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The 10th P is Purpose and Why It Matters More Than Ever

By Noel Pacarro Brown, CIMA®, CPWA®



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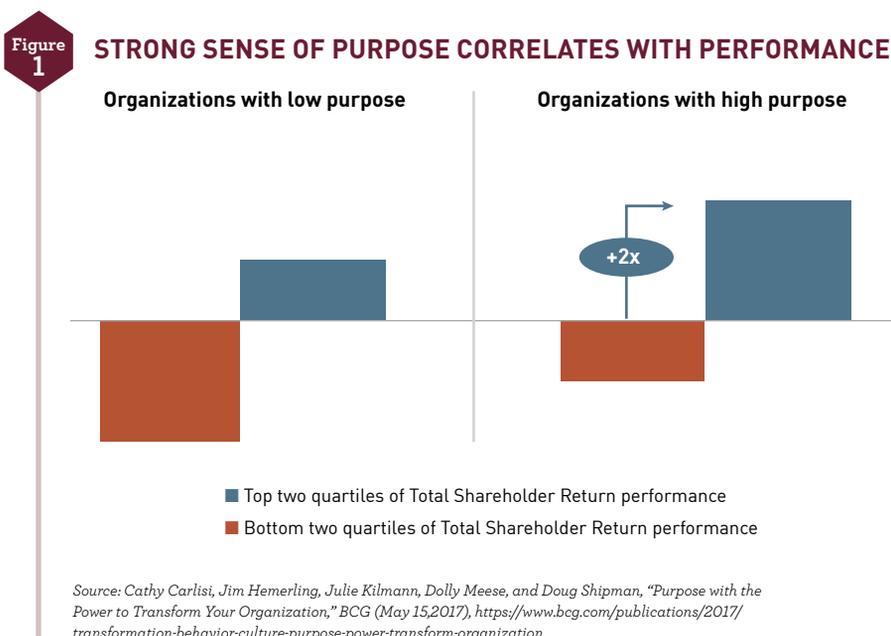
The 10th P is Purpose and Why It Matters More Than Ever

By Noel Pacarro Brown, CIMA®, CPWA®

Creating an investment solution that is truly in the best interest of a client requires a process that considers the client's goals, both present and future. Most advisors, investment consultants, and certainly all Certified Investment Management Analyst® professionals have been properly trained to utilize the “nine P's” in the investment due diligence process. By analyzing an investment manager's philosophy, people, process, plans, product, progress, place, performance, and price, financial professionals have been able to determine the merit of a strategy and whether or not it is an appropriate fit for a client's stated objective. The “why” of a strategy, however, has not been widely explored through this process. What does the strategy accomplish beyond the goal of meeting a client's financial goals? This article will try to define the “10th P”—purpose. An analysis of purpose is helpful in the investment due diligence process, and it's also important for investors and the asset managers who seek to maintain purpose within their organizations.

PURPOSE AND PERFORMANCE

In 2020, Larry Fink, chief executive officer of BlackRock, the largest asset manager in the world, wrote in his Letter to CEOs, “Without a sense of purpose, no company, either public or private, can achieve its full potential.”¹ Purpose is not easily defined for individuals, and it is even more challenging to define for an organization. For many, purpose is not the what, the where, or the how. Purpose is the why. Oftentimes we can experience a purpose more easily than we can



define it. For example, a clear purpose across an organization could be evident in every interaction, whether as a customer, an employee, or an investor. Similarly, when an organization lacks purpose, the result often is a breakdown of culture and a purely transactional sense of exchange. Simply put, if an organization has a purpose, it matters, and therefore, if it were to go away, the world would miss it. Defining a purpose that is authentic and integrated across an organization should matter to the investing community, both investment managers and the parent asset manager, because recent studies by the Boston Consulting Group (BCG) and others have found that purpose and performance are clearly linked (see figure 1).²

In a *Harvard Business Review* Analytics Report, the tie between purpose and

performance is further evidenced: “Purpose-led companies outperformed the S&P 500 by 10 times between 1996 and 2011.”³ These studies by BCG and *Harvard Business Review* have focused primarily on corporations and entrepreneurs, but the results should be of interest to portfolio managers, asset managers, and investment firms. Moreover, with the influence of the capital markets, purpose within asset managers and investment firms becomes more significant because it can influence investment strategies, efficacy, and ongoing relevance. With asset managers already feeling pressure from fee compression, compounded by a Darwinian environment with larger players acquiring smaller firms, evolution is necessary to survive. As explained in a recent article published by Bloomberg about asset managers in decline:

