

## Investment Committees: More than the sum of the parts

Arnerich Massena, Inc.

October 2010

*Contributors:*

Tony Arnerich; Howard Biggs; Sheree Demers Arntson;  
Vincent Galindo; Jacob O'Shaughnessy, CFA;  
Jillian Perkins; Travis Pruitt, CFA

© 2010 Arnerich Massena, Inc. All rights reserved.

This material is for the general information of clients and prospective clients of Arnerich Massena, Inc. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Past performance does not guarantee future results. Readers should consult with a legal, tax, or accounting professional before acting upon any information or analysis contained herein. The investments and strategies discussed herein may not be suitable for all readers. Investors may be required to meet certain minimum financial qualifications prior to investing. The information within this document is drawn from sources believed to be reliable. However, no endorsements are made as to the accuracy of the information; we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material. This material may not be sold or printed for distribution without the express written permission of Arnerich Massena, Inc.





## Table of Contents

**Why investment committees? ..... page 3**

**Building a team, not just a committee..... page 4**

- The size of a committee*
- Diversity*
- Leadership*
- Voting and decision-making*

**Group dynamics..... page 8**

- Groupthink*
- Information sharing and confirmation bias*
- Social loafing and the Ringelmann effect*
- Group polarization*

**Group heuristics .....page 12**

- Representativeness and availability bias*
- Overconfidence*

**Committee correlation to portfolio results .....page 13**

- Ability to look forward*
- Openness to new ideas and information*
- Commitment to making use of member contributions*

**Consultative or discretionary advisory service? .....page 14**

**Conclusion .....page 14**

**Review of techniques to improve committee performance .....page 16**

**Endnotes .....page 17**

## More than the sum of the parts

*“None of us is as smart as all of us.”*

*- Ken Blanchard*

### Why investment committees?

Common wisdom is that decisions made by a group of people are better than individual decisions, particularly when facing the complexities of investing and asset management. In a group, multiple opinions and perspectives, as well as a potentially broad base of knowledge and varied experiences, can be brought to bear on any given issue. Thus it seems only natural to form an investment committee to take on the decision-making responsibility involved in overseeing assets. But research shows that it takes more than a collection of people to make an effective committee.

Whether or not a group’s decision-making skill proves superior to that of an individual has everything to do with both who is in the group and how the group functions as a team. Committees that lack diversity, fall prey to groupthink, or fail to adequately share knowledge are likely to make less-than-optimal decisions. On the other hand, a carefully constructed committee with team members who have diverse backgrounds but common values, a firm and effective leader, and clear processes has the greatest potential to optimize decision-making.

While a great deal of care and thought go into the investment standards committees use, the appointment of committee members can be based on politics, convenience, expediency, and/or other secondary concerns rather than in a deliberate consideration of differentiated and relevant skill sets and personalities. When the process for member selection is suboptimal, so too can be committee decision making. Investment committees steward trillions of dollars in assets, and their ability to function effectively as a team can have a tremendous impact on the performance of those assets. For this reason, it is worth applying intention and focus to committee structure and decision-making.

In this paper, we will discuss the potential pitfalls and biases of group behavior that can affect investment committees and explore how a committee can make the best use of its collective knowledge and diversity of experience. While much of the information to follow applies to any working group or committee, this paper is focused specifically on improving the effectiveness of investment committees. The terms “committee” and “investment committee” are used interchangeably throughout.

“Groups as decision-making bodies have been afforded a special status in society from at least the times of the early Greek civilization that developed democratic voting structures. This special status remains intact in most societies and cultures today. Legislatures decide which bills to pass into law; juries decide the guilt or innocence of defendants and the amount of damages awarded to plaintiffs; school boards decide how to structure the curricula used to teach our children; sales teams decide how to market new products; corporate boards decide which investments are warranted and which person should serve as CEO.”

*- Tindale, Kameda, & Hinsz, 2007*

## More than the sum of the parts

### Part 1: Building a team, not just a committee

It's easy to assume that if everyone in a group simply did their part individually, contributing as necessary and not overstepping bounds, that a team would function smoothly and efficiently. However, J. Richard Hackman of Harvard Business School and expert in group and organizational dynamics, points out that a team is not just the sum of its parts: "The best way to get individuals to behave well in a group is to do a good job of setting up and supporting the group itself." (Hackman, 2002) Choosing team members, establishing roles, and determining the team's structure all have a long-term effect on how the group performs its tasks.

---

"It's easy to get good players.  
Getting them to play together,  
that's the hard part."

