Willis Towers Watson PODfolio_episode_5_
The role of culture in asset management

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SPEAKER 1: Welcome to The Podfolio, Willis Towers Watson's investment podcast series, where we'll give you an update on the latest developments across global markets and talk to expert guests on hot topics that matter to institutional investors and their portfolio.

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LOK MA: Hello, and welcome to The Podfolio podcast. I'm your host, Lok Ma. And with me today, we've got Luba Nikulina, who heads up our Global Research function. So thank you very much for your time, Luba, and welcome to the show.

LUBA NIKULINA: Thank you, Lok. It's a pleasure to be here today with you.

LOK MA: And Luba and I are going to be talking about culture at asset managers. So how can the managers set themselves up to make the best possible investment decisions? And for me, this is very much an extension of my conversation last time with Josh Hall, who headed up our Operational Due Diligence team. So the ODD team go into the asset managers and examine their processes. And what they're looking for is potential failures of process, bad things happening like counterparty failure or exposure to cyber risk.

So for me, ODD is about preventing bad things from possibly happening. And today's conversation is very much kind of flipping that idea on its head, and thinking about what are the good things that asset managers could bring, where can they add value. And I think most people would say that an asset manager adds value by making good investment decisions. And central to that idea, I think, is the concept of culture.

So Luba, before we start, I think the word culture could mean different things to different people, and even in different situations. So for example, I'm Chinese and my wife is English, and we often talk about how the differences between our cultures influence the kind of decisions that we make, so like the way we handle our children, for example. So in the investment context and thinking about the asset managers, what is your definition of what culture means?

LUBA NIKULINA: It's a very good question to start us with, Lok. And the word culture is probably one of the most overused and also misunderstood terms out there. So it's very important to get the definition right and, when we go and assess assets managers and their culture, actually be on the same page of what it is that we are actually assessing. So when we think about culture, we usually think about shared values and beliefs in the organization, and their collective influence on how this organization thinks and behaves. So this is our definition. There is a simpler way to define it. It's the way we do things around here.

LOK MA: And how wide is that definition of culture? If I think about culture and an asset manager, I might be thinking about things like workplace culture, so things like we have a relaxed dress code or we work flexibly or we're generally very nice people. Does your focus include wider things like that, or is it quite narrowly defined in terms of the decision-making process around investments?

LUBA NIKULINA: At the end of the day, we are trying to get to good investments made by our preferred managers, but we do think that the key for their success in the longer term and in a sustainable basis is their culture. And when we do the assessment, we actually include all those things that you described. So dress codes, flexible hours, this all will be included in our assessment. However, to give our people the toolkit and the consistent framework when they go out and assess different asset managers, we had to come up with a framework.

So the framework that we use, it includes three key pillars. When we talk about culture of assets managers, we cover client value proposition, the way they treat clients, alignment. Hugely important. Their employee value proposition. And this will include the dress code, flexible working hours, but it will also include incentives, development opportunities for people. So a number of things related to employees. And then the third but probably the most important one is the quality of the leadership. And leaders will be the ones who will shape culture, manage it, and also enable the way the organization works with clients and treats its employees.

LOK MA: Right. I think let's go through some different examples of culture of the asset managers. And I'm afraid I'm the kind of person who's probably more naturally drawn towards the bad examples. So let's go through some bad examples first, Luba. And probably because I like a bit of gossip. So on your travels, are there any kind of particular examples of bad practice in that cultural sense that have maybe kind of alarmed you, or maybe even shocked you a little bit?

LUBA NIKULINA: There are plenty of those. Plenty of those, Lok. Well, considering that we look at the whole universe of asset managers, and there are 100,000 out there, and we only pick up 1% out of this whole universe, and we do culture assessment on those who have already passed this bar, by definition, when we do a deep dive on culture, we will usually deal with the best in class there. So there are definitely plenty of shocking examples out there in the asset management industry, but when we do our work, it's usually much more nuanced.

And I would like to give you an example. I wouldn't call it a bad example. I would call it an example that is quite common and unfortunate. As our industry is trying to grapple with the whole diversity and inclusion, it's quite interesting to observe because many of our managers get the diversity point and actually trying to do something about it. And there are a number of examples I can think of, at least a handful, where they're basically saying, OK, we get it, we need diversity, we go out and hire someone diverse. And it often means a woman.