As the business of managing money is being upended, the heyday of Lynch, Miller and Gross is receding further into the past. In their scramble for survival and under consistent fee pressure, firms are being forced to adapt. Many will be absorbed by other bigger competitors, some will disappear altogether and almost all will need to either cut costs or hone their strategies to increase profit in these uncertain times.⁴

Perhaps by defining purpose, an organization can better adapt and survive. So, how can we define the 10th P as it relates to the investment due diligence process?

DEFINING PURPOSE

Figure 2 shows the BrightHouse division of BCG's guide for helping companies define a purpose, and it can be applied to asset managers as well. BrightHouse tells us that

[P]urpose is a central, organizing principle that guides employee actions at all levels of the company and provides an authentic foundation for strategy, culture, investment decisions, and societal impact. ... [It] expands how the firm sees its role in the world.⁵

To define purpose, an organization must be able to define itself and the societal need it meets. In the past the due diligence process, though thorough, in most cases did not consider the environmental

or social impact of the investment process and outcomes. Now the research shows that this could limit investors, given the relationship between purpose and performance.

During the due diligence process, an advisor or investment consultant can ask a series of questions to learn about how a manager defines its purpose. Such questions include the following:

- Does the manager clearly define itself and how its work specifically addresses a societal or environmental need?
- What is this manager's depth of understanding of the environmental/societal needs we face?
- What sources, resources, and research does the manager utilize to maintain an ongoing understanding of environmental and societal needs? How does this play out in the manager's strategy?
- Does the manager vote proxies? Are proxies voted in alignment with an expressed purpose? What about other forms of shareholder engagement? Are these efforts useful in driving performance and impact outcomes?
- Will a manager sell a security based on the deterioration of a company's purpose?
- Does the manager address environmental and societal needs solely through the investment process or also through charitable or philanthropic activities? Does this point to a distinct corporate culture?

- How has this manager's definition of purpose evolved over time?
- How does a manager's purpose align with the client's expressed objectives, both financial and societal goals? How does this manager demonstrate this?

In this evaluation, advisors should be able to assess whether a manager's purpose is thoughtful, authentic, based in deep research, and most importantly, whether it will consistently match the expectations of the client.

THE RELATIONSHIP BETWEEN PURPOSE AND ESG DATA

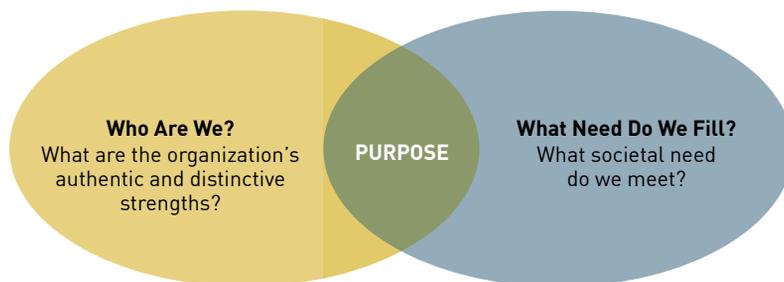
Purposeful asset managers tend to invest in purposeful companies, and the way in which they measure and identify such companies is most often by utilizing environmental, social, and governance (ESG) data as part of their investment selection process. Though the two are not synonymous, they do reinforce each other. Simplistically, ESG metrics could be viewed as a lagging indicator, and purpose could be seen as a real-time or even a leading indicator. As explained by a BCG report on transforming organizations:

Purpose is also aspirational: it depicts what the organization can be and goes beyond brand positioning to take a stand. Rather than being only market driven, a purpose-based organization is also driven by values, culture, and ethos. ... purpose reframes an organization's compact with the world; instead of being an obligation, social responsibility is seen as an opportunity. ... Rather than employees, a purpose-based company has missionaries. Instead of customers, it has advocates. In place of social charity, it avows social conscience.⁶

By defining purpose as transformational, its value to an organization could be seen as perpetually paying off on multiple levels. ESG data at the asset manager level and at the investment level are crucial to

Figure 2

PURPOSE IS AT THE INTERSECTION OF TWO FUNDAMENTAL QUESTIONS



Source: BrightHouse, BCG

determining how managers have been able to integrate societal and environmental needs into their organizations and their investments. Learning of an asset manager's purpose helps an advisor determine current and future relevance.

