutional investment organisations. In our opinion 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 your culture without recourse to stereotypes is the best starting point to that journey.

Various research (particularly Kotter and Heskett, and Schein) indicates the importance of culture and leadership in all enterprises, but particularly in people businesses. This research goes deeper into the importance of culture to asset managers and asset owners.

The special factors applying to institutional investment start with the differences between asset owners (not-for-profit entities) and asset managers (for-profit entities). The ownership models of these organisations turn out to be quite significant in culture formation through the explicit and implicit incentive structures that go with each model. But ultimately, we see culture being shaped most by the influences of leaders past and present.

The paper advances certain best practice principles of culture by reference to exemplar case studies of both asset owners and asset managers that combine strong historic performance and attractive cultural attributes. The study of these exemplars suggests that there is no single best practice for culture. Excellent culture can take different forms but its complex DNA among investing institutions generally depends on five factors:

- **Purpose and drive** – this is often highly reflective of ownership and incentive structure; its client-centricity versus self-centricity factor is critical
- **People ethos** – where respecting personal development wishes, encouraging maximum creativity, facilitating collaboration opportunities and personal recognition are all critical.
- **Excellence** – with uncompromising expectations for performance, quality and consistency.
- **Integrity** – where innate respect, openness, support for diversity and ethical orientation are present.
- **Distributed leadership** – how leadership involves serving others with wide empowerment and effective networks.

Cultural traits are enabled by incentive structures, change capability and, critically, leadership. Leadership overlaps on many cultural points but uniquely defines the distributed power in leadership and the leadership courage that strong culture requires. Strong culture is mean reverting – it is likely to drift into a lesser (milder) state without highly focused actions by leadership to maintain it.

The cultural differences between asset owners and asset managers are most evident in the client-centricity area where asset managers have, over time, been increasingly drawn to more self-centred values in response to commercial pressures. This paper argues that the future sustainability of the asset management model requires much better trust between asset owner and asset manager. The research describes the characteristics of the idealised 'professionally cultured firm' that, through strong empathy to client interests and outcomes and clear alignment to the asset owners' needs, is in a position to develop that trust.

One surprising part of culture is that while there are various positive attributes needed for good culture, having too much of a good thing with culture can become a bad thing and the trick is getting to an optimal 'sweet spot' for each.

Culture is deeply embedded and so responds weakly to unsystematic attempts to alter it, but culture can be changed successfully through change processes particularly, by using organisational transformational methods; by reworking organisational design, including the layout of where power is distributed; through compensation redesign and helping people understand what is important through incentives, and most critically through leadership where leaders influence through example and by introducing change.

The research

Previous research supports the importance of culture and leadership in all enterprises, particularly in people businesses. For example, Kotter and Heskett (1992[1]) show the causal link from good culture to both firm results and client results. The link from bad culture to destructive results is perhaps even clearer – think Enron and others.

The study of culture starts with a clear definition and understanding of its linkage to leadership.

Culture	Leadership
The influence on an organisation's thinking and behaviours from shared values, beliefs and expectations	**Influencing an organisation to achieve its shared goals through strategy, motivation, incentives and development**
Value added by culture. • Aligning values and beliefs; establishing expectations and trust • Capturing the power of communication and engagement • Building focus on the important things while reducing uncertainty	Value added by leadership. • Developing values and beliefs; setting vision and direction • Building organisational muscle – including alliances and providers • Building culture and team spirit; setting expectations and incentives

The most commonly used definition of culture was coined by Marvin Bower – 'It's the way we do things around here'. At one level this is effective in conveying the essence of culture in describing the norms of behaviour. But a full definition needs to explain *why* things are done that way (mostly about values and beliefs) and *how* things are done that way (mostly about leadership and incentives, also about governance and management). For culture to add value it must be turned into action.

Where Schein (2009) describes the factors present in good culture among corporations, in this current research the author investigated the special factors characterising culture among institutional investment organisations. This is timely research given the much increased focus on culture by regulators and in the discussions about finance being to the benefit of the many, not just the few.

While the subject of culture in asset management has been considered in this industry over many years (Urwin, 1990[2]) and was well covered by MFS in their recent research monograph (MFS White Paper Series, 2014[3]), the scope here breaks new ground in two areas – the integration of culture into the institutional investor's strategic roadmap and consideration of the special case of asset owner culture.

Asset owners are generally profit-for-member entities while asset managers are profit-for-shareholder entities. The ownership models of organisations turn out to be quite significant in culture formation through the explicit and implicit incentive structures that go with each model. In this area some differences of culture are clearly evident. But in many other areas the taxonomy of culture is very similar in both groups.

The research method used considered a wide range of institutional exemplars of good practice to build a coherent view. In all cases, these organisations reported on their culture in public disclosures, which were represented as forming part of their value propositions to stakeholders. This narrative was used in the research to build a basic understanding of these organisations' culture. But more importantly, the research included discussions on culture with leadership figures at these organisations centred on how participants perceived their own culture. This identified what their culture looked like, how strong it was (how it was positioned in alignment and consistency), how it synced with strategy (how it delivered strategic value) and how leadership worked with it (how their efforts amplified its effects). The author also had the benefit of having worked with all these organisations over extended periods.

A total of 20 organisations were sources to the thinking in the study – 10 were asset managers, 10 were asset owners. These are listed in the Appendix. The author is indebted to them for their valuable insights.

