

The Impact of Culture on Investment Performance

Over the years of researching asset managers in South Africa and globally, there have been many cases of successful asset managers who have seemingly fallen apart, lost assets and faced uncertain futures. This deterioration often happens quickly and without warning. We spend significant time analysing whether there is a common thread running between these firms that face collapse. Is there any specific factor or common denominator that we could focus on which would allow us to identify those asset managers in advance and avoid them?

Examples of factors used by many to identify issues within an asset manager are things such as prolonged poor performance, a key member of the investment team leaving the business or high levels of turnover in the investment analyst team. The challenge is that these issues normally occur after the situation has already deteriorated. They often happen as a result of the collapse rather than being the cause, therefore using these factors to identify problems means it is already too late and the negative performance impact has already been felt.

Based on our analysis and experience of researching managers, we believe the most common factor driving long term success or failure of an asset management firm is the culture of the organization. This is why we spend so much time when assessing a fund manager trying to understand the culture of the firm, and how that culture impacts on decision making.

Investment Edge

During our due diligence process, we always ask the asset manager what they see as their unique edge: What makes them stand out from other asset managers? How do they believe they will deliver a superior outcome for the end client over time? It is a question that the vast majority of managers struggle to answer, and invariably the answer will include one or more of the following:

- Being independent or having an owner mentality
- Differentiated investment philosophy
- Quality of the research or the investment processes
- Strength or experience of the team

We would agree that all of these are important elements to the success of an asset management business, however we would question whether these factors give them a competitive advantage over the long term given that many firms will also tick these boxes.

In our experience, the edge for many of the best firms is the culture of the firm and the positive impact that the culture has on decision making throughout the business. After all, you can have the best research process in the world, but you still need to make good decisions when implementing investment calls in the portfolio.

David Fisher, Chairman of the Capital Group, one of the most successful asset management firms of all time, put it succinctly when he said, “our only competitive advantage is culture”, and [Charles D. Ellis](#), wrote in his book “[Capital: The Story of Long-Term Investment Excellence](#)” that “Successful firms do flourish by holding fast to fundamental values: sticking to the right path; taking the long-term view; and insisting always on quality and excellence. In the long run, culture dominates”. We would agree.

The Problem with Culture

So if culture is so important, why do many asset managers struggle with it? Asset managers are often hesitant to talk about culture, preferring to spend time strategising about remuneration schemes, or team roles and responsibilities. This is not surprising given that the stereotypical portfolio manager is cynical and analytical, and culture is difficult to define and measure. Culture is often viewed as an intangible in a world dominated by facts and figures.

We think Mitesh Sheth defined culture well in his 2014 paper entitled “The essential C-word in investment management”:

“Culture is embedded in the unwritten rules colleagues tell new joiners – ‘this is how things are done around here’ or ‘we have always done it this way’. Culture is a set of repeated habits, rituals, narratives and expectations that govern how people do things in organisations, and are based around the inherent values of decision makers. Culture is a control system that carries the behavioural norms that must be upheld, and determines the social consequences for those that do not stay within the boundaries.”

There is also no one perfect culture that can be identified and then replicated. Culture is an evolving concept that is specific to each asset management firm. However, we would argue that there are a number of elements of culture that are tangible and reasonably easy to identify as either positive or negative. It is not a perfect science, but there are certainly common traits that are identifiable in asset managers that have struggled or face collapse, as opposed to those that flourish.

Elements of a Positive Culture

Examples of cultural traits that create a positive environment for decision making are:

Trust: Trust is at the core of any high performing team. Trust is believing that other members of the team have the team’s interest at heart and that your contribution to the team will be supported by others. It is a belief that all are looking for the best possible outcome from the decision making process. Unless there is a sufficient amount of trust in a team or firm, the other behaviours mentioned below will not evolve. In an environment with no trust, a member of the investment team will generally not feel safe being honest with their opinions.

Introspection: The best investment teams have members who are open to feedback from anyone and will use that feedback constructively in improving decision making. They welcome introspection about the process and about themselves as opposed to being defensive. They want to learn and see what they can do better next time to ensure an improved outcome.

Honesty: Good investment decisions come from investment teams where individuals are willing to say it as it is, to be honest and share their opinions without fear or favour. Differences of opinion based on different experiences is essential to balanced decision making, and the culture in the firm is crucial in whether these differences of opinion are welcomed or frowned upon.

Accountability or taking responsibility: A culture where each individual is accountable for their part in the process also leads to better decision making. Each member of the team takes responsibility for their actions that lead to a specific outcome, and does not try to take credit for others work or pass on any errors.

The flipside of these examples of a positive performance or decision making culture occurs when fear is rampant in an organization. People are naturally fearful and when threatened, our ability to think and perform is greatly reduced. Instead of being curious and wanting to learn, we constrict and want to win the argument. We want to be right. In an investment team, this generally leads to poor decisions over time.