PURPOSE AS A DRIVER OF INNOVATION

With purpose and performance directly linked, it's important to ask: Why is purpose such an important factor in performance? Perhaps one explanation is that purpose is a basic human need. In fact, it has been found to be the most important human need. In a recent interview with NPR, Alan Rozanski, a professor of medicine at the Icahn School of Medicine at Mount Sinai who has studied the link between purpose and health, said:

Just like people have basic physical needs, like to sleep and eat and drink, they have basic psychological needs. ... The need for meaning and purpose is No. 1. ... It's the deepest driver of well-being there is.⁷

Based on such findings, it's clear that any organization with a strong purpose that helps the people within it fulfill their need for purpose will be at a major advantage. Beyond a basic need, other studies point to greater innovation when purpose is integrated at every level of an organization.

A recent study by the Economist Intelligence Unit (EIU) reported, "63.4% majority of executives believed that having a sense of purpose and aspiration beyond their day-to-day commercial mission made their company more innovative and therefore more able to disrupt or respond to disruption."⁸ The EIU study then went on to explore why purpose is such a positive driver for innovation and it found the following:

Purpose creates a culture that supports innovation. When people understand their organization's values, they are engaged and inspired to work together to promote those values. So,

employees who are engaged by a company's purpose are more motivated and willing to invest their time and energy in developing new ideas. EIU reported that 71.7 percent of respondents in its study said they felt that staff were enthusiastic about their companies' broader goals.

Purpose strengthens innovation by focusing on meaningful impact beyond traditional corporate metrics. The prospect of revenue growth or a higher stock price does not resonate with humans in the way that purpose does. Purpose helps people to focus on the big picture; it encourages them to think beyond incremental product or service improvements and aim for more-ambitious outcomes. One company, a global provider of medical technologies, cites its purpose "to restore people to full life and health" as being the driver of dramatic product innovations.

Purpose facilitates external collaboration. Great innovations are often the result of alliances that span organizational boundaries. Purpose can be the common denominator that allows organizations (even competitors, in some cases) to collaborate with each other (and their customers) on new solutions and achieve common goals. For example, one global consumer products company essentially crowdsources 60 percent of its research and development pipeline, crediting its purpose of "making sustainable living commonplace" as the catalyst for the success of its open innovation digital platform.

Purpose enables organizations to think differently so they can act differently. The EIU report asked executives which measures would effectively foster a culture of innovation in their organizations. Of the respondents, 32.2 percent said that setting a tone from the top about purpose would be the most effective way of going about this.

When advisors, portfolio managers, and investors consider the importance of innovation in a company's growth

trajectory, it's obvious to consider the factors that fuel continual innovation. For example, in taking a simple inventory of the top five largest stocks by market capitalization of the S&P 500, four out of five are considered by many to be the most innovative companies in history. Clearly, the link between purpose and innovation should not be overlooked. On the contrary, consumers and investors are becoming attuned to this connection, and they will continue to support organizations that advance it and cancel those that don't.

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THE PURPOSE GENERATION

In addition to the studies that show how embedding purpose into an organization leads to greater innovation and performance, another reason to value purpose is for talent acquisition and retention. Now that millennials represent the most-populous generation in the United States⁹ and in the workplace,¹⁰ to sustain its workforce an organization must be able to attract and retain millennials.