> "If I had six hours to cut down a tree, I'd spend the first four hours sharpening my saw."
>
> **Abraham Lincoln**

Framework

The missions of the institutional investment organisations we are studying are all concerned with producing investment performance. Our framework for asset owners considers how those performances are produced, which in our model separates the enablers from the investment process. This is deploying the 'governance budget' and applying it to the 'risk budget'.

The governance budget (see Clark and Urwin, 2007[4]) is made up of four elements:

- Organisational design and process (the structure, resources and processes employed in decision-making)
- Culture and leadership (the key top-down influences driving organisational behaviours)
- Talent and reward (the key bottom-up influences on the organisation)
- Value chain (the system by which the internal and multiple outside agents are configured, the features of in-house and external activities)

The risk budget is also made up of four elements:

- The optimal risk framework and risk allocation given stakeholder wishes and requirements
- The investment strategy as to where that risk is best taken in asset allocation and what are the expected return consequences
- The manager allocations and their return consequences
- The portfolio construction (piecing together the actual portfolio)

I make this point about framework here because it positions culture (and leadership, its 'cousin') as a *critical enabler* to the risk budget decisions that ultimately determine the investor's return.
The lag in this process is apparent. Any work undertaken to change culture today helps to create a better cultural condition in the future (maybe a year later), which supports better decisions on the risk budget then and better returns further into the future (maybe two or three years after the change).

The framework for producing returns is an institutional design question that can be helpfully considered in an ecological context – how can the multiple organisations from different locations be combined successfully (Clark and Monk, 2014[5])? The full framework we use to address this question maps an institutional investor from its mission and beliefs system through its enablers to its investment strategy decisions as illustrated in **Figure 02** on page 17.
The strong temptation is for investors to concentrate on the main action in disc 3. Arguably, the main comparative advantage is marked out in disc 2 and in the culture in particular.

The thinking above relates to asset owners. A similar flow is appropriate for asset managers if the business strategy (products, distribution, marketing, pricing and so on) is substituted for value chain.

'Good culture'

Excellent culture is likely to combine a *strong* culture with a *value-adding* culture. In strong cultures, individuals have shared values and beliefs and work and act in a similar way. In value-adding cultures, the culture aligns with the strategy to deliver value in the mission. Through both these lenses, we believe culture is a cohesive and aligning force that coalesces individuals and their actions into an effective framework at an organisational level.

The study of our exemplars suggests that there is no single best practice for excellent culture because of the range of contexts and complexities involved. Culture's complex DNA generally groups into six core factors which form the base of what I term a *culture profile* in **Figure 01** on page 17:

- **Purpose and drive** – this is often highly reflective of ownership and incentive structure; its client-centricity versus self-centricity factor is critical.
- **People ethos** – where respecting personal development wishes, encouraging maximum creativity and facilitating collaboration opportunities are critical.
- **Excellence** – where there should be uncompromising expectations for performance, quality and consistency in standards.
- **Integrity** – where innate respect, openness and a no-blame approach, support for diversity and ethical orientation should all be present.
- **Risk ethos** – where the merits of managing risk successfully play out and where the risks and rewards of innovation, diversity and contrarianism play a part.
- **Long-termism and sustainability** – where preparedness to forgo current gains (or not) for better future outcomes well down the track is critical.

The list could be lengthened by two factors, which are strictly organisational design factors that reflect culture and also put culture into action:

- **Incentive alignment** – the design and practice of performance management and compensation to support the employee value proposition.
- **Change orientation** – the design and practice of strategic and tactical actions to adapt and re-position the organisation by undertaking change actions.

Two more factors describe the leadership imprint on culture. This extends the culture profile to 10 points:

- **Distributed power** – personal empowerment, servant leadership or unselfish leadership, working with the benefits of a network more than a hierarchy
- **Leadership courage** – diversity of input, preparedness to act differently, strength in dealing with adversity.

The list of factors bears testimony to the dangers of stereotyping culture. Many descriptions of culture simply use the terms 'people culture' or, 'performance culture'. The complexity and interconnectedness of culture only yields insight when the culture language is expansive.

But long lists like this are difficult to get your head around. To leave a more memorable mantra, there seem to be two principal factors that are dominant in many of the most successful culture signatures. These are the purpose and drive of the organisation and its people ethos. I call these two the 'culture keystones'.

In the discussions with the exemplars in the study, the people ethos cluster was present in all cases. But purpose and drive only figured significantly among the asset owner group.

'Performance culture' was a term used by many organisations but it did not appear clear to the author quite what this was – some mixture of excellence and purpose was implied.

There are some elements of how culture evolves over time that are not widely understood. First, strong culture is mean reverting – it is likely to drift into a lesser (milder) state without highly focused actions by leadership to maintain it. All organisations that have grown strongly would have been at risk from this pull to the mean. In our view, culture is innately slow to build but quicker to degrade.

Second, the normative attributes needed for good culture can have limits. These attributes can become counter-productive in excess. There are institutional investment firms (but not among the exemplars) that are the walking wounded on this point. Having too much of a good thing with culture can become a bad thing and the trick is getting to an optimal 'sweet spot' for each. Put in other terms, the culture profile has to be considered contextually in an interconnected way and have holistic balance.