-Casey Stengel

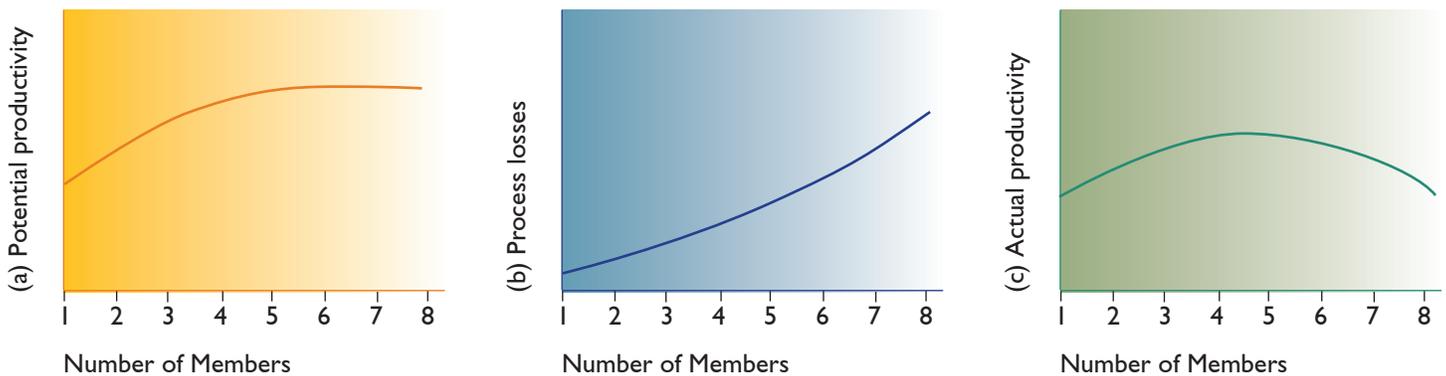
---

#### *The size of a committee*

In a group that is too small, the team may find that it has inadequate resources or that members feel overly exposed and uncomfortable expressing disagreement. But in a group that is too large, the team runs into difficulties with coordination, social loafing (described on page 11), and communication conflicts.

Psychologist Ivan Steiner studied group productivity at different sizes and arrived at a model which describes the change in productivity of a group at different sizes. As one would expect, adding a new member to the team also adds productivity. However, the amount of productivity added declines slightly with each new member; the addition of the seventh member does not add nearly as much productivity as the addition of the fourth member. Also, each time a team member is added, they also increase "process losses," or losses in productivity caused by coordination problems, inefficiencies, and reduced motivation across the team. Thus, at a certain point, productivity begins to decline with each additional team member. (Hackman, 2002)

### Relationship between group size and productivity



Source: Steiner, 1972

## More than the sum of the parts

“Consistent with the findings of previous studies, there was more dissatisfaction with group processes as size increased. The larger the group size, the more members complained that the group was too large for effective task performance. Larger groups were seen as being highly competitive, as having considerable disagreement, and as showing disunity. Members reported feeling that some individuals talked too much in the larger groups and that they themselves felt inhibited from expressing their feelings. Considerable differences in ability and competence were seen as characterizing the larger groups.

Although individuals in smaller groups tended to feel that the groups were too small for best results, they also felt more personally involved in them. They indicated more often that their own opinions were considered by other members, that they personally influenced the solution, and that they in turn were more influenced by other group members. Finally, members of smaller groups felt that the group operated more efficiently and made better use of its time than did members of larger groups.”

-Hackman & Vidmar, 1972

Most research supports the idea that beyond a group size of four to seven members, larger groups become unwieldy and the disadvantages substantively outweigh any added value. J. Richard Hackman recommends that a group be no larger than six people. (Hackman, 2002) Is there an optimal size for an investment committee? Investment committees serve a wide variety of organizations and face different sets of tasks and responsibilities. They are often structured out of necessity or political considerations and may require the presence of certain key individuals. All things considered, the best rule of thumb is to keep the investment committee as small as possible given the circumstances and requirements of the organization.

### Diversity

The composition of a group can be analyzed in a variety of different ways. Social category diversity, including differences in gender, age, and race, is only one measure of diversity. There is also informational diversity (differences in education, skills, and knowledge) and value diversity (differences in values, commitment, priorities). Research in this area suggests that some types of diversity can improve a group’s performance, while other types of diversity can actually hinder a group in its ability to function as a team.

---

“Strength lies in differences,  
not in similarities.”

- Stephen Covey

---

“...[T]o the extent that groups are more diverse in their perspectives and approaches to problem solving, they would outperform groups with less diversity. However, to exchange information, groups must have both the ability and the willingness to engage in constructive, task-focused conflict to integrate their divergent perspectives.”

