

# Investment Committee Construction

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## Executive Summary

### SELECTION

- Building a well-functioning Investment Committee (IC) is a critical step in the stewardship of perpetual assets. It determines how effectively the investment program is governed, which translates directly into dollars and cents. But who should serve on that committee, what experiences and principles should they bring, and how the group should work together are critical questions that should be asked
- Completing an IC composition matrix can help identify characteristics and areas of expertise that are important for IC members to possess, as well as highlight any current gaps
- Based on our experience, the best IC members are often those that, irrespective of their professions, possess “soft skills” like open-mindedness and strong listening skills

### SIZE

- Determining the ideal size of an IC requires weighing factors that can increase or decrease the potential effectiveness of the committee
- In GEM’s experience, a 4-5 person IC is often ideal, as it forces a level of engagement that can be lost in larger groups. Some experts broaden that range and indicate that a 1-9 person IC can be best depending on the size of the organization<sup>1</sup>

### NORMS

- In GEM’s experience, establishing and enforcing strong IC governance norms is the key differentiating factor for committee effectiveness
- GEM has put in place a number of practices to help ICs establish and maintain foundational norms like IC member preparation (reviewing all materials and submitting questions in advance), focus on long-term investment horizon, and ongoing IC member education



# Selection

The composition of an IC is often an unintended outcome, rather than the result of careful design and planning.

## Selection in Theory

Assembling a highly functioning team can be an exercise in alchemy. McKinsey & Company and governance specialists at BoardSource recommend that boards develop a composition matrix of critical attributes to help frame the discussion of member selection. In *The Board-Building Cycle*, Susan Meier argues that “composition ideally reflects diversity in gender / identity, age, race / ethnicity, skill sets, professional expertise, circles of influence, and personal and leadership characteristics” in the context of the organization’s needs and strategies.<sup>2</sup> GEM has observed that, far too often, boards and—as a result—committees, are composed of individuals who have demonstrated loyalty to the organization via financial support, but are not necessarily best suited to IC service.

The composition matrix is a useful framework for identifying characteristics and knowledge areas that are important for IC members to possess, as well as helping to identify current gaps. It can be particularly useful in teasing out important “soft skills”: collaboration, open-mindedness, and strong listening skills, among others.

The composition matrix template on the following page covers key aspects that are important for ICs to consider when selecting members. Additional IC composition resources are available through BoardSource and McKinsey & Company; they are linked in the sources at the end of this paper.

## Selection in Practice

The Yale Endowment IC is often cited as an exemplar for strong governance. Charley Ellis, well-known industry consultant and former Yale Endowment IC Chairman, reflects that members were “carefully chosen to be people who, number one, play well with others. A key characteristic is they listen not for their opening, but for an understanding of the other person’s real point.”<sup>3</sup>

The Greenwich Roundtable, a nonprofit research and education organization, advocates for investment expertise from as many IC members as possible.<sup>4</sup> In contrast, GEM has found that the best committee members are often ones that are not necessarily specialized finance experts, but rather individuals who, regardless of their day jobs, possess the requisite “soft skills” described at left. For example, CEOs or Executives are often great committee members as they tend to be better attuned to delegation and organizational behavior.

Strong alignment and continuity between the IC and the investment office is also important as demonstrated by Scott Malpass’ success as the former long-term Chief Investment Officer of the University of Notre Dame. “In Scott’s thirty years at Notre Dame, he worked with only two investment committee chairs. That continuity allowed Scott the luxury of a deep understanding of the process, familiarity, and efficient dialogue.”<sup>5</sup>

Have you ever sat on an investment committee with **Dominant Donor Dan**, **Helicopter Harry** or **Self-Interested Sam** and everybody else just listened politely? -Myra Drucker, Member, GMO Board of Directors <sup>4</sup>