The question may be asked why it is helpful to spell out an organisation's culture under these headings. The answer seems to be a fairly basic one: that the simple discipline of thinking through these attributes is a value-adding experience. It is not an onerous process; we have prepared a simple culture profile tool to take on such a review. In undertaking such a process an organisation is able to add a significant measure to its key performance indicators (KPIs).

What would you do with the results of such a review? The classic way to use such a review is a gap analysis. You can think of a matrix of 10 attributes down the page. You complete the matrix across the page: there is the current 'as-is' positioning in the first column, an alternative preferred state in the 'to-be' column, some action steps that would help the organisation towards that 'to-be' state in the third column.

How is culture changed?

The short answer to how culture is changed is 'slowly'.

Using the short-form view of culture defined as 'the unwritten rules governing the way things are done round here', it is clear why it takes time to understand, let alone change. Culture is deeply embedded and so responds weakly to unsystematic attempts to change it. But it does respond over time if the approach taken is systematic and focused.

Such culture change methods include; reworking of organisational design including the layout of where power is distributed; compensation and incentive design to help associates understand what is important; wider change processes, particularly organisational transformation, and most critically through leaders walking the walk and talking the talk – the leader's influence will be through their personal example, their insights, their communication in the organisation and by introducing change.

> "Culture is deeply embedded and so responds weakly to unsystematic attempts to change it."

Cultural traits are developed and changed by incentive structures, change capability and, critically, leadership. The idea that leadership overlaps on many cultural points is self-evident but there are critical cultural components in how power is distributed (which links to people ethos) and how leadership exhibits courage (with its links to risk ethos). The full cultural signature includes these leadership points as described on the Exhibit.

So what about leadership?

Leadership in our research is *influencing an organisation to achieve its shared goals through strategy, motivation, incentives and development*. This influencing is from person to person.

Leadership's influence starts with how they use incentives. 'People respond to incentives, the rest is commentary' is the one line economics definition. To obtain better culture, we need good incentives to nurture that culture. Leadership is the catalyst for this. Leadership effectiveness involves setting and bringing to life those incentives. Think here, amongst others, of the power of 'well done' and the power of the 'freedom to perform'. Talent craves recognition and interaction with great colleagues allied to opportunities from autonomy, mastery and purpose (Pink, 2011[9]).

Core leadership roles include, building organisational muscle, ensuring that the organisation and its individual managers are accountable, and being the carriers and developers of the culture.

Leadership should also be at work in setting direction and managing change. Leaders can only do this with deep understanding of the whole context of the organisation (not easy) and by determining the causes of dissatisfaction and the limits to trust (not easy again). They will generally need to recognise the desirability of change, regardless of current performance, and take responsibility for deciding on the goals of a culture change effort and articulating a new set of values and behaviours (not at all easy). The opportunities for leadership influence, for better and worse, have never been greater.

Distributed power increases leadership influence. It is desirable that leadership roles are played by many – and leadership opportunities often reside outside the top hierarchy. Any associate stepping out of their core role to make a difference to the wider organisation is adopting the role of a leader.

The personal dimension of this leadership challenge is critical. If leaders are to be successful in carrying and developing culture, they need to be strong articulating and curating the values and behaviours desired as well as living them themselves. Associates are very sensitive to the tone at the top, and this has been widely recognised by regulators.

The leadership model of the past was built around the principles of *command, control and coerce*. The workforce's cultural response to this was in tune once but this is no longer the case. A change in the wishes of the workforce, and particularly the talented upper layer, has made this inappropriate. The principles that describe good leadership practice today would be *distribute, devolve and develop*. And leaders need to have a much more direct relationship with the workforce, which is captured in their ability to *empathise, engage and empower*.

Why does culture go wrong?

As a general observation about current times, failures of culture are quite frequently observable in the asset management sector. Such failures are never of the scale of Enron perhaps but indicative nevertheless of a decline in core values. And the value most commonly in decline has been the value of being client-centric.

The decline in the cultural condition of some parts of the asset management industry is observable in various ways, notably poorer results net of costs and instances of misalignments with client interests and breakdowns in trust.

One dimension that is troubling is the limited authenticity and integrity in how asset managers may present themselves. The tacit and deferred nature of the institutional investors' offerings invites the risk of a 'saying-doing gap', that is, the organisation says one thing but does something entirely different; it describes the expected outcome but delivers a very different outcome. The all too common breakdown of trust is generally associated with this gap.

Certain declines of trust have been part of a trend for a while. There are three instances. The first is that the priority-setting principle for associates within an organisation – putting client first, employer second, yourself third, in that order – is under challenge.

There has been an apparent shift in values through the self-centring trend of many asset management firms over the last 20 years, embraced in a rise in commercial self-interest over professional interest. Commercial interest is favouring the firm; professional interest is favouring the client.

There is also the time compression trend in which shorter-term pressure on financial performance has been at the expense of longer-term value-adding actions. Significant value-adding activities often have lags and uncertainty in their pay-offs, both of which are all too easily discounted in a quarterly capitalism world. When the measure, quarterly earnings, becomes the target, the measure's value degrades (often referred to as Goodhart's law). The short-termism human gene, described by Andy Haldane (2010[7]) at the Bank of England, is pervasive and insidious, and carries its mark in the cultural signature of many institutional investors. The challenge of good culture here is to reframe and review the short-termist psychological reaction, or to collectivise the behavioural response as the bias becomes more surmountable at a group (or organisational) level.

> "The challenge of good culture here is to reframe and review the short-termist psychological reaction..."

