

CHAPTER 1

Non-Negotiable Integrity

“DO THE RIGHT THING.”

Before you are a successful businessperson, you need to be a person. By that I mean a certain kind of person—a person with strong core values and, most importantly, integrity.

It was my grandfather, Frank Russell, who was my first model of integrity, and that’s where my personal story begins.

Frank had worked on Wall Street, but decided to retire after the Crash. He came home to Tacoma in 1936 at the age of 58. My grandmother was sickly, so she and my grandfather, Frank, lived with us at times, or else in a nice house just down the block. Frank founded a mutual fund company called Bondstock, which you’ll hear about in Chapter 2.

Right now, I want to focus on the fact that Frank was present for me, throughout my childhood, on a daily basis. My father, George, on the other hand, was a workaholic. He ran several businesses, and puttered in the basement in his “spare” time. In fact, he was an inventor who accumulated more than 100 patents. The by-product of his work was that I ended up having Frank as my closest family influence.

And Frank was a man of integrity. I don’t mean that he preached it. He never lectured or indulged in parables or

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abstractions. We simply spent a lot of time together; all of it was what's now called "quality time"; and I came out of the family home with the experience of knowing an upright man whom I loved and respected.

Frank was also highly respected in the community for the way he conducted his business. After he died, I took over his business and his clientele. A lot of the investors in Bondstock were local people and one of them was a rough-looking, gruff-talking commercial fisherman, who wandered into the office one morning. Our receptionist found him so intimidating that she called in John James, a promising young executive I had recently managed to lure away from Bank of New York. John retired just a few years ago after more than 35 years with the company; as he tells it:

I came out and introduced myself. Without saying anything, this man reaches into his pocket, whips out \$15,000 in cash and throws it on the desk. He had just come back from fishing in Alaska. He said, "Invest it for me."

I said, "Where would you like to invest it?"

"Go ask George Junior," he said. "He'll know where I want my money." And he started for the door.

I called out after him, "Can we give you a receipt...?"

"If I need a receipt," he said, "this company's changed and I want my money back."

You can see why my grandfather became my first role model. He founded his business on trust and integrity, and I simply did my best to copy him.

Building Character

I met my second role model in high school. My parents sent me back east in 1946 to attend Philips Exeter. Prior to leaving, I'd been diagnosed with a heart murmur and counseled never to do anything that would get my heart rate up. That's a pretty stiff sentence for a 14-year-old.

Fortunately, when I got to Exeter, I landed in a dorm supervised by Robert H. Bates. Even back then, at the age of 35, Bob was a world-class mountaineer. He had helped to map the Canadian Yukon for the National Geographic Society and was the first to climb 17,147-foot Mount Lucania, which had been the highest unscaled peak in North America.

In 1938, Bob and his friend, Charlie Houston, put together an expedition to climb K2. That's the secondhighest mountain in the world and a more difficult technical challenge than Mt. Everest. Nobody managed to conquer K2 until 1954—a year later than Everest—and only 280 people have ever summited K2, compared to 10 times that many for Everest. Obviously, Bob and Charlie didn't succeed in 1938. But they got to within 1,000 feet of the summit before turning back for lack of adequate supplies of food and matches to melt drinking water.

Now, imagine what Bob must have thought when he first caught sight of me, a homesick 14-year-old who'd been told never to exert himself or get too excited. I was about to say "Bob took me under his wing," but it'd be the wrong metaphor. In fact, he pushed me out of the nest. He told me to go see Charlie Houston, who at that time happened to have a medical practice right there in Exeter. Charlie listened to my heart for about five minutes. Then he said, "Forget it. Go to work. Get busy. Do things."

That's exactly what I did. I joined the wrestling team—a sport I pursued with some success throughout high school and college. (My wrestling weight was 137 pounds.)

And, now that I had my "Get Out of Jail Free Card," Bob didn't waste any time getting me involved in mountaineering. Together we set up the Exeter Mountaineering Club. I was its President for four years, and what a terrific experience that was! Bob took us up to the White Mountains in New Hampshire and to the cliffs by the ocean. We learned all of the fundamental mountaineering skills, such as how to rappel and how to save a climbing partner if he happened to slip.

Looking back over the years, I consider my time with Bob as the cornerstone of my education. He pushed me out into the

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world with all its risks and challenges and, in doing so, introduced me to the rewards of proving yourself in the natural world and in competition with other people.