# Selection

## ILLUSTRATIVE IC COMPOSITION MATRIX

	IC MEMBER 1	IC MEMBER 2	IC MEMBER 3	IC MEMBER 4	IC MEMBER 5
Year Joined	2021	2015	2017	2020	2018
Career / Designations	PE Investor	Professor of Economics	Former CIO	Corporate Executive	Nonprofit CFO

### Qualitative Characteristics

Good Listener	✓	✓	✓	✓	✓
Works Well with Others	✓	✓	✓	✓	✓
Quick Learner	✓	✓	✓	✓	✓
Asks Good Questions	✓	✓	✓	✓	✓
Open-Minded	✓	✓	✓	✓	✓

### Expertise

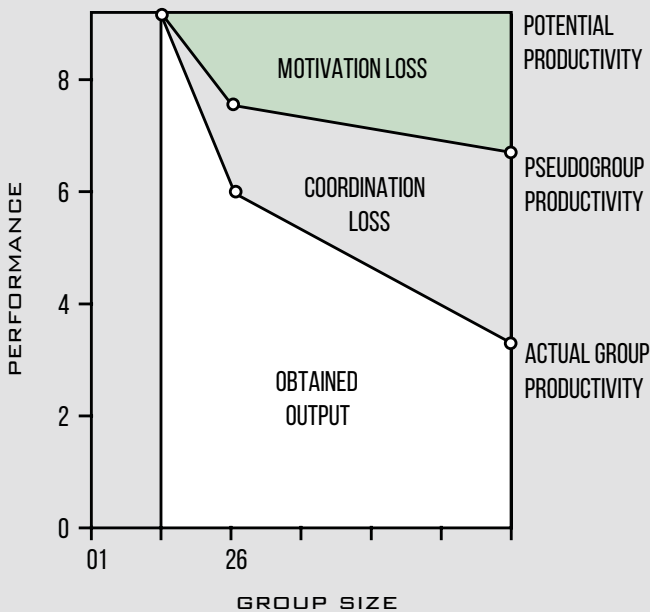
Asset Class Knowledge	✓				
Endowment / Long-Term Investing			✓		
Economics		✓			
Risk Management				✓	
Governance / Nonprofit Mgmt.					✓

# Size

Determining the ideal size of an IC is not an exact science. In our experience, **IC effectiveness is less often a result of the committee's size, but rather stems from the traits and personalities of the individuals on the board.**

## Size in Theory

Groups of volunteers meeting on a quarterly basis, in a social environment, and who favor consensus, tend not to make optimal decisions. The larger the group the more those issues are exacerbated. The tendency to become less productive as groups increase in size is widely documented.<sup>6</sup> In *Group Dynamics*, Donelson Forsyth explains that coordination loss introduces inefficiencies into a group, and motivation loss is an outcome of the individuals not working as hard when they are in groups as they do when they are alone. On the other hand—intuitively—a group's collective memory and knowledge base expands as the size of a group grows. Selecting a committee size requires balancing these dynamics.



Source: *Journal of Personality & Social Psychology*, 1979.

## Size in Practice

Charley Ellis believes having a 5-7 person IC is ideal.<sup>7</sup> Greenwich Roundtable broadens that range and articulates that anywhere from 3-9 people is often best depending on the size of the organization.

Interestingly, Greenwich Roundtable goes so far as to say a single person, with extensive experience in long-term investing, could be an effective IC for a small organization.<sup>4</sup> A one-person IC can be effective for certain organizations, as it clearly attributes decision-making accountability to an individual.

In GEM's experience, a 4-5 person IC is usually the sweet spot for those we've observed and partnered with, as that size forces a strong level of engagement and facilitates norms of earnest conversation. Maintaining a small committee size can help you avoid Milton Berle's description of a Committee "as a group [of people] who keep minutes and waste hours."



# Norms

Having strong IC governance norms is the key differentiating factor for committee effectiveness.

## Norms in Theory

Norms are a fundamental part of any group. They define what is accepted as conventional behavior and what the group expects of its members.<sup