And they bring a senior woman in, and they actually even include her in the investment committee, the decision-making, but guess what? Diversity doesn't work without inclusion, and inclusion is much more challenging to create, especially in our industry that is so full of dominant personalities. And then guess what? You're actually making things worse rather than better, and this diverse person is not able to make it home, and she or he leaves. And it's not good. You've actually made a step back rather than making a step forward.

LOK MA: So that was kind of an example of maybe kind of more dodgy cultural practices of asset managers. Can I just get a sense of how important this area is to you relative to other areas of kind of the investment processes? If you were to give somebody a bad score, I guess, fail them or downgrade them within our rating system, roughly-- very roughly-- what kind of proportion of those fails would be on the grounds of poor culture? Or is it something that doesn't normally feature very heavily?

LUBA NIKULINA: No, it features very heavily. And the reality is that most organizations that we decline without taking a deeper look, we'll probably see immediately that it's just the alignment is not that, and hence cultural characteristics, they are just not something that even deserves our time to do deeper due diligence. Now, there are situations where we would do the full due diligence. And then what we currently do at the end is we engage with senior leaders for a few hours into the conversation around their culture.

And this is where you're really getting under the hood. And the probability of success, having done 200 to 300 hours of investment due diligence, is that we actually are likely to be comfortable with their culture. But guess what? I do have examples where, at the end of this process, we have actually realized that leaders do not think about how to manage the culture of their organization in the right way, where we can gain comfort that it's going to be sustainable on a going forward basis.

And what we do, we usually try to make an assessment today that this organization is going to be the right partner for our clients for years and years ahead. And you asked me, so how would you rate culture compared to everything else. Well, it's much more important than everything else. It's just so much more difficult to assess than everything else.

LOK MA: Yeah. And so let's kind of look to the positive, then. Luba, can you just give us some examples of particularly good bits of cultural practices that you've come across? Maybe especially things that have developed more in the recent years that you've seen?

LUBA NIKULINA: Absolutely. Well, maybe the first thing that I wanted to mention, Lok, is that no single culture is the same, so you don't have-- it would probably have been easy if we had a template saying, oh, this is how a good culture looks. No, it doesn't work like that, unfortunately. Or fortunately, because it gives those investment firms who are thoughtful about it an opportunity to differentiate themselves. But then there are some common trends, and especially the more recent ones that you alluded to.

So culture doesn't really like excesses. So good culture is about balance. And we spoke about leadership. And this is where there has been a noticeable evolution. If I think just 10 years ago, having an investment firm, which is pretty much around one man, usually man, was the common practice. And we ourselves were getting comfortable with a guy with a [INAUDIBLE] and him being able to make great investment decisions because the whole environment, the markets, they were different.

Now, the markets are so fluid and so complex that, in order to ensure that your investment decisions are indeed robust, you do need to have teams. It cannot be about just one guy. You need to have diverse and inclusive teams. And this means that, as a leader, you really need to balance between two extremes.

On the one hand, as a leader, you need to be strong and confident, and provide the future direction for your team. But then on the other hand, you also need to be humble and also need to ensure that you are very open-minded and able to harvest this opportunity of having the diverse team offering you a variety of views. And this is where good cultures tend to gravitate towards nowadays.

LOK MA: Fab, fab. And right, here is a bit of a philosophical poser for you.

LUBA NIKULINA: Oh, OK.

LOK MA: Because I've been thinking about this for a bit of time, that the idea of diversity is obviously hot news at the moment within the investment world, but just more widely in the kind of professional world. And to me, diversity in this context, you've got two possible meanings. So people are talking about the need for diversification, as in in the investment portfolio, you want to invest across a range of different asset classes so that, overall, your portfolio outcome is more stable. And we had a conversation with Craig Baker a couple of weeks ago where we talked about how we continue to see the diversified approach as a good thing to adopt, even at this point in the market.

And then there's this other concept of diversity, which is, for me, involving people from different backgrounds in kind of collective decision-making so you have a more rounded view and you don't miss any important angles. And I buy into both of those concepts. I'm just trying to get my head around the interaction between those two things. And this is me maybe being a devil's advocate a little bit here.

Is there an argument that, actually, in my portfolio, I want one manager who has a kind of type of culture that you don't necessarily agree with? So for example, why don't we have one manager which is really run by this kind of one person, dominant personality making the big calls. I think you might describe it as kind of a cult of personality kind of setup.

And why don't we have another asset manager which is mostly run by women in the senior positions, because they might come up with different types of decisions. And then averaged across the portfolio, you get that good level of diversity. Are you inadvertently narrowing down the managers that you would invest in into a specific type with the kind of image of culture that you're looking for? And does that actually detract from the overall level of diversification?