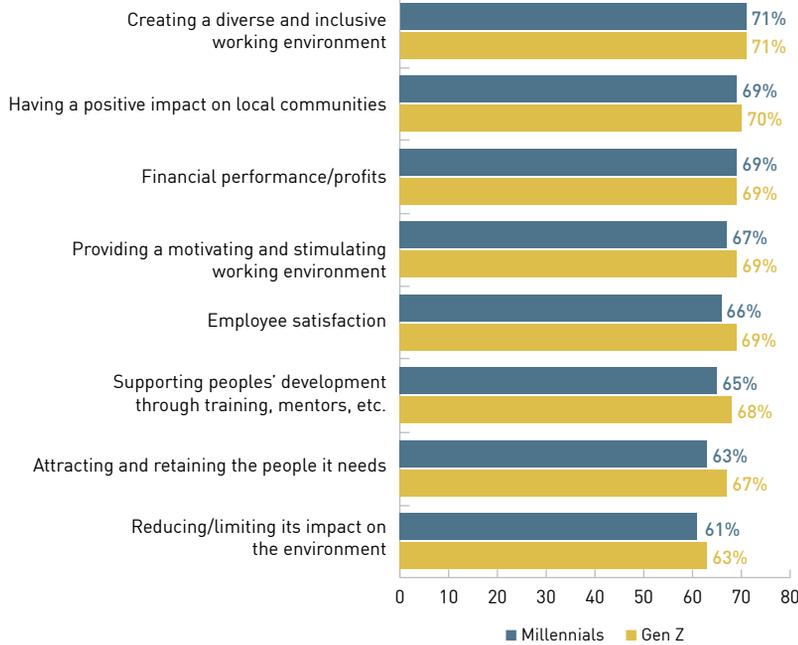
A recent study by The Society for Human Resource Management reported that "94 percent of millennials want to use their skills to benefit a cause."¹¹ For millennials, the desire to work with impact is central to which organizations they choose to work for. These organizations need to consider the needs of this generation.

Many millennials are starting or raising young families, and their desire for work with purpose is amplified. With the

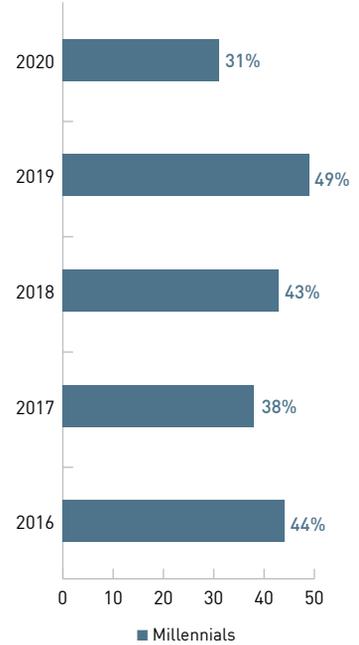
Figure 3

EMPLOYERS ARE DOING MORE TO ALIGN WITH MILLENNIAL AND GEN Z INTERESTS

Q: In your opinion, how is the organization where you currently work* performing in the following areas?
*** If you work for more than one organization, think of the one where you spend the most time.**



Percent of millennials who expect to leave in the next two years:



Source: "The Deloitte Global Millennial Survey 2020: Resilient Generations Hold the Key to Creating a 'Better Normal,'" <https://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html>.

looming threats of climate change and now a global pandemic, most young professionals seek work that could positively impact the future; this may be especially true for parents with young children.

In addition, most employees of asset managers and investment firms now are working from home. Due to limited childcare options during the pandemic, spouses are juggling to manage the well-being of their children and the demands of their jobs, and the choice of how they want to allocate their energies is constantly under scrutiny.

Do young parents want to dedicate their energies to work purely for the sake of making money, or do they seek a job that allows them to make money and make a difference in alignment with a purpose? Data show that millennials will choose the latter almost every time. In fact, Deloitte recently surveyed 27,500 millennials and Gen Z pre- and post-COVID-19 for their views about

business, government, climate, and the pandemic, among other issues (see figure 3). The survey shows that

*"... despite the individual challenges and personal sources of anxiety that millennials and Gen Zs are facing, they have remained focused on larger societal issues, both before and after the onset of the pandemic. If anything, the pandemic has reinforced their desire to help drive positive change in their communities and around the world. And they continue to push for a world in which businesses and governments mirror that same commitment to society, putting people ahead of profits and prioritizing environmental sustainability."*¹²

Based on the data, it is apparent that the organizations that embed a purpose that speaks to who they are and how they address the needs of the world will continue to meet the expectations of the

younger workforce. As advisors and investment managers continue to age out and firms need to recruit millennials and Gen Zers, defining a purpose becomes essential.