The third issue is the increasing specialisation in siloes that has become part and parcel of the organisational design of asset managers. The budget pressures on these siloes produces a focus on within-silo outcomes. The across-silo actions, where considerable value often resides, are rarely easy to measure and the priorities are to favour the measured over the meaningful. This accounting and budgeting culture has made collaborative cultures more difficult.

Fair cultures versus blame cultures

The secular pressure on organisational performance that has produced short-termism is generic to all for-profit entities. In one area institutional investment organisations are especially exposed. It concerns attributing results fairly on the basis of the merits of different associates' and teams' skills and competencies.

Investment decisions involve considerable uncertainty and competition, producing equivocal accountability (the decisions and compositions of teams change over time), limited controllability (high noise to signal), and significant hysteresis (clear outcomes only emerge with a lag). These factors are not unique to investment organisations but they are arguably uniquely strongly exposed to them.

The culture and practices of the institutional investment organisation exist on a spectrum:

- Contextual focus (preference to build a narrative and a fair and rounded picture of performance context, what you might call a culture of trying to be 'fair').
- Crude results focus (the results are all that matters, performance context is not considered, what you might call a 'blame or credit culture').

The difficulty with the 'fair culture' is exactly that – it is difficult. Considerable work is required to build the performance attribution and narrative process and embed it in cultural practice, including the compensation arrangements. There is an example of the performance narrative in Panel C on page 15. And the natural cognitive process even in investment firms is to expect the performance figures to be meaningful. The phrase 'the proof is in the performance' is widely used and believed in investing but is highly suspect. Performance can never prove anything in the complex adaptive ecosystem we are part of as investment professionals; at best it is a source of a small amount of information about skill.

The blame culture – only the results matter – is simpler but there is evidence that it is unlikely to be successful. Some evidence for the poor outcomes arising from blame cultures are given in Hsu, Ware and Heisinger (2014[8]): 'We find that blame is strongly associated with a variety of undesirable firm attributes and can be predictive of poor stakeholder outcomes for investment organisations.'

Do all asset management firms need a client-centred culture?

The research focus on professionalism leads to attention on the firms that emphasise the 'soft' aspects of the partnership of interests for both clients and associates. Such organisations might be mischievously called the 'softies'.

The research also shed light on firms that travelled a different cultural path to success that was not client-centred but instead performance-driven and self-centred.

Almost every firm benefits from a high-performance cultural focus reflecting:

- A focus on excellence and a passion for good investment performance
- Success with attracting and retaining great people, a focus on the 'people edge' necessary for consistently good performance
- incentives that reward good performance

Some organisations may try to build a more extreme version of this culture which puts this performance orientation well ahead of other values. This goes with an ownership model in which senior professionals benefit from their own performance edge – particularly evident in the GP ownership model. The culture is hard-nosed and self-centred. These organisations are the 'selfies' of the investment industry.

There are challenges in making this successful and sustainable: the skill has to be authentic and exceptional, client loyalty will be limited ('live by the sword, die by the sword' principles apply), and the benefits of having a large compensation pool to allocate get dissipated by the problems of allocating fairly and on merit. There are also the dangers of excessiveness highlighted earlier.

How does compensation play a part in culture?

Culture and compensation should be aligned. The 'pay for performance' design used by most asset managers is meant to contribute to this alignment but it is far from clear how well this works in practice.

The first thing to mention here is a good news point. The very high levels of compensation in most areas of the investment industry do make attracting and retaining good people a whole lot easier. So continuity of key people is reasonable in the industry and culture is improved by virtue of this. There is a parallel bad point. The fairness in allocating these high levels of compensation is not easy in the time-varying conditions that organisations encounter. Speaking as a generality, many compensation allocation processes are not meritocratic.

The foundations for good compensation are related to strong HR practices in making sure associates have clarity of responsibilities and accountability for outcomes. This extends to the performance management disciplines which investment organisations generally struggle with. Practical problems with paying for performance are apparent in most cases:

- Performance only emerges slowly and reflects a wider team effort – the compensation design for performance awards, deferral and attribution is difficult.
- Performance always carries risk, which introduces hazards in incentive and inequity in reward.
- There is less inclination to reward work that advances enablers and effective investment policies – even though this is the work that delivers future performance – because it is hard to measure and attribute.
- Perfect alignment of compensation to meet all interests is not possible; compensation will always have an element of rough justice, as it cannot exactly reflect fairness when it incorporates outcomes with limited controllability.
- Compensation linked directly to performance will tend to overpay in aggregate (problems of optionality) and pay inequitably (problems of noise).

The incentives laid down by this compensation approach are superficially appealing but under examination are often toxic. They do produce a focus on performance but generally it is a focus on short-term performance. They can generate selfish, not collaborative, ways of working. They can reinforce a culture that resorts to blame all too easily.

The obvious omission in concentrating on realised investment performance is not making the measurement of service performance part of the formula. In the development of processes that capture 360 degree inputs, the direct use of client assessment seems very apposite.

The compensation practices in variable pay of asset owners are generally more qualitative and less formulaically grounded. But asset owners compete for talent with asset managers and so mimicry of asset management compensation practice seems to be growing.

Compensation design remains a highly controversial field, where there are widely differing and competing arguments. From an incentives and culture perspective, there is room for more enlightened design that drives 'performance from pay' by rewarding contributions to the enablers of performance.