- Mannix & Neale, 2005

In general, social category diversity — such as age, gender, and ethnicity — tends to have a negative effect on group performance, although the findings of different studies are mixed. Difference in age seems to have the weakest negative effect of these, with the strongest negative effect coming from tenure diversity. Tenure diversity has been shown to consistently impede social integration and communication ability, while increasing conflicts. Continuity is particularly important for investment committees, which are charged with making long-term decisions. High turnover can result in both a high degree of tenure diversity and a lack of continuity.

## More than the sum of the parts

No matter what the makeup of a group, how issues are approached can maximize diversity advantages and minimize obstacles. For instance, negative effects from social category diversity can be neutralized by supporting a cooperative organizational culture and emphasizing the group's values as opposed to individual values. Staying focused on the committee's common goals promotes unity and prevents members from concentrating on social differences.

One of the strongest advantages of a committee is likely its informational diversity and diversity of backgrounds, combining a variety of skills, education, and personalities for a greater collective wealth of experience. However, in order to reap the benefits of this diversity, a committee must embrace a degree of conflict and encourage full and open discussion. Research shows that groups have a strong tendency to focus on information common to all members (known as shared information; see page 10) rather than invite individual expertise from members, and that team members who hold minority or unique opinions may pay a social or psychological cost for speaking up. (Mannix & Neale, 2005) For this reason, a team needs to make a concerted effort to encourage and foster an atmosphere of information sharing. In addition to conflict management and open communication, emphasizing a group identity and common objectives rather than focusing on individual differences can be a step toward accomplishing this goal.

### *Leadership*

There is no single ideal style of leadership. Different teams may require different approaches and often, the same outcome could be generated by several different styles. Research has shown that a purely autocratic style of leadership tends to have poor results, but a purely democratic leader effects similarly poor results. One of the most important skills an investment committee chair can have is the flexibility to adapt fluidly in changing situations.

---

“The man who occupies the first place seldom plays the principal part.”

- Johann Wolfgang von Goethe

---

Nearly all experts agree that in order for a leader to be the most effective, a group leader should focus on the process of the group rather than the outcome. It is the team's job to arrive at the outcome, not the leader's. The chair's job is to support and guide the team throughout the process. A committee chair can facilitate smooth teamwork by the following:

- Establishing clear goals for the team and emphasizing a common purpose
- Promoting a cohesive and unified group identity
- Determining the specific roles and responsibilities of team members
- Prioritizing tasks and scheduling time allotments
- Keeping the group focused and on track during meetings
- Making sure all team members are sharing their information and input
- Maintaining adherence to the agreed-upon decision-making process

“Excellent team leaders...attend carefully to the circumstances of the moment, and vary their behavior in real time to exploit unanticipated leadership opportunities and circumvent obstacles that risk blunting their initiatives.”

-Hackman, 2002

## More than the sum of the parts

### *Voting and decision-making*

How does your team come to a decision? A committee charter that clearly establishes the rules by which the committee votes and decides will help the group function more efficiently. The committee is able to focus on the issues that require thought, discussion, and insight, rather than taking time to negotiate decisions that should be straightforward. A committee may choose more than one method of decision-making, depending on the decision to be made. It may make sense to leave some decisions to a single authority, while a democratic process of voting may work best for others. *Robert's Rules of Order* are a useful starting place for many committees.

How the voting procedure is accomplished deserves considerable attention. While a ye or nay vote may be expedient, the team might be better served by using secret ballots for major decisions. Ballots eliminate the potential for one member to unduly influence other members' votes. Although an oral vote may result in greater consensus, it could be because team members are withholding opinions in order to avoid being isolated, resulting in an unfortunate process loss for the committee.

One of the committee chair's primary functions is to make sure the decision-making process outlined in committee documents is adhered to, enforcing and maintaining the rules established by the team. It cannot be overstated how essential it is that the chair fulfill this duty; any failure to follow procedure is likely to undermine the team's confidence and ability to make decisions, as well as potentially constituting a breach of fiduciary duty.

"A consensus may be reasonable for certain decisions, like determining the mission of the committee or for simple questions of fact. But in dealing with future unknowns, it is probably too high a bar to clear. A committee that reaches consensus on how to deal with the future is failing to register the true views of the committee members. Frequently, dissenting views are sublimated in order to 'move forward,' which may appear to increase group harmony but ultimately undermines decision-making effectiveness."

-*Mauboussin, 2009*

"A number of years ago, I was on a committee that was voting on whether to bring a person into the organization. After hearing the balance of the evidence on the candidate, I was in favor of bringing him in. The committee chair then started going around the conference table, asking for a verbal 'yea' or 'nay' on whether we approved of the candidate.