When you think about it, both mountaineering and wrestling test your integrity in unique ways. To climb a mountain, you either have it or you don't. Physically, mentally, you'll know whether you have the strength to take another step forward, or that it's time to turn around and head home. There's no possibility of cheating. When you succeed, your spirit soars and you gain confidence. When you fail, it's disappointing, but you gain experience. You establish a personal benchmark that you can try to exceed the next time. You understand that failure is not the end; it's the beginning of a new opportunity. As Bob and Charlie put it in *Five Miles High*:

Men who climb mountains go in humility to try their skill and knowledge against wind and cold, great heights and far distances. They know that the contest purges them of artificialities, returning them to their homes refreshed. Having faced life stripped to essentials, they can better appreciate and properly evaluate the luxuries of civilization.

Wrestling presents a different challenge. You pit your strength and stamina and wiles against someone who is as much like you as possible. The weight differentials in wrestling are usually only a pound or so at the most. There can be no excuses on account of your competitors' inherent physical advantages. There's no equipment involved and no teammates to pick up the slack or let you down. It's just you and the other guy. The umpire is right on top of every move, so it's virtually impossible to cheat. Does wrestling teach non-negotiable integrity? You'd better believe it.

Reach for the Summit

Mountains, and mountain climbing, have long symbolized challenges—such as spiritual quests and the attainment of excellence. Frank Russell Company is situated in the shadow of Mount

Rainier, so “the mountain” as we call it was the logical symbol for our logo, as well as our advertising when we finally got around to it.

For anyone in the investment management business, the summit is a nice metaphor for the goal of long-term investing. Individuals want to be able to maintain their standard of living in retirement, or whatever else they aspire to. For pension funds, it’s the ability to pay for employee benefits—to keep up their end of the pension promise. Foundations spread the benefits of health, wealth, culture, and so forth. And some university endowments have been so successful in their investment programs that they are, just now, acting on their ability to significantly lower, if not eliminate, tuition for many of their students. Wrap all of these types of clients into one package and you have the Frank Russell Company mission: *Improving financial security for people*. That’s the mountain we try to climb every day.

Surprisingly, wrestling also has an interesting analog in the investment business. As a consultant, our first assignment was to identify and select investment managers for pension funds. Back in 1969, when we started, it was typical for a corporate treasurer or CFO to simply call in whichever bank the company happened to be borrowing from and give them the complete mandate for investing the pension fund assets. In those days, it was a relationship-based system.

Our value proposition was that clients would benefit by moving to an objective, measurement-based system of choosing managers for their pension funds. To deliver on our promise, however, we had to invent tools that would allow us to accurately compare managers. It all seems obvious in hindsight, but we needed better benchmarks, style analysis, and performance universes.

Otherwise, it would be like asking a 137-pound wrestler to go up against someone in the 160-pound weight class. In other words, a large part of our contribution to the industry was helping to figure out the right “weight classifications” for managers: That was the only way we could decide who was really doing a better job.

In this respect, you could say that integrity wasn’t just a standard of behavior for employees—or “associates” as we always called

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them—but really the philosophical core of our business. Let me give you a couple of examples of how non-negotiable integrity was vital to the success of our business.

Our Business is Based on Trust

First I'll describe what it was like researching institutional money managers back in 1969. In those days, pension assets were concentrated in relatively few trust banks and insurance company fixed-income products. These were grand old institutions, where the bankers sometimes acted as though they were doing their clients a favor by accepting their money. Even a corporate treasurer at a blue-chip corporation, in charge of a multimillion-dollar pension, might have felt uncomfortable asking too many questions about process or performance.

Madelyn Smith, who was our first director of equity research, describes the scene when she began researching managers in London, where traditions were even more relationship-based than in New York, if possible. Madelyn recalls,

We would visit the Merchant Banks and they all had ornate dining rooms and their own chefs. They would serve a three-course lunch with wine and tell you that they had been in business for 200 years; that they had all these assets under management; that they were from very solid educational backgrounds. And they seemed to assume that we would, of course, recommend them to our clients.

After lunch we would try to carry on a more direct conversation. We asked questions that people of good breeding would never ask. We'd grill them about their investment process, and they agonized over giving us performance data. No doubt these Merchant Bankers thought we were brash Americans.

In fairness to the money managers, we were subjecting them to something they had never experienced before. Over time, many grew to appreciate the process and we'd start to hear comments like, "You understand us better than we understand ourselves."

But in the early days, it's easy to see why some firms might have been uncomfortable opening their doors to a virtually unknown firm that was requiring that they explain their trade secrets. That took a lot of trust on their part, as they knew we would also be talking to their competitors. Of course, the assets that our clients commanded were a significant enticement. But without integrity our business simply would not have worked. The managers had to believe that they would be treated fairly; that they would be analyzed on objective criteria; and, most importantly, that their confidential information would be scrupulously guarded.

