

Investment Manager Diversity The Hardest Taboo to Break



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THIS CASE STUDY EXAMINES HOW ONE COMMUNITY FOUNDATION – SILICON VALLEY COMMUNITY FOUNDATION WITH ASSETS UNDER MANAGEMENT OF \$4.7 BILLION – APPROACHED THE ISSUE OF INCREASING INVESTMENT MANAGER DIVERSITY WITH ITS INVESTMENT ADVISOR – COLONIAL CONSULTING WHICH ADVISES \$30 BILLION OF CAPITAL. THESE FIRST-PERSON ACCOUNTS FROM THE COMMUNITY FOUNDATION'S CEO AND THE INVESTMENT ADVISOR PROVIDE CANDID ASSESSMENTS OF HOW THEY ADDRESSED THE ISSUE OF INCREASING INVESTMENT MANAGER DIVERSITY. THE HOPE IS THAT BY SHARING THESE OBSERVATIONS OTHER FOUNDATIONS AND THEIR INVESTMENT ADVISORS WILL FIND THE COURAGE TO DISCUSS AND ADDRESS THE ISSUE OF INVESTMENT MANAGER DIVERSITY, THE HARDEST TABOO TO BREAK.



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INVESTMENT MANAGER DIVERSITY – A CEO'S PERSPECTIVE

For the past 20 years, I have had the privilege and responsibility of leading two outstanding and very different community foundations. I served as CEO of The Minneapolis Foundation for nearly 13 years and am currently CEO of Silicon Valley Community Foundation, where I have served for over seven years. Through speeches, research and programmatic efforts I have been an outspoken advocate for the importance of diversity. This dates back to the late 1980s, when I was a program officer overseeing the Ford Foundation's U.S. and international grant-making programs related to philanthropy and the nonprofit sector. I also have served as Board Chair of both the Council on Foundations and the Association of Black Foundation Executives, as well as Investment Committee Chair of Blue Cross/Blue Shield of Minnesota.

I mention this background to emphasize that I have been immersed in discussions and efforts to promote diversity within philanthropy and the broader nonprofit sector for decades. Notwithstanding the usual pronouncements that permeate the foundation community about the importance of diversity, the statistics show that the CEOs and senior management of foundations and their boards of directors remain overwhelmingly white.¹

When diversity is the focus of attention, it is usually viewed as a project rather than an ongoing holistic assessment relevant to all operational aspects of the organization.² In recent years, issues of race and diversity have become even more difficult to talk about because of the widespread belief that America has entered a post-racial society and, as a result, any focus on race is inherently discriminatory.³ In this framework, the absence of diversity is inevitably viewed as a supply problem – the inability to find qualified people – rather than a systems issue – a problem with the process or criteria that intentionally or unintentionally favors one group over another.

Over many years, I have come to realize that moving the needle forward on diversity requires either a committed CEO or board champion. Without a commitment from one or ideally both of these organizational leaders, the natural inertia that exists to maintain the status quo is likely to prevent any change. There is perhaps no area where I have seen discussions of diversity get short-circuited faster than in the area of investment management. Time and time again, I have watched CEOs and board members who are champions of diversity when it relates to providing grants to diverse communities, recruiting diverse board members and staff and hiring diverse vendors turn silent when the topic changes to investment manager diversity.

I have come to believe that there are at least two reasons why attempting to diversify investment managers is especially difficult. The first is that investment committees of foundations and nonprofit organizations believe, and rightfully so, that their responsibility is to maximize returns to support the organization's mission. Unfortunately, the hidden bias is that some think that identifying a diverse pool of quality investment managers is somehow contradictory to the goal of maximizing returns. The unstated and incorrect assumption often operating is that since investment management is complex, it is unlikely that there are qualified firms that are managed by people of color. As a result, it is mistakenly assumed that a focus on hiring diverse firms will result in compromising investment returns.

The second reason that diversifying investment managers is difficult is that the oversight of the investment portfolio requires specialized expertise that neither the CEO nor the average board member is likely to possess. As a result, board members and senior staff are likely to defer to the recommendations of the external investment consultant about identifying and selecting the best investment managers for the foundation's portfolio. Because of these two factors, investment consultants hold considerable influence in the process of determining the investment managers that are identified for consideration, reviewed and eventually recommended for inclusion in the foundation's investment portfolio.

The central role of the investment consultant in the manager selection process makes it essential that every investment advisory firm has a process that does not inadvertently make it difficult to identify and review the performance of investment firms owned or substantially led by people of color. Without a positive recommendation from the investment consultant, it is highly unlikely that a CEO or board champion can successfully diversify the investment managers in the foundation's portfolio.