"It so happened that the man sitting next to me was a physicist who had won the Nobel Prize and is probably the smartest person I have ever met. He was to vote right before me, and offered a nay when the chair called on him. So here I was, set to say yea, but faced with the world's smartest man saying nay only seconds before. Feeling seriously conflicted, I said nay and slumped in my chair.

"Diversity is one of the key ingredients in group decision making. But by going around the room as he did, the chair invited social conformity and reduced independence. To get the best possible results from the committee, the chair must ask for independent votes.... The chair should not ask for opinions sequentially, and should not reveal his preference until after the process is over, if at all."

-*Mauboussin, 2009*

## More than the sum of the parts

### Group dynamics

#### *Groupthink*

“Groupthink occurs when members of a cohesive group are more interested in avoiding conflict and maintaining unanimity than in realistically appraising the various courses of action....When groupthink occurs, the desire for group unanimity overrides the motivation to realistically discuss and appraise different alternatives.” (Mottola & Utkus, 2009) Unfortunately, the tendency toward groupthink grows as a group’s cohesiveness grows. Irving Janis, who coined the term in 1971, identified eight main symptoms of groupthink:

---

“You don’t get harmony when everybody sings the same note.”

-Doug Floyd

---

“I use the term groupthink as a quick and easy way to refer to a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when concurrence-seeking becomes so dominant that it tends to override critical thinking. Groupthink is a term of the same order as the words in the newspeak vocabulary George Orwell presents in his dismaying world of 1984, where we find terms like doublethink and crimethink. In putting groupthink into that Orwellian class of words, I realize that it takes on an invidious connotation. Exactly such a connotation is intended since the term refers to a decline in mental efficiency and in the ability to test reality and to make moral judgments. Most of the main symptoms of groupthink arise because the members of decision-making groups avoid being too harsh in their judgments of their leader’s or their colleagues’ ideas. They adopt a soft line of criticism, even in their own thinking. At their meetings, all the members are amiable and seek complete concurrence on every important issue with no bickering or conflict to spoil the cozy atmosphere.”

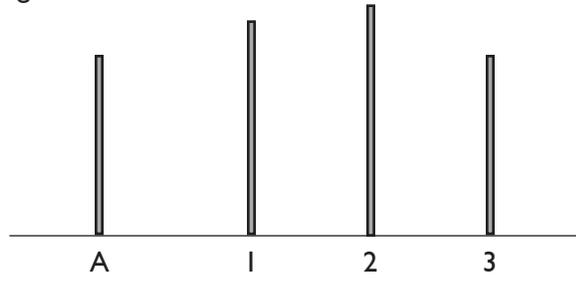
-Janis, 1971

- Pressure: The group may apply pressure, either subtly or overtly, to dissenting members. Members who continually express doubt about decisions may find themselves isolated or otherwise excluded.
- Self-censorship: Members purposely refrain from expressing an opinion that differs from the majority.
- Unanimity: The group begins to believe that the majority view is correct by virtue of being unanimous among respected members. Team members rely on consensual validation rather than critical thinking.
- Invulnerability: The group overestimates its ability to form correct decisions. This can lead to a group taking extraordinary risks based on an illusion of invulnerability.
- Rationale: Victims of groupthink will ignore or dismiss information that runs counter to their decisions. They will construct rationalizations to negate even factual information that doesn’t support their decisions.
- Morality: Groupthink victims tend to believe that their decisions are moral because they are supported by the group. Loyalty to the group becomes the highest form of morality. A team may reject legitimate questions of ethics or morality in their decisions.
- Stereotypes: Groups that fall prey to groupthink tend to hold stereotyped views of competing groups, demonizing “enemy groups” and potentially causing inter-group conflict.
- Mindguards: Members may actually proactively work to prevent the leader and other members from learning about information that is adverse to the group decision.

### Tendency to conform

A famous experiment conducted in 1956 by social psychologist Solomon Asch demonstrates the power of the tendency toward social conformity. Subjects were placed into groups of seven to nine people in which the other members were, unbeknownst to the subject, assistants to the experimenters. The experiment consisted of 18 trials. Six of the trials involved no prompting of the confederate members, but in 12 of the trials, those members were assigned specific roles.

Figure 1



In the experiment, the groups were shown a picture (Figure 1) and were asked, “Which line — 1, 2, or 3 — is the same length as line A?” In the six unscripted trials, all subjects chose the correct line: line 3. But in the other 12 trials in which the confederates convincingly gave wrong answers, 75 percent of the subjects said that line 1 was equal to line A in at least one trial. They were convinced to give the wrong answer in the face of obvious evidence to the contrary.