LUBA NIKULINA: It's very philosophical, Lok. I would even call it existential, your thinking. Existential because, when we assess cultures, we really think about those firms, how successful they're going to be in the longer term, and indeed are they going to exist as an independent franchise, as a successful organization. And this is where a bad culture gives us a pause, because you wouldn't want something where you assign a lower probability of the longer-term success.

And what I described about leadership or what you and I discussed about diverse teams, which by the way, those firms that are managed just by women are equally non-diverse as the ones that are managed just by men. So we want to have the real diversity there. So they just have a higher probability to make better investment decisions and be successful businesses in the longer term.

Now, I do take your point about having different cultures as part of the diversification of your portfolio. And this is where I will go back to my point, then, no single culture is the same. They all have different cultural DNAs. And if you think about our experience when we go to a massive global multi-asset class investment organization, the cultural experience is really very different for us and for their employees and for their clients compared to what you get from a boutique firm that focuses just on one small strategy and have, I don't know, 5, 10 people working for it. Very different cultural experience. And guess what? We have both in our clients' portfolios, as long as we can get comfortable that culture is healthy and going to be successful in the longer term.

LOK MA: Got you. So I think what you're saying is the investment world is big enough that we can still avoid the bad examples while still kind of preserving the level of differences across different styles. So yeah, I absolutely agree with that. Let's bring this conversation around culture back to kind of current events a bit, as well, if I may. So obviously, we're working under very unusual conditions at the moment. Most of us are working from home. Do you have a view as to whether certain types of asset managers with their own cultures, whether some of them are coping better than others under these conditions?

LUBA NIKULINA: Yeah. Well, I think I would firstly like to acknowledge how fortunate we are as an industry, both us and asset management, that we can actually do our work virtually, connect with clients, connect with each other, move money around, and do it all from our homes. That's not the luxury that every industry has. Now, in terms of asset managers' preparedness towards this crisis and this change, quite clearly those who practiced flexible working arrangements in the past, they were so much quicker to transition to this new arrangement. But that was pretty much the only differentiator.

So when I look at our lineup right now, it took a week or two, depending on where you were in your infrastructure arrangements and ability to work from home, but everyone is dealing with it quite successfully. If anything, the market events and volatility, they have probably had more of an impact, rather than the transition into this working from home and connecting virtually.

SPEAKER 1: And then here's my kind of usual silver lining question. There's a lot of talk about how, when we come out the other side of this COVID-19 crisis, that we would hopefully have learnt a few good lessons along the way about how we live our lives and, indeed, go about our work. Do you see any kind of positive developments happening, particularly those that might become permanent as we kind of come out of this extended period of lockdown?

LUBA NIKULINA: Yeah, no, absolutely. Well, I think one thing that I am noticing and I think is hugely positive is that our engagement on sustainability, ESG, climate change is becoming much more deeper. The awareness of it after what we have experienced in the last couple of weeks has just elevated to a completely different level. And I genuinely believe it's incredibly positive.

Now, that's definitely a change that I see. And it's going to be good for the industry and good for the world. Now, in terms of more practical arrangements, working from home is likely to become much more common. Connecting with each other virtually, rather than traveling to all parts of the world to be able to meet in person is going to become much more common. And it's so very positive, but we will need to see how it evolves over time.

So for now, my observation is that strong cultures, they have only become stronger as a result of this experience, and weaker cultures experience difficulties. But we have just a few weeks of observation. And because what we do involves talented people getting together and coming up with new, innovative ideas, and also servicing our clients, it remains to be seen how it evolves and how much of this is going to be virtual and how much of it will have to revert to in-person interaction.

LOK MA: And then I think that just underlines how important this focus on culture is. The current event is essentially a good way of proving that the right structures do bring benefits. Well, thanks very much for your time, Luba.

LUBA NIKULINA: Thank you, Lok. Your questions were great. I really enjoyed the experience. Thank you.

LOK MA: And I think it's safe to say that Luba touched on quite a few things that are probably big enough topics to warrant their own podcast. She mentioned inclusion and diversity, and I think I&D could warrant its own podcast. She also mentioned ESG, as well. And also the focus of today's conversation was very much around asset managers. I think we'd like to have another conversation about some of these principles and the way that they apply to asset owners. So for example, trustee boards for pension schemes, as well. But we hope, in the meantime, that the audience enjoyed our conversation today. And please do take care of yourself. Thank you very much.

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