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HIGH-PERFORMANCE CULTURES: IMPOSSIBLE DREAM FOR PENSION FUNDS?

Thinking and Acting Like Goldman Sachs

The quote above comes from an article on Goldman Sachs (GS) in the most recent (April 29th) issue of *The Economist*. After marveling about GS's financial performance in such disparate areas as trading, asset management, principal investments, and investment banking, the article poses the question of the common thread to it all. In the end, the writer decides the common thread is GS's relentless high-performance culture. The foundations of this culture are highly demanding hiring and promotion processes, which in turn breed intense levels of energy and loyalty among high-performing GS employees. While the article doesn't explicitly say so, we would go further and say that this kind of culture can only be sustained by a senior management team that itself has a high-performance mindset, and by a board of directors that creates an environment in which it can thrive.

So what do these observations have to do with pension funds? Well, aren't trading, asset management, principal investments, and arguably even investment banking the primary activity areas of pension funds as well? And if GS can make a great deal of money in each of these four areas, why can't pension funds too? The paragraph above provides what we believe to be the answer. It is because the vast majority of

pension funds have not consciously set out to build a high-performance culture. Most senior management teams have not themselves lived it. Most boards of trustees have not created the environment in which it could thrive.

What difference would it make if pension fund boards of trustees and senior managements did choose to adopt and develop high-performance cultures inside their own organizations? We firmly believe that it would make a fundamental difference in two ways. First, it would directly improve the financial performance of pension funds themselves. Second, because of their sheer size, most of pension funds' available risk capital would be allocated to the 'principal investments' category (we have used the term Long Horizon-Risky or LHR investing in previous *Letters*). This in turn would lead to increased pressure from pension funds on the boards and managements of these LHR 'principal investments' to create sustainable competitive advantage and long-term wealth. As we noted last month, such a win-win 'upstream' development would close the virtuous 'pension fund socialism' circle Peter Drucker foresaw 30 years ago.

Can pension funds in fact choose to adopt and develop a GS-style of high-performance culture? Or is this an impossible dream? These are the questions this *Letter* addresses.