Integrity also played a central role when we launched our investment management business. We understood that our core consulting clients might have concerns about our introducing a new area of focus, so I traveled and talked to each client, face to face. It took me three weeks to do that. I asked them what they thought. Most said that our knowledge of managers was our core bread-and-butter business and they understood why we would want to leverage that. Only three out of 40 said they were worried: "You will make more money in the funds business than you do in the consulting business and you will dilute your attention to us."

I gave them my word of honor that we would not do that. I promised, "I will come back five years from now and I will prove it to you." Of course, I went back more frequently than that. But five years later they were still clients and continued to be happy with the relationship.

In fact, our consulting business continued to develop over time. We expanded our roster *slightly*, to 45 major corporations, whose assets grew *phenomenally*—representing more than \$1 trillion in assets as of 2008. As the assets grew, so did the awareness within these organizations that professionals were needed on staff to fulfill their fiduciary responsibility. In 1969, only the treasurer was paying attention to the pension plan. Now these corporations all have major teams of highly sophisticated investment professionals.

Our clients' increasing ability to perform more of the work themselves changed the dynamic of our relationship. We knew

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Russell had to develop new capabilities that were of value for them or we'd never have a job. They would fire us. The Russell organization remained highly motivated to serve its consulting clients. Over time, we developed more sophisticated, better ways of selecting managers. We pioneered new asset classes, including international and real estate in the 1970s and private equity and alternative strategies in the 1990s. And we built a next-generation asset liability modeling system, capable of handling multiple time periods and different definitions of risk. Most of these innovations eventually worked their way into the funds, but the necessity of keeping ahead of the curve with our consulting clients was always the spark.

Now we can look back and take satisfaction in the fact that we've had 30-year anniversary celebrations with many of our original clients. But in 1980, the outcome was in doubt, and we really needed the support we received from our consulting clients, particularly when it came to dealing with the press. Some money managers whom we were researching for our consulting clients stated strong concerns that we would be competing with them in our fund business. Other observers felt it would be a conflict of interest for us to recommend managers to consulting clients and also hire the same or different managers as sub-advisors to our funds.

I explained to the press that, first, we did not recommend our own funds to the consulting clients, so that wasn't a conflict, and second, the managers in the funds were not paying us to get the assets—we were paying *them*. Also there was a significant difference based on the size of the pension fund: We made customized recommendations for the large plans that could meet the managers' minimums. The only way the smaller plans could access many of these managers was through our commingled funds.

Criticisms were floating around for about 18 months. But the fact that we had the support of the consulting clients enabled us to keep our heads up. I kept restating that there was no conflict and eventually people began to accept that. Again it boils down to integrity. We could never have moved into the asset management side of our business without the trust of our original clients.

Integrity is More Important than the Bottom Line

It's not enough to have integrity *most* of the time, because even a single exception can kill you. That's why I always talk about *non-negotiable integrity*. Strictly speaking, it's probably redundant. But in our world where everything, including values, is viewed in relative terms, I feel it's necessary to make it clear that integrity is *absolute*. It's either 100 percent or it's not integrity.

A panel I attended at the Economic Forum in Davos reinforced this point for me. One area of focus at Davos was Global Competitiveness. A panel of CEOs explored the topic: What are the characteristics that allow an organization to last—not just for decades—but centuries? Two of the companies represented were British Petroleum and Westinghouse—no strangers to controversy. I was fascinated to see the conclusion. The panel agreed that companies that paid most of their attention to the bottom line would fail. The companies that have the best chance of long-term success are the ones that are honest and accept a set of core values.

It's not hard to see why. The downfall of Barings Bank in 1995 was brought on by the illicit trading activities of a single employee. Over decades, Barings' executives had made thousands of business decisions and taken countless risks. As Great Britain's oldest merchant bank, they had financed the Napoleonic Wars and the Louisiana Purchase. But they couldn't survive dishonesty within.

Today, the press amplifies the consequences of any misstep or perceived impropriety. Bad news gets front-page treatment. The correction goes on page 14, below the fold. Former Labor Secretary Ray Donovan's rueful comment, "Which office do I go to to get my reputation back?" is simply a fact of life for anyone whose work is subject to public scrutiny.

Do the Right Thing

At Frank Russell Company, we felt that simply obeying the law wasn't enough and that industry ethics simply enshrines a herd mentality. We wanted to set the bar a bit higher, so, as part of

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our culture, we talked about “doing the right thing.” It’s closely related to non-negotiable integrity; you might say it’s the proactive version.