Source: Wood, 2006

Any group is susceptible to groupthink. Fortunately, specific techniques can help a committee avoid groupthink and/or counteract its effects:

- Committee chairs should refrain from expressing an opinion when an issue is initially approached by the group. This allows members to discuss the issue without being affected by the leader.
- Group leaders should explicitly encourage healthy debate.
- Committees may decide to include opposing opinions in meetings by inviting outside experts or appointing a devil’s advocate.
- The chair can form subcommittees to discuss important issues, so each group can deliberate under a different leader.

## More than the sum of the parts

### *Information sharing and confirmation bias*

“Perhaps one of the most disappointing findings from the group-decision-making area in recent years is that information exchange in groups typically focuses on information that is known and shared by all group members before the interaction, rather than information that is uniquely held by individual experts.” (Mannix & Neale, 2005) Related to the phenomenon of groupthink, groups consistently demonstrate poor information sharing, resulting in tremendous process losses. Information available to only one or a few group members may not be discussed, in which case the group is failing to make use of the complete collective knowledge of the group.

---

“In teamwork, silence isn’t golden, it’s deadly.”

- Mark Sanborn

---

“Confirmation bias is a tendency for a group to acquire information that confirms the group’s views and to disregard information that conflicts with the group’s views.” (Mottola & Utkus, 2009) Group members will tend to conduct research that will support their perspectives. Shared-information bias compounds this issue: group members are even less likely to share information when it conflicts with the majority opinion of the group.

Why do groups focus on shared information rather than introducing new information? Partly it is due to the fact that shared information is typically more common information and is thus brought to mind more easily and frequently. But it also has a sociological root; similarly to groupthink victims, members have a propensity toward things that connect them to a group and an aversion to bringing up information that separates and differentiates them.

“In a classic study, psychologists Garold Stasser and William Titus wanted to see how groups aggregated information. The task was to select between three candidates for student body president, but it is easy to imagine the group selecting a consultant or investment manager. Stasser and Titus set up the experiment so that candidate A was the most attractive.

“The psychologists then created two conditions. In the first condition, groups of four members all received the same pieces of information about each of the candidates, and were asked as a group to select the best one. In this case, 83 percent of the groups selected candidate A, as you would expect.

“In the second condition, each member received eight pieces of information in common as well as two pieces of unshared information. The researchers designated the unshared information so that, if shared, it would represent a full view and would naturally lead to the selection of candidate A. But based solely on the shared information, candidate B appeared better. In fact, when the groups were asked to select, 71 percent of the time they chose candidate B.

“So while in the second condition the group members had between them all of the information necessary to make an optimal decision, they consistently failed to pool their unshared information.”

-Mauboussin, 2009

## More than the sum of the parts

“Conflict, which would otherwise be viewed as detrimental among diverse people, was perceived as beneficial when the organization emphasized collective outcomes.”

-Chatman, et al, 1998

One solution to the information sharing problem is called “bridging.” A bridge is any social connection between members. In studies, groups in which team members had social ties were more likely to share information than groups of strangers. The social ties, or bridges, fostered trust and made it possible for members to take the necessary risks involved in sharing their particular knowledge. (Mannix & Neale 2005) Bridges don’t necessarily have to be outside social ties; the organizational culture of the team can serve as a bridge. When the culture of the committee emphasizes its shared vision, goals, and values and creates a cohesive collective identity, members are more likely to feel comfortable sharing unique information and engaging in constructive conflict.

### *Social loafing and the Ringelmann effect*

The Ringelmann effect “describes the inverse relationship between the size of a team and the magnitude of each group member’s contribution.” (Wood, 2006) As the group gets larger, each individual member feels less obligation to contribute the same amount of effort. In larger groups, individual efforts may be recognized less, providing less incentive to participate wholeheartedly. It also becomes easy to blend into the group and expect the collective team to take up the slack.

Social loafing is easily counteracted by taking measures such as the following:

- Have a method for identifying individual members’ contributions and hold everyone accountable for their participation.
- Reduce the Ringelmann effect by creating interesting and challenging tasks.
- Demonstrate trust in individual members, ensuring that members have a sense of personal responsibility.
- Decrease social loafing by valuing and publicly acknowledging members’ contributions.

“Maximilien Ringelmann, a French agricultural engineer, asked individuals to pull on a rope attached to a strain gauge, which measures effort. He then asked multiple people to pull on the rope at the same time to see if the aggregate force would equal the sum of the individual averages. Instead, he found that people pulled less hard when in groups.”