"Asset owners compete for talent with asset managers and so mimicry of asset management compensation practice seems to be growing."

How do other incentives play their part in culture?

In most investment organisations the employee value proposition (the 'alliance' between employee and firm, also termed the 'give and get') is not dominated by compensation. Associates are influenced by motivations from more intrinsic sources.

Intrinsic motivations vary widely. Most organisations have recognised the value of personal development, personal recognition according to merit and the benefits of great colleagues who are mutually supportive. The Dan Pink 'surprising' set of motivations – autonomy, mastery and purpose – have particular resonance for investment organisations (2011[6]).

One other investment-specific aspect of incentive lies in career advancement. Organisations will have a natural ability to retain their strongest performers if they are effective with career advancement and can differentiate a lot on the pace at which people progress through the levels. This is also about how well leadership opportunities and responsibilities are given. It is also evident when firms have given individuals variety of roles, leaving them satisfied in multiple stretch situations rather than leaving them stuck with limited growth. 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?'.

"The strengthening of the employee value proposition reinforces the implicit and explicit incentives that drive individuals' contributions to the organisation's mission."

In a Towers Watson research monograph (Are Your Interests Aligned or Maligned, 2011[9]), the thesis is advanced that in theory organisational alignment is more likely to be secured between managers and clients with performance fees, co-investment and employee ownership. In each case there is a link at both the organisational level and the employee level. With performance fees, many investment firms allocate performance carry to senior associates; where investors invest in their own products, financial interests coincide, and firms with employee ownership, particularly partnership organisations, create certain commonality in purpose and cohesion. The research does point out that the degree to which these principles are practised in the industry is limited.

The strengthening of the employee value proposition reinforces the implicit and explicit incentives that drive individuals' contributions to the organisation's mission. Such actions have direct impacts on the client value proposition that is at the centre of success for all investment organisations. There is a flow to this thinking.

Getting asset owners to a better place with their asset managers

The cultural differences between asset owners and asset managers are most evident in the client-centricity area, where asset owners have not been drawn into more self-centred values in response to commercial pressures. This is in part due to the fact that there are no direct revenue and profits.

The sustainability of the asset management model requires much better trust between asset owner and asset manager along with a stronger value proposition. At present the limits to trust result in far too high a turnover of manager mandates. This poverty of trust is leading asset owners to reconsider the value chain. This is causing more assets to be allocated to passive mandates, in-house mandates and smart betas where the asset management roles are diminished.

This research puts a focus on what the characteristics of an ideal partner might be that enable this greater trust. For self-evident reasons I term this the 'professionally cultured firm'.

The model of the professionally cultured firm seems to work for both asset manager and asset owner if it has these characteristics:

- Mission – culture/strategy coherence that uses a deeply held system of investment beliefs and values (with a self-aware view of comparative advantage) to derive strategy and integrate the culture, embedding the ethos of 'clients come first'.
- An integrated employee value proposition that attracts, retains and develops talent including balanced compensation design and practice.
- An integrated client value proposition in all products and services – products that do not stand a realistic chance of adding value should not figure. Capacity limits are a key part of this idea.
- Adherence to ethical and excellent practice – the essence of which can be captured, I would suggest, in the adherence to the CFA Asset Manager Code[10].

The key dimension here is the opportunity for the professionally cultured firm that accepts some short-term investment as a route to long-term business and client success.

Asset management firms aligning with these attributes are likely to be trustworthy, sustainable (that is, unlikely to change much in the near term) and well-suited to the assignment of long-term-oriented mandates and patient capital.

Asset owners with these traits should build strong bonds with both their beneficiaries and their outside managers.

Getting asset owners to a better place with their sponsors

The unique organisational characteristic of most asset owners is that they have a sponsoring entity that finances the deal for their beneficiaries. In the case of the defined benefit pension fund, the sponsor's position is particularly important: while the formal position of asset owner is with the trustee board, the sponsor is represented significantly on that board.

The cultural impacts and implications from this relationship are, in some cases, critical. We can easily see how significant this is in the world of public sector pensions. The spin-off is large, starting with the inherited public sector culture that is associated with bureaucracy and process and proceeding through inherent weaknesses with flexible compensation in such institutions. Asset management as a creative intellectual capital entity will not gain much cultural richness from its sponsor in these cases, but quite the reverse.

Some asset owners may have a chance of having their culture enhanced by the sponsoring organisation, but in most situations this is not the case and cultural strength and value is actually detracted from this cause. The particularly unusual aspects of investing and pension finance exacerbate this point. The widget manufacturer that has developed great domain knowledge and control over their results in a high signal-to-noise industry may not find it easy to accept the exact opposite situation in asset management and its pension finances. This is one big reason why corporate defined benefit pension funds are threatened species.

Are there ways to offset this problem? The natural position to take is one of separating the entity, either in formal incorporation or by other means including physical separation. Such approaches are generally positive and can provide the latitude for organisational excellence to develop. Of course the investing entity will always meet the sponsor in the trustee board environment and in other situations where financing considerations arise. The cultural factors that come from these situations may still present issues.

Surprises in this research

There were some surprises in the research. The first surprise was that the organisations in our exemplars were not committing more resources to guiding culture. The over riding sense was an optimism that good culture would develop and be self-sustaining without significant management. Given that the research validated the premise that the cultural condition of institutional investors is more deeply embedded in future success than other normative attributes, and all discussants agreed with that premise, I expected more attempts to pro actively guide these organisations towards the best culture.