In the mid-1990s, Lynn Anderson was president and CEO of our investment management business. Lynn is a smart and talented executive, with a sense of humor as dry as the plains of Kansas where he hails from. We initially brought him in because of his tremendous leadership and fund operations expertise. Now he was in my office with a couple of members of his team, trying to sort out a difficult problem.

We had launched a real estate equity fund that was experiencing temporary liquidity problems tied to the market slump in the early 1990s. This was a unique vehicle at the time, providing direct ownership of commercial property in a commingled fund. Possibly some of the clients weren’t used to the format. In any case, the fund had a queue for redemptions, which we paid out whenever properties were sold. Some clients complained about their position in the queue; they wanted cash right away.

It took Lynn and his associates quite a while, a half hour or more, to explain the situation and the different options for dealing with it. Frankly, I barely listened to a word they were saying. I was thinking about Russia at the time—specifically, how would they handle the transition to a market economy?

When Lynn finished, I said, “Thanks for telling me that. Incidentally, if a reporter got wind of this, what would you want to see on the front page of the *Wall Street Journal* tomorrow?”

There was dead silence. They just got up and left.

Later, Lynn told me he got on a plane with a couple of checks, paid directly from our company account, that he hand-delivered to the clients. He said the amount of money wasn’t that significant, but it seemed to make a big difference to the clients. Lynn did the right thing.

As a side note, I’m not sure the clients in the queue did the right thing. When the real estate market turned around, as it inevitably would several years later, that fund performed like gangbusters.

Integrity Cannot Be Negotiable

We didn't have too many integrity issues during my time at Russell. As I said, we made it clear that integrity was non-negotiable. It wasn't three strikes and you're out. Our policy on integrity issues, things that could potentially affect the entire enterprise, was that you'd have one strike and that was it. It happened only once. One fellow had been with us for 15 years prior to his misbehavior, which wasn't something that a typical corporation would see as cause for terminating the person. But we did.

There was no argument from him; he knew it was non-negotiable. And we didn't make an announcement or publish it.

But word gets around pretty fast. And so you begin to build the expectation of a behavior pattern that includes a high level of ethics, honesty, and keeping things in plain sight—nothing's under the table.

This may sound punitive, but really our culture was very people-friendly in almost every way. As I said, we didn't have many integrity issues over the years. A large part of that had to do with the way we hired people. To succeed at Frank Russell Company requires a special kind of person. In the first place, our location in Tacoma is not for everyone. If you like the outdoors, particularly a bit of mountaineering or sailing, then you're in paradise. But if you're addicted to the bustle of Manhattan, you're probably not going to find a suitable place in the Pacific Northwest. So we always first brought people out here, so they could get a good feel for the place.

On our end, we also wanted people to get a strong exposure to the culture. So we'd arrange a series of interviews—as many as a dozen. We figured if you ran the gauntlet of that many people, you'd get a pretty good flavor of how we operate. At that point, you'd be either very excited about joining us, or wanting to get away—as far and as fast as you could.

So, a rigorous vetting process was the first step in indoctrinating associates into the Russell culture. But you can't just put it out there once and forget about it. We also knew it was important

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to make certain that the basic culture of the company was talked about on a regular basis by as many people as possible. We used to keep saying it in the hallways; we used to keep talking about it. Because unless you do that it will eventually fade away.

I no longer have any official role at Russell Investments, as the company is now known, but of course they're just down the street. Occasionally, someone in senior management will ask if I have any thoughts about how to run the company. When that comes up, I always advise them to make sure that the basic culture is talked about and believed by everybody. That's number one. And it's probably all they need to hear from me. The reason is that subscribing to core values is the best way to ensure the longevity of the organization.

Of course, there are short-term benefits as well. When you're part of an organization whose number-one rule is non-negotiable integrity, you're not worried about your colleagues—they're all honest people.

In fact, that might make a good academic project for you: See whether you can quantify the productivity advantage resulting from non-negotiable integrity.

Key Points from Chapter 1

1. Core values will sustain a company over time; focusing on the bottom line will not.
2. Integrity, the core value at Frank Russell Company, was central to our core competency of objectively measuring managers. We could not have built our business without it.
3. Integrity must be non-negotiable. One slip can ruin the entire enterprise.
4. It's not enough to simply obey the law. *Doing the right thing* cements relationships and is the best PR strategy.
5. Take the time to carefully vet new employees and make sure everyone supports your core values.