- Mauboussin, 2009

### *Group polarization*

Committees tend to make more extreme decisions than individual members. When a group is leaning toward a decision in one direction or another, the collective momentum of the group can shift the decision to either a riskier or more cautious decision than most members would have chosen on their own, depending on which way the group was initially leaning. Through confirmation bias, information sharing, and groupthink, the team reaffirms the direction of the decision, pushing the group consensus further and further in that direction and away from a more centered or balanced decision. “Group polarization has been demonstrated repeatedly in psychological laboratories, but it has

## More than the sum of the parts

also been linked to decisions made in economic, political, and legal arenas. This research has obvious implications for investment committees that are routinely charged with determining the risk characteristics for a given investment portfolio.” (Mottola & Utkus 2009)

The key to combatting group polarization is diversity. Having even one dissenting voice as part of the group can reduce the tendency toward group polarization.

### Group heuristics

Behavioral economists have identified a set of heuristics, or mental shortcuts, individuals use to make financial decisions. While heuristics help people make quick decisions, they can also result in irrationalities in decision-making. Unfortunately for committees, some specific heuristics that contribute to illogical decision-making are amplified in a group context.

#### *Representativeness and availability bias*

Representation occurs when a small or single sample is mistaken as being representative of a larger category. For example, suppose a committee member had a bad experience with her credit card company, in which the company made a significant error. If that same company is recommended as an investment opportunity to the committee, the member may bring up her story. Although the story represents only a single experience out of the hundreds of thousands of customers of that company, that is the story that committee members will hear and discuss. Based on that sample of one, they may elect not to invest in that particular company, even though a rational analysis might have shown it to be a solid, appropriate investment selection for their portfolio. One member’s personal experience with a particular type of investment can color the committee’s general opinion, closing the portfolio off to potential opportunities. The group’s individual experiences and knowledge base, because they are readily available, will influence how they make judgments and predictions.

#### *Overconfidence*

Individuals are prone to overconfidence in their own ability to make decisions. Committees, who have the affirmation of an entire group, tend to be even more so. Furthermore, investment committees often lack the feedback that would let them know when they have made a poor decision. Between pressing business under time constraints and turnover, few investment committees have the time or opportunity to review and evaluate past decisions. A committee affected by overconfidence may be dismissive of new information to the detriment of the discussion, believing that they already have all the knowledge and information needed to make a decision.

---

“Good decisions come from experience, and experience comes from bad decisions.”

- *Author unknown*

---

“Committees rarely keep track of decisions well enough or long enough to identify systematic biases that creep into their deliberations. Without feedback, people struggle to understand what works and what does not.”

- *Wood, 2009*

### Committee correlation to portfolio results

Over our nearly 20 years as an independent investment advisor, we have worked with scores of investment committees and committee members. These committees are across corporate, non-profit, and public environments. They include committee members compelled to service by their titles and those who volunteer to better their community, alma mater, or workplace. We have been able to observe firsthand many of the factors discussed in this white paper and how some of the more negative characteristics of group dynamics have impacted portfolio performance. These characteristics arise out of the ongoing process of integrating different personal experiences and biases into a cohesive group setting. By having your committee examine itself in the context of this discussion, it is our hope that we can engender a continually improving process of decision-making and consequent to that, we believe, better investment results.

Over our experience, we have observed some committees generate better investment results than others, relative to their investment objectives. Why do portfolios underperform? Is it because some committees just have better investors, or are there group dynamics at work that systematically rob a committee of its ability to consistently generate good performance? A number of factors can impact performance; following are some characteristics that, in our experience, contribute to a committee's potential to improve long-term performance outcomes.

#### *Ability to look forward*

The best investors are often those who take a contrarian viewpoint rather than going with the tides of the market and chasing returns. What leads a committee to be more comfortable embracing an investment strategy after it has generated substantial returns, instead of beforehand, when the opportunity for profit is greater? Overconfidence and confirmation bias may contribute to preventing a committee from embracing strategies that are not currently in favor.

---

“There is no data on the future.”

- Laurel Cutler

---

#### *Openness to new ideas and information*

Strong committees are open-minded, are willing to embrace new information, and engage in open dialogue. What are the obstacles to incorporating new information into an investment strategy? Groupthink, overconfidence, confirmation bias, and representativeness may be culprits. Committees that can address these challenges are able to use a wider variety of tools and take advantage of more opportunities than those committees who reject ideas that may be new or unfamiliar.

#### *Commitment to making use of member contributions*

A group that actively seeks opinions and discussions from all of its members is making the best use of the knowledge and experience at its disposal. Encouraging dissenting voices may help to avoid group polarization and groupthink.

### **Consultative or discretionary advisory service (outsourced CIO model)?**

Investment committees can be very effective in making investment decisions and stewarding funds. However, to be an effective committee requires dedication, skill, knowledge, teamwork, and time. Some committees are able and willing to dedicate themselves to their fiduciary responsibility as portfolio management decision-makers. Other groups, however, may find that their teams are not well-suited to the tasks necessary for effective portfolio management. There are circumstances under which a discretionary model (or outsourced CIO model), in which the adviser is empowered with the authority to make investment and asset allocation decisions, within the boundary of the portfolio investment policy statement, may make more sense. A discretionary approach can provide some relief for the committee, allowing the group to focus on the evaluation and oversight of the investment adviser. The following situations would be scenarios under which a committee might benefit from considering a discretionary approach with an investment adviser:

- High turnover of committee members, making it difficult to have continuity
- Large number of committee members, making coordination and teamwork difficult
- Little time to devote to the investment management of the portfolio
- Inexperienced committee members as it relates to long-term diversified investing
- A committee with a desire to offload some of its fiduciary responsibility

A consultative approach to advisory services may be appropriate when committees have the time and resources to dedicate to making portfolio management decisions. We recommend that this approach be adopted if a committee has the following:

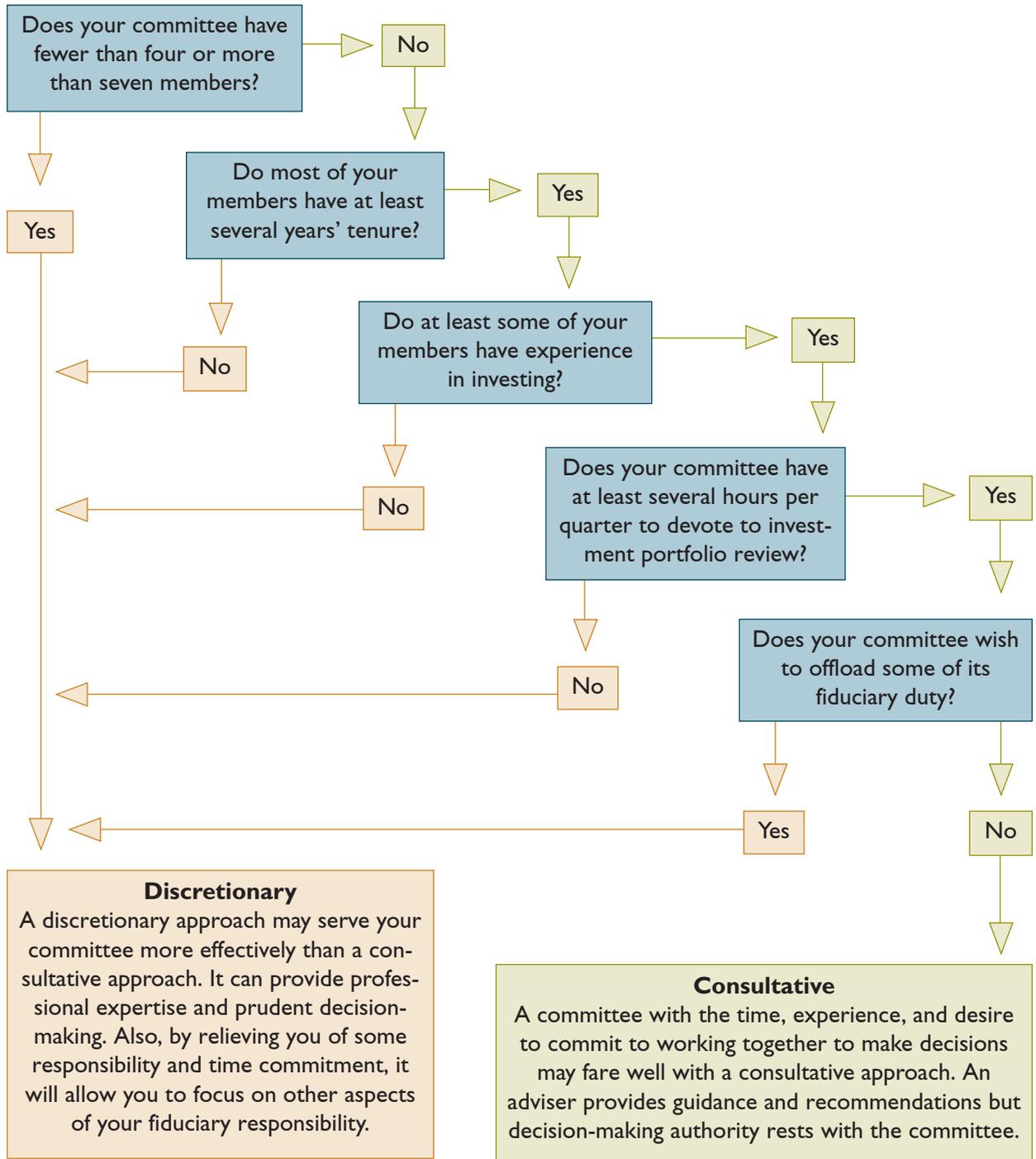
- A minimum of several hours per quarter to devote to investment portfolio management
- No less than four and no more than seven committee members
- Committee members with experience in investing
- Tenure of at least several years for most committee members
- Diversity and leadership