The second surprise was that the discussions on culture did not flow easily. While descriptions of good culture abound, they tend to use the stereotypes. The descriptions resemble the blind men discussing the elephant. To some the elephant was the trunk, to others it was the legs, to some it was the tail. The communications on culture did not yet seem at ease with the holistic grasp of the whole animal.

The third surprise was why asset owners were not giving the subject of the culture of their external managers more weighting in their hiring and firing decisions. Manager preferences have generally been based around *business – people – process*. Surely a better balanced scorecard might well line up *culture – business – people – process*. As an interesting historic footnote, Towers Watson's predecessor firm Watsons adopted culture as a manager success factor in the 1990s (see Urwin, 1990[2]) and the current firm have increased its weighting to a position where it has three factors reflecting 'competitive advantage' and three related to culture and the 'sustainability of competitive advantage'.

The author believes that even more weighting is desirable but such progress will require greater attention to the assessment of culture. There are really only two well-respected methods for assessing subjective business characteristics: direct assessment – use of an expert with inside access to multiple key stakeholders; questionnaire assessment with a stakeholder group considering various normative factors; a blend of the two has appeal.

An approach to doing this assessment would start by using these two methods on 'discovery' and 'profiling' before turning to the analysis of results.

1. The **discovery** process derived from a number of questions on an organisation's culture around what it is and how it is differentiated, how it creates an edge and how it is turned into action.
2. The culture **profiling** – the list starts with the purpose and drive of the organisation and concludes with leadership (see **Figure 01**).
3. The **analysis** that completes the assessment comes from three acid tests.
   - How *coherent* is the mission-strategy-culture mix? There are three principal spectrum issues: business versus client; talent versus team; crude results versus contextual (results are everything versus narrative matters). The coherence lies in having the culture align with the mission and strategy.
   - How well does *leadership* put culture into action? Strong, effective leadership provides the principal transmission mechanism for culture to be put into action.
   - How *sustainable* is the culture? Culture assessment has to be forward-looking to be of value.

Some conclusions

The research supports these very important points. First, culture is a unique ingredient in the recipe for competitive advantage. While business strategy and investment strategy can be mimicked by competitors, culture is very difficult to recreate. Second, there are ways for culture to be managed and developed over time. Third, by having a better assessment of culture, we can describe it better and afford it the respect it deserves, and critically we then have better KPI tools to manage it.

To conclude, I suggest what should be on the organisation's roadmap for further cultural change. The roadmap to become a professionally focused firm falls within this. Tangible actions that have surfaced to help move in this direction include these:

- The creation and communication to stakeholders of a culture dashboard measuring cultural condition.
- The revision of incentive compensation arrangements and the employee value proposition.
- The clear and authentic communication of the client value proposition – institutional investors need to express in accurate and realistic terms client and stakeholder expectations in performance and service.
- The trust audit and performance narrative processes.
- The place of a C-suite culture and talent officer to leverage the importance of the field (to professionalise the activity, not to absolve leadership collectively of their role in the field).

These areas add up to a build-out of the professionally focused firm as illustrated in Panel B on page 14.

We close by suggesting that the study of culture has far to go. There is room for more research to explore how the evolving pattern of the most progressive new economy companies like Google and Netflix will change workforce dynamics and motivations. The investment industry has not been subject to much change from these forces as yet, no doubt much more will follow.

More particularly, there is considerable need for cultural improvement in the industry. The obsessive preoccupation with investment performance over short-term periods has not produced any sustainable value. We measure what we do because we can. But we can measure more than what we currently do. The understanding and assessment of so-called 'soft' or intangible factors represent a key step forward for institutional investors. These are a source of considerable comparative advantage for those who recognise its increasing power and take the path of cultural improvement.

> "I came to see, in my time at IBM, that culture isn't just one aspect of the game, it is the game."
>
> **Lou Gerstner**

Panel A

The design of the trust audit

Working principles

- Trust in asset management is confident reliance by asset owner X on asset manager Y.
- Trust is mediated and moderated by perceptions of values, competencies and incentives/conflicts of Y developed through effective engagement between X and Y.
- Trust importance grows with risk, uncertainty and asymmetric information and understanding.
- Trust is part of the behavioural economics context for investment: Satisfaction = Perceived Outcomes – Perceived Expectations. Perceptions vary from reality given asymmetric understanding in particular.
- Asset owners' perceptions are best understood by asset managers through empathetic process.

  (Example: Humble Inquiry | Schein[11])
- **Trust = Trustworthiness of Y + Trustingness of X** – can be the basis of a trust audit and gap analysis as follows:

Trust audit

Trustworthiness Asset manager factors	Trustingness Asset owner factors
• **Values** – client-centric values are critical	• **Values** – some sense of shared values
• **Competency** – rating of AM's proposition	• **Knowledge** – of AM's proposition
• **Commitment** – intensity of client experience	• **Relationship** – prepared to commit time
• **Alignment** – to client interests	• **Alignment** – to AM's client value proposition
• **Transparency** – open disclosure of material factors	• **Results** – performance and quality