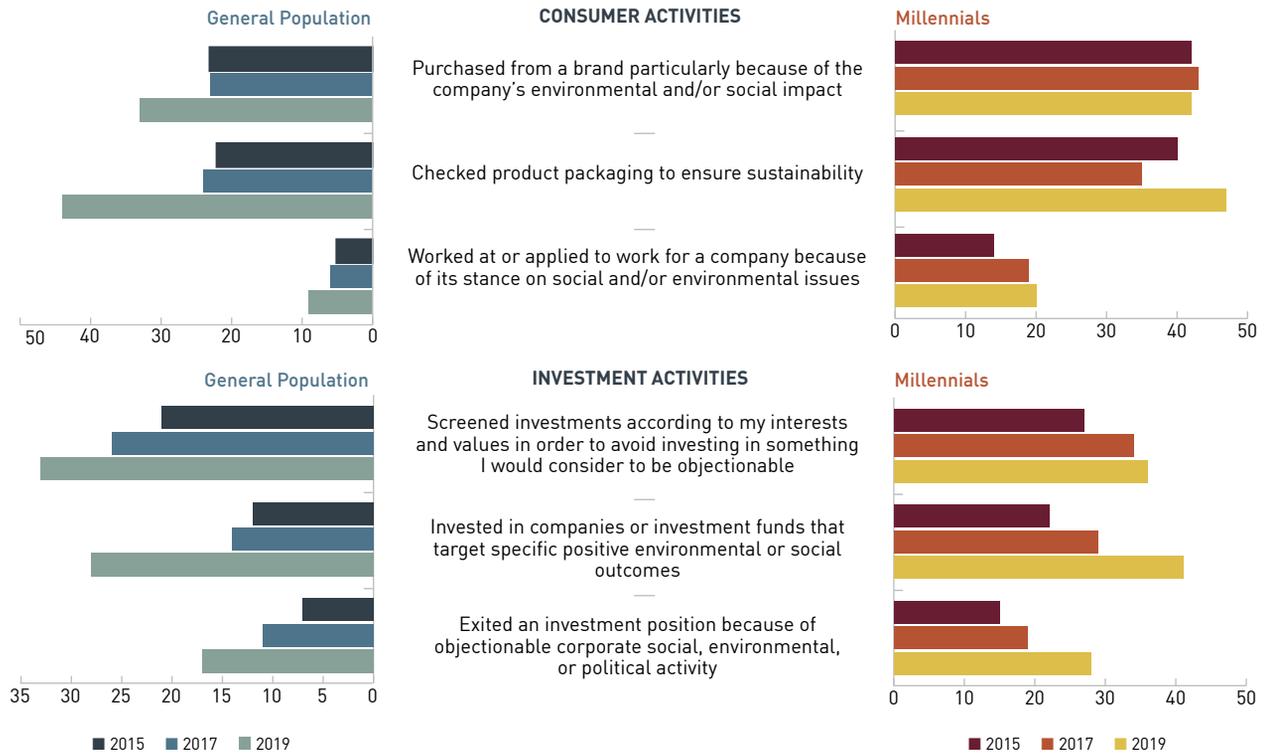
PURPOSE AND THE NEXT WAVE OF WEALTH

Numerous studies have shown that the next wave of wealthy individuals has a major preference for integration of ESG and values alignment in their investments and consumer behavior. The desire for greater sustainability and social consciousness, however, is not limited to millennial investors and consumers; there has been a growing interest by the general population as well (see figure 4).¹³

Figure 4 shows millennials' preferences for brands and investment strategies that integrate environmental and social outcomes, and it shows the general population's growing desire to embrace these ideals as well.

Figure 4

CONSUMER AND INVESTOR BEHAVIORS COMPLEMENT EACH OTHER



Source: "Sustainable Signals: Individual Investor Interest Driven by Impact, Conviction and Choice," Morgan Stanley Institute for Sustainable Investing (2019)

In other words, the need for purpose is not just a millennial story. The data point to a mounting desire for purpose within organizations by all generations, as employees, consumers, and investors. Investment and wealth managers are taking note, and, in some cases, doing the hard work to define their purpose in order to evolve and thrive. ●

Noel Pacarro Brown, CIMA®, CPWA®, is a family wealth advisor, investing with impact director, and first vice president with the Conscious Wealth Management Group at Morgan Stanley. She serves on the Investments & Wealth Institute Board of Directors. She earned a BA with honors from Brown University and a Masters in Teaching from Pacific University. Contact her at noel.brown@morganstanley.com.

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INVESTMENTS & WEALTH INSTITUTE®

5619 DTC Parkway, Suite 500
Greenwood Village, CO 80111
Phone: +1 303-770-3377
Fax: +1 303-770-1812
www.investmentsandwealth.org

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