### **Conclusion**

It is our hope that this paper is helpful to all different types of investment committees. We firmly believe that an effective committee results in better long-term returns. Our consultants can further discuss your committee approach and how to gauge opportunities for improving its effectiveness. We look forward to continuing the discussion. On page 16, we've provided a brief review of some techniques your committee can implement that may help make the best use of your team's time and expertise.



**Should your committee consider consultative or discretionary portfolio management services?**



### Review of techniques to improve committee performance

- Keep your committee size as small as possible (no fewer than four members, however).
- Informational diversity (diversity of skills and knowledge) can give your team a wide variety of experience from which to draw in making decisions.
- Longer tenure for committee members will improve continuity and reduce tenure diversity. Developing an education program for newer members that provides context and history can help members be more successful in integrating themselves and their ideas into the committee decision-making process.
- Create an organizational culture with a unified group identity and collective goals. Emphasize the team's shared vision and objectives to bridge social diversity and improve the sharing of information.
- An effective committee chair understands his or her role and responsibilities and is flexible in his or her approach.
- A committee charter should outline the roles and responsibilities of committee members and describe the methods selected for voting and decision-making.
- An investment policy statement should clearly outline the policy for investment decisions.
- Promote objective voting and prevent undue influence from swaying voters by using a secret ballot form of voting for important decisions.
- Encourage healthy debate, assigning a devil's advocate or inviting outside experts when appropriate to provide different viewpoints. Conflict should be managed, not eliminated.
- Identify individual members' contributions to the team, so that committee members feel a sense of personal responsibility and accountability to the team.
- Explicitly request that members share information and express opinions during discussions.
- If possible, create and implement a process for reviewing and evaluating past decisions.
- Periodically invite members to review team processes and make suggestions for improvement.

## More than the sum of the parts

### Endnotes:

Chatman, Jennifer A.; Polzer, Jeffrey T.; Barsade, Sigal G.; Neale, Margaret A. "Being Different Yet Feeling Similar: The Influence of Demographic Composition and Organizational Culture on Work Processes and Outcomes" *Administrative Science Quarterly*, Vol. 43, No. 4; December 1998

Hackman, J. Richard, *Leading Teams: Setting the Stage for Great Performance*, Harvard Business School Press; 2002

Hackman, J. Richard & Vidmar, Neil: "Effects of size and task type on group performance and member reactions," *Sociometry*, 33, 37-54; 1970

Harrington, Brooke "Dollars and Difference: Values, Diversity and Investment Team Performance" *Academy of Management Journal*; December 2005

Janis, Irving L. "Groupthink" *Psychology Today*; November 1971

Janis, Irving L. "Groupthink Among Policy Makers" *Sanctions for Evil* edited by Nevitt Sanford and Craig Comstock; Jossey-Bass, 1971

Mannix, Elizabeth & Neale, Margaret A. "What Differences Make a Difference? The Promise and Reality of Diverse Teams in Organizations;" *American Psychological Society*, Vol. 6, No. 2; 2005

Mauboussin, Michael J. "Investment Committees: How to Build a Team to Make Good Decisions," *Mauboussin on Strategy*, Legg Mason Capital Management; September 1, 2009

Mottola, Gary R. & Utkus, Stephen P. "Group Decision-Making: Implications for Investment Committees" *Vanguard Investment Counseling and Research*; 2009

Payne, John W. "Investment Committee Decisions: Potential Benefits, Pitfalls, and Suggestions for Improvement" *Perspectives on Behavioral Finance* edited by A. Wood; July 2009

Steiner, I.D., *Group process and productivity*, Academic Press; 1972

Tindale, R. Scott; Kameda, Tatsuya; Hinsz, Verlin B. "Group Decision Making" *Sage Handbook of Social Psychology* edited by Michael A. Hogg and Joel Cooper, Sage Publications Ltd.; April 2007

Wood, Arnold S. "Behavioral Finance and Investment Committee Decision Making" *CFA Institute Conference Proceedings Quarterly*, December 2006