For any CEO to raise issues of diversity with regard to any area of operations is a calculated risk. Discussions of race are not easy topics to manage and, at most foundations and nonprofit organizations, the performance review of the CEO is unlikely to have promoting diversity as a major goal area. It is because of this that having a board champion can be critically important. For a CEO of color, venturing into discussion of diversity can be especially tricky and complex. A focus on diversity can be viewed by others as putting personal motivations above institutional interests. Especially at the start of their tenure, CEOs of color must first establish their bona fides and fidelity to the foundation's mission after which they can use that trust and credibility to raise issues of diversity. At times, so much effort

is expended tackling diversity with regard to the board and staff composition and community initiatives that there is little energy or goodwill left to raise issues of diversity with regard to investment manager selection.

When I arrived at Silicon Valley Community Foundation (SVCF) in late 2006, my entire focus was to execute a never before attempted mega-merger between two of the largest community foundations in the U.S.⁴ In that chaotic environment, and as a newcomer to the community, my singular goal was to make the merger successful. Diversity issues were an important but secondary priority. As we transitioned from the merger, I began to lay the groundwork about the importance of diversity and inclusiveness, which are two of SVCF's core values. With the support of board and staff members, we began with a focus on programmatic diversity and slowly turned inward to board and staff diversity. Every year, SVCF's board is provided with a report on our year over year progress on staff diversity, which is a process that I instituted at The Minneapolis Foundation.

In 2011, SVCF reached the point where I felt we could engage in sustained discussions about investment manager diversity of the community foundation's then \$2.0 billion in assets under management. I began conversations in both open and executive sessions with the Investment Committee about the importance of diversity and inclusiveness as core values of the community foundation and how we had engaged in this work in other areas. I also held private conversations with our investment consultant, Mike Miller, Managing Director of Colonial Consulting. It helped that Mike and I have known each other for over 10 years.

In discussions with Mike and SVCF's investment staff, I began to ask: Why don't we have more investment manager diversity? In the beginning, the understandable explanation was that SVCF had inherited the investment portfolios of our merger parents, which were not particularly

diverse. As time passed and we began the inevitable process of terminating some investment managers and adding new ones, I continued to ask why we were not seeing more investment manager diversity for our consideration. The response was that there were really no managers of color in the spaces where we had needs, and who had the history and track record of performance to meet SVCF's criteria. I was assured in both private meetings and in meetings with the Investment Committee that diversity was a value that Colonial Consulting shared with SVCF. Given my prior history with Mike, I didn't doubt that this was the case, and yet we weren't making any headway.

And so, at an open session of the Investment Committee I asked Mike if he would examine, and share with SVCF's Investment Committee, Colonial Consulting's historical track record in recommending diverse investment management companies to all of Colonial's clients. Mike readily agreed to this idea and thought that this would be a good process for his firm as well.

Several months later at a regularly scheduled Investment Committee meeting, Mike reported that to his surprise and dismay, notwithstanding the staff diversity within his firm, Colonial Consulting had not recommended nearly the number of diverse investment managers to their clients that he would have hoped for or guessed. As a result of their review, Mike and his colleagues are instituting new policies and procedures that I believe will not only benefit SVCF's desire for greater investment manager diversity, but also will benefit the many other foundations and other clients that Colonial Consulting advises. Only time will tell if this new approach results in more investment managers being recommended for consideration. We will, of course, continue to monitor our progress in this area and make other adjustments as warranted.

I asked Mike if he would be willing to publicly share this story with others, fully expecting him to say no. It is a testament to his strong personal commitment to issues of diversity that without hesitation he said yes. My hope is that together our stories will encourage more CEOs to ask their investment consulting firms difficult questions about investment manager diversity. Specifically, foundations should regularly ask their investment consultant firm to report on how many diverse investment management firms they have recommended to all of their clients, including the foundation. I also hope that all investment consulting firms will have the courage to follow Colonial Consulting's example by examining their own track records in recommending diverse investment managers. By doing so, they will demonstrate that they see no inherent dilemma between promoting diversity and recommending high performing investment management firms.

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AN INVESTMENT ADVISOR'S PERSPECTIVE

In the course of Colonial Consulting's nearly thirty four year history, we have been able, through a combination of skill, hard work and luck, to assist our clients with the prudent and productive investment of the capital that has been entrusted to them. I have had the privilege of working at Colonial for just over 27 years and have been able to watch how the consulting industry in general and our firm specifically have evolved.

Back in 1986 when I joined the firm, we had nine employees and nine clients. Today, we are fortunate to have more than sixty exceptionally talented people who have chosen to work at Colonial. With a client list that totals just over 127 (117 of which are nonprofit organizations) and reflects over \$30 billion of capital under advisement, we are proud to work for many great organizations comprised of remarkable individuals who serve on their Boards, Investment Committees' and staffs. Included in this group are several who have entrusted us as their advisor for more than thirty years.

