Building Effective Relationships: Partnership

Fred H. Speece, Jr., CFA
Principal
Speece, Lewis & Thorson, Inc.

Managers and their foundation or endowment clients form a partnership with one common goal—successful management of the fund. Key to the partnership is that both sides understand the client's objectives, the client's spending policies, the manager's business plan, and the manager's investment approach. Other key ingredients to maintaining a successful partnership are mutual trust, communication, cooperation, sound business practices on both sides, and commitment to the chosen policies.

The relationship between the money manager and the investor client should be a partnership. Both parties have parallel needs and tasks involving long-term planning, the chosen investment approach, running a good business, communicating, and working together.

Stay with the Long-Term Plan

The client–manager partnership is based on carrying out the same task—management of the fund. For the partnership to work, the partners need to have and adhere to a long-term plan. These plans should be communicated to and understood by both partners.

Money managers must have a long-term business plan that addresses the amount of assets to be managed, the growth rate of the assets, the number of client relationships, and the number of products. They should explore these elements within the firm, agree upon them, and explain the plan to their clients and prospective clients. A manager's long-term plan is very important to clients. For example, a manager's growth pattern entails risks, particularly for existing clients. Rapid and/or significant growth can change the manager's ability to deliver the promised investment approach or services. For their own protection, clients should monitor their managers' adherence to the long-term plans.

Investor clients must also have long-term plans, and investment policy is a critical part of those plans. Foundations and endowments have long-term objectives for their organizations, and their investment policies should be constructed to achieve those objectives. Spending policy must be consistent with the investment policy, and investment policy must be consistent with realistic return expectations and the organization's willingness and ability to assume risk.

Managers need to understand their endowment/foundation clients' goals and policies, including their spending rules and other policies under which the clients operate. In addition, managers need to realize that their clients are spending funds under the assumption that the managers will meet the clients' investment objectives. The partners working together and focusing on these elements will increase the chances of success.

Stay with the Investment Approach

Trust is the foundation of the client–manager partnership, and at the core of this trust is adherence to the agreed-upon investment approach. At the beginning of the relationship, client and manager generally come to a "meeting-of-the-minds" about the investment approach to be used. This meeting-of-the-minds should establish a long-term commitment to the chosen investment approach, which is part of a larger strategy to meet the organization's investment objectives.

An investment firm should market only the investment approaches and products that it can deliver consistently. A manager hired to be a large-capitalization/value manager should not later turn into a small-capitalization/growth manager. Clearly, such a change is a breach of the agreement, and it may well have a negative impact on the fund because the role the client designated this manager to play has been abandoned.

Similarly, the client should not change the manager's role. If the client decides the current approach is no longer appropriate, the incumbent manager might be asked to provide an alternative. This approach is risky for the client, however, because the manager might not have the expertise to fill the new role.

A critical challenge to manager and client commitment to the investment approach comes during the inevitable periods when the particular approach is "out of phase." At such times, it is essential that *both* partners stay with the approach; assuming that returns revert to the mean, this phase will be followed by a period of very attractive returns to the chosen investment approach. Willingness to stay with the approach during difficult periods has a great deal to do with the investment acumen of the partners and each partner's confidence in the other.

Run a Good Business

The client–manager partnership is like playing tennis: The game is more enjoyable and better, for both sides, if both—as professionals—are at a similar skill level. Providing lead time for the other side to prepare for meetings or take actions is an important part of a successful partnership. Such lead time is particularly important when shifts in assets are concerned; providing the manager time to carefully execute a shift ultimately benefits the client.

Ethical and professional behavior on one side often spills over to the other. If the client (manager) is late for meetings, is ill prepared, does not understand the investment objectives/approach, or cannot explain them, the relationship will sour.

Communicate and Work Together

Effective communication is vital; without it, there will be no relationship. The basic principles of good communication are well known: State complicated issues in their simplest form and develop the conversation from there. Clear, candid, and honest presentations and responses are good forms of communication that build confidence. Lack of confidence will result in a poor, if not terminated, relationship.

Avoiding surprises is another good principle, particularly with regard to performance. The most dangerous manager is one who cannot explain good or poor performance. Managers must understand that an important part of their job is to help the foundation/endowment fund staff communicate performance and other information to the investment committee.

Managers as Extended Staff

Many foundations/endowments are understaffed, so managers can be helpful to these organizations in ways beyond delivering performance. The potential services vary with each situation but generally include asset allocation, budgeting, economic information, and investment policy.

The client must decide which managers have the repertoire of information, willingness, and skill to serve as extended staff. Equally important, each management firm should decide whether the firm can/should provide those services.

The Committee

The investment committee is the ultimate client. The committee is a very important, albeit somewhat unpredictable, part of the process. The manager and endowment/foundation staff must determine the most effective way to communicate with the committee, and the best approach is for the manager and staff to work together on this vital task.

Because foundation/endowment investment committees meet infrequently and the members are rotating volunteers, the manager should begin each meeting by *explicitly* reminding the committee of the manager's approach and role: "Our approach is . . ." or "You hired us to . . ." In addition, the manager should remind the committee of the agreed-upon target return or benchmark and time horizon.

A good committee has strong leadership, continuity, and a disciplined culture and process—the same attributes clients look for in a money management firm. A committee tends to be more emotional than its individual members; therefore, a disciplined committee culture and a focus on the long-term plan are extremely important. The committee leadership has the responsibility to develop this culture; the manager's responsibility is to understand this culture and work within it.

Final Note

Like any relationship, the client–manager partnership requires trust, mutual understanding, a common purpose, honesty, humility—and a sense of humor.