We are often asked how one identifies these traits of culture during a due diligence process. There are times when a culture of fear is easy to identify : when meeting with an investment team, the team members constantly look at the dominant leader in the team before answering a question as if to ask permission, and then again once they have finished answering to check whether the answer meets their approval. Similarly there are obvious signs of a lack of debate in a team when the dominant leader talks over the top of everyone else and doesn’t let the rest of the team respond to any questions, displaying a lack of trust in their ability to answer the question well. Sometimes identifying a positive or negative culture is far more difficult, and relies on experience and spending more time with the team.

In Conclusion

Asset management is complex and in the most part driven by marketing. The glossy exterior can often hide what is really happening behind the scenes. At some point, the reality of challenges faced inside the business through an embedded poor culture will come to the surface often with disastrous consequences for the asset manager and its clients. While it is difficult to identify these underlying issues, we believe that many clues to identifying potential disasters lie in trying to understand the culture of the firm and how that culture impacts on their decision making.

data provided by Reuters and Datastream

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	4.5%	-1.7%	15.0%	6.7%	11.1%	9.8%	10.5%	14.6%
FTSE/JSE SA Listed Property	ZAR	-2.2%	-21.4%	-9.9%	0.9%	6.7%	16.0%	14.1%	14.8%
SA All Bond Index (ALBI)	ZAR	-3.8%	4.0%	10.2%	7.8%	7.4%	9.8%	7.8%	7.7%
SA Cash Index (SteFI)	ZAR	1.8%	3.6%	7.3%	7.3%	6.7%	6.9%	0.2%	0.5%
Balanced Benchmark	ZAR	4.9%	1.0%	12.4%	7.8%	10.9%	10.6%	6.8%	8.8%
SA Inflation (1 month lag)	ZAR	1.3%	2.8%	4.4%	5.3%	5.4%	5.5%	1.3%	1.3%
GLOBAL MARKET INDICES									
Global Equity (MSCI World)	USD	1.9%	0.8%	11.7%	9.1%	10.6%	6.9%	10.0%	16.0%
Emerging Markets Equity (MSCI EM)	USD	-7.9%	-6.5%	8.6%	6.0%	5.4%	2.6%	14.9%	22.2%
Global Bonds (Barclays Global Bond Index)	USD	-3.4%	-0.9%	1.9%	2.8%	1.1%	2.1%	5.3%	6.5%
Global Cash	USD	0.6%	1.1%	1.8%	1.1%	0.7%	0.7%	0.2%	0.2%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	4.5%	-1.7%	15.0%	6.7%	11.1%	9.8%	10.5%	14.6%
Global Equity (MSCI World)	ZAR	17.9%	11.5%	16.8%	13.6%	17.9%	13.0%	13.4%	14.5%
Emerging Markets Equity (MSCI EM)	ZAR	6.6%	3.5%	13.6%	10.4%	12.4%	8.5%	12.3%	15.4%
SA All Bond Index (ALBI)	ZAR	-3.8%	4.0%	10.2%	7.8%	7.4%	9.8%	7.8%	7.7%
Global Bonds (Citigroup)	ZAR	11.8%	9.7%	6.6%	7.1%	7.8%	7.9%	12.3%	14.6%
COMMODITIES									
Gold (US Dollars)	USD	-5.5%	-4.0%	0.6%	2.3%	0.6%	3.1%	14.2%	18.1%
Gold (Rands)	ZAR	9.4%	6.3%	5.3%	6.5%	7.3%	9.0%		
CURRENCIES									
Rand / Dollar	ZAR	15.7%	10.7%	4.6%	4.1%	6.7%	5.8%	13.8%	16.7%
Rand / GBP Pound	ZAR	8.9%	8.1%	6.3%	-1.8%	3.7%	1.5%	15.3%	15.7%
Rand / Euro	ZAR	9.8%	7.6%	7.1%	5.8%	4.4%	2.6%	12.7%	13.3%

Spot Rates		3-Jul-18	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US\$	Rand	13.72	13.71	13.19	9.93	7.30	6.14
Rand/GBP	Rand	18.08	18.10	17.40	15.05	14.47	10.04
Rand/EUR	Rand	15.98	16.00	15.56	12.90	11.40	-
RATES							
Libor 6m \$	US\$	2.47	2.47	1.45	0.42	3.12	5.78
Repo Rate	Rand	6.50	6.50	7.00	5.00	12.00	20.53
Prime	Rand	10.00	10.00	10.50	8.50	15.00	22.25
All Bond Index Yield	Rand	9.24	9.17	9.42	7.32	-	-
COMMODITIES							
Gold (\$/oz)	US\$	1,301.83	1,301.83	1,243.92	1,387.92	942.90	295.65
Platinum	US\$	903.00	906.00	910.00	1,455.00	2,075.00	364.00
Oil (Brent Crude) \$	US\$	76.54	77.09	47.74	103.03	141.37	12.38
INFLATION							
SA Inflation	%	-	-	4.6	5.5	11.8	-

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