As advisors, one of our responsibilities is to identify and assess investment management firms. As such, we must be students of human nature and the qualities that tend to generate long term success. A common trait amongst outstanding organizations and people is a willingness to look inward and attempt to understand their own strengths and weaknesses. For Colonial, introspection allows us to learn and grow as advisors, a pre-requisite for contributing to investment excellence. In addition, we have also benefitted from the fact that our clients have long been willing to share their knowledge and perspective, thereby leaving us with the fairly simple task of listening.

When Emmett Carson began asking questions regarding the diversity of Colonial's manager research effort, I, confidently indicated that we possessed two very important qualities that virtually assured that the playing field was level and that talent, regardless of race or gender, would be identified.

Our work is centered on assessing people and organizations on factors such as transparency, ethics, conviction, courage, etc.



First, through our pursuit of exceptional investment managers, we have long been convinced that it is important to identify firms in their early years when desire for success is arguably strongest and the capital they oversee is most manageable. In other words, smaller, younger firms without lengthy track records are embraced rather than avoided at Colonial. This is governed through a comprehensive assessment process that is intentionally geared to miss exceptional managers from time to time in order to avoid allowing mediocrity to infiltrate client portfolios.

Second, Colonial as a firm does not see diversity as a tangential issue. Rather, our work is centered on assessing people and organizations on factors such as transparency, ethics, conviction, courage, etc. To do this well, one must possess experience, good judgment and perspective. Better conclusions are possible when individuals with diverse backgrounds who share a common purpose combine their efforts. This view is deeply ingrained within our firm and has been utilized for many years as we have built a talented and diverse research team.

Returning to Emmett's question, measuring the ownership diversity of managers that we either vetted or recommended both turned up statistics that we found surprising and disappointing. How could a firm that embraces diversity itself and had no obvious structural impediments fall short? I must admit that we still cannot fully answer this question but that matters little.

Of far greater significance is where we go from here. Fortunately, the characteristics which we assumed to be important are just that – therefore, the distance we must travel is relatively short.

1) Our internal research database now includes fields that measure the diversity of a firm's ownership. Up until a year ago, we possessed this data through a 3rd party database. However, it was not a part of our own system and members of our team were not required to track this information.

2) We have formed an internal taskforce consisting of six members of our research team who are working to ensure that our process begins with a diverse set of managers to consider.

3) Leaders of the various research segments within our firm are being asked to be sure that their teams have considered diversity as they seek to explore the landscape of potential investment managers. This will be assessed annually with specific objectives in mind.

Note that we have not and will not establish goals for diversity amongst the small number of firms we recommend to clients. Given our view that diversity is far more likely to enhance rather than detract from the talent and me-

asurable success of an investment management firm, we see a straight line between improving the diversity of the opportunity set we consider and the diversity of the firms we recommend. This may not yield an immediate change in the composition of recommended managers. However, it will ultimately produce the outcome we predict and will also allow us to remain focused on our primary objective of populating client portfolios with only the most exceptional managers.

As we begin down this road, we are struck by how many difficult and interesting questions there are to consider. For example, is ownership the sole measure of diversity? What about the composition of an investment team or a firm's senior management? How should we think about publicly traded asset management companies? We have not yet determined how we intend to address these and other questions although we do know that the depth of our research allows us to avoid the simplest approaches and instead focus on the best ones.

Today, we also face a more pressing issue as many of the exceptional managers we have identified in the past have now grown to levels where they no longer can accept additional capital without compromising their results. As such, the need for us to identify future winners has never been greater. At times though, talent is not enough and smaller or newer firms need guidance as to how best to meet the demands of institutional investors.

To be clear, Colonial is not in the business of advising investment managers – instead, we work to identify talent and then look to ensure that these individuals and firms are able to contribute to the long-term success of our clients. As such, we believe that a more inclusive vetting process will allow us, in our own way, to improve the diversity of managers that others in the consulting and institutional investing industry may consider.

¹ State of the Work 2012: The Road to Great Diversity, Equity, and Inclusion in Philanthropy, (Chicago, IL: Rockefeller Philanthropy Advisors, 2012), http://www.d5coalition.org/wp-content/uploads/2012/05/D5_State_of_the_Work_2012.pdf.

² Emmett Carson, "Let's Stop the Craziness," afterword in Wit and Wisdom: Unleashing the Philanthropic Imagination, ed. Mark D. Constantine (Emerging Practitioners in Philanthropy, 2009), pp. 194-199. http://www.siliconvalleycf.org/enews-articles/may/ww_emmett_carson.pdf.

³ Emmett D. Carson, "Foundations and the Fallacy of a Post-Racial America: African American Men and Civic Engagement," (Little Rock, Arkansas, Clinton School of Public Service, March 29, 2013).

⁴ Janet Rae-Dupree, Tying the Knot: The Founding of Silicon Valley Community Foundation (Mountain View, Silicon Valley Community Foundation, October, 2011), <http://www.siliconvalleycf.org/sites/default/files/svcf-case-study-2011.pdf>.

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