Panel B

The professionally cultured firm

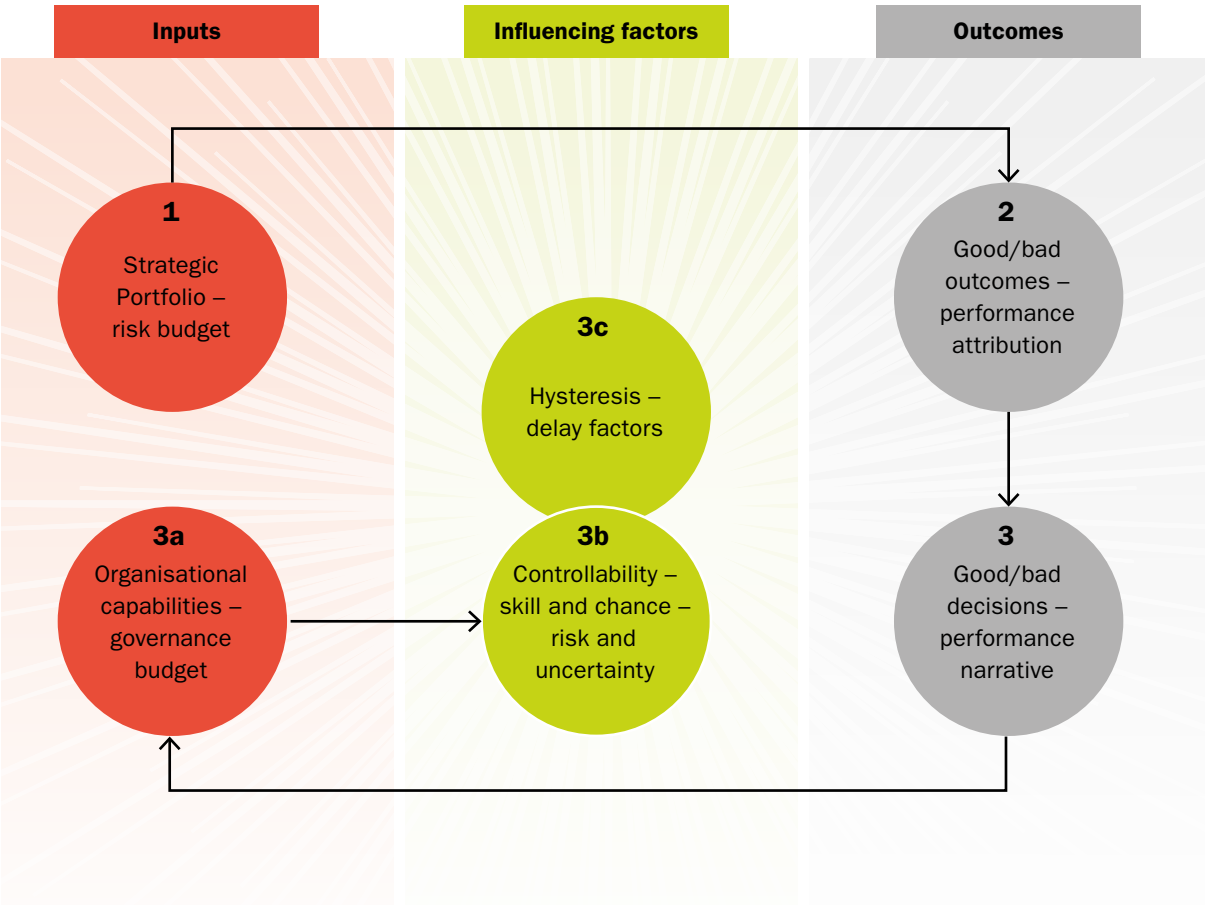
	The professionally cultured firm – An outline to the build-out
Mission – culture/strategy coherence	• Coherence developed through intensive mission – vision – values – beliefs process • The coherence and sustainability of mission and vision has great importance • Strategy elements are derived by aligning differentiating internal capabilities with the appropriate external market • Some organisations can be positioned through culture and leadership for longer-term client success, ultimately producing business success • Culture signature has positive orientation both with respect to strength and value-add under assessment model • Culture is developed by active management
Integrated employee value proposition (EVP)	• EVPs comprise extrinsic and intrinsic factors • Differentiation in EVPs often a positive factor • Individual needs include consideration of quality of leaders, bosses and colleagues, clarity and scope of development opportunities, and empowerment • Large intrinsic motivations from challenging work, individual recognition, growth in personal competencies and responsibilities • Linkage with business needs to define 'give and get' and 'alliance'
Integrated client value proposition (CVP)	• Realistic appraisal of value-added elements • Management of capacity limits • Fees subject to appropriate principles and limits • Client service intensively managed • Expectations managed actively • Client relationship management is critical

Adherence to ethical and excellent practice	• CFA Asset Manager Code[10] considers the organisation's delivery of these six points
	  • Act in a professional and ethical manner at all times
	  • Act for the benefit of clients
	  • Act with independence and objectivity
	  • Act with skill, competence and diligence
	  • Communicate with clients in a timely and accurate manner
	  • Uphold the applicable rules governing capital markets

Panel C

Performance narrative

Steps in process			Responsibility for step
1	**Strategic portfolio and actual portfolio**	Allocations to risk budget Portfolio construction	Chief Investment Office function + Investment function
2	**Outcomes**	Good/bad outcomes – performance attribution	Monitoring and risk function
3	**Narrative**	Good/bad decisions – performance narrative	Monitoring and risk function + Chief Investment Office function
3a	**Organisational capabilities?**	Which responsibilities and accountabilities were called on? *Team effort or not?*	
3b	**Controllability?**	What chance factors were called on? *Lucked in or out?*	
3c	**Delayed emergence?**	What further outcomes may emerge with a lag? *Jury is in or out?*	



Acknowledgements

The following organisations contributed their time and insights to the research as culture 'exemplars'. The author is extremely grateful for their valuable input.

Asset managers	Asset owners
AMP	**ADIA**
BlackRock	**Barclays**
Coronation	**British Airways Pension Scheme**
Fidelity	**British Telecom PS**
First State	**CalPERS**
Investec	**Future Fund**
MFS	**New Zealand Super Fund**
Schroders	**PGGM**
SSgA	**Railpen**
Wellington	**Wellcome Trust**

Discussion agenda with exemplars

1) What is your organisation's culture? Describe it in brief by reference to three or four points of differentiation.

2) How would you rate your organisation on the strength and value-add in its culture?

3) What edge does your culture give you in its impacts on your clients?

4) What edge does it give you in its impacts on your organisation?

5) How do you balance the different interests competing for your priorities: your personal interests, your team's/people's, your shareholders', your clients', your wider stakeholders'?

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Figure 01. Outline of culture signature

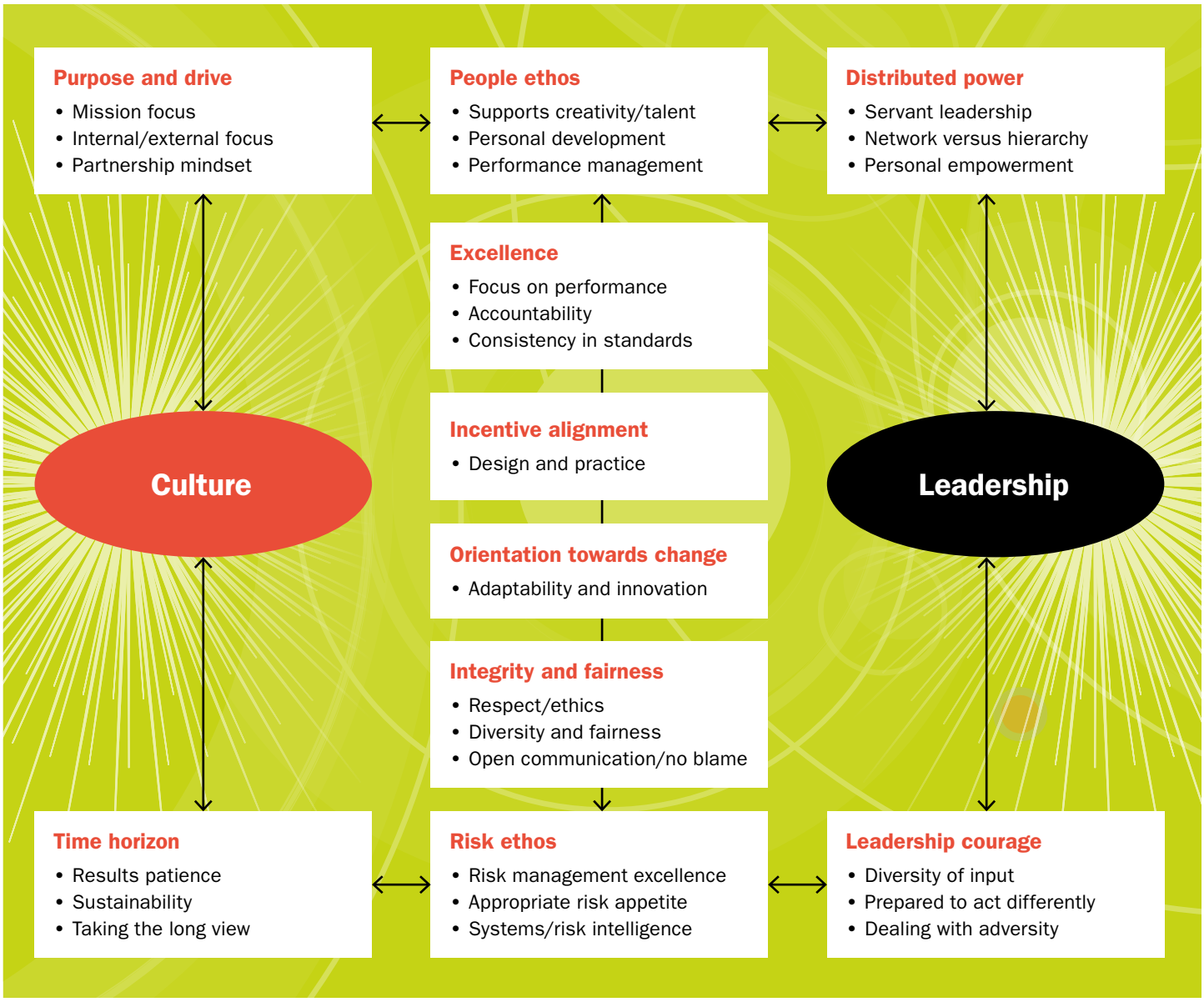

Figure 02. Organisational mapping of institutional investors

Further information

For further information, please contact your Towers Watson consultant, or

Roger Urwin
+44 1737 284849
roger.urwin@towerswatson.com

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71 High Holborn
London
WC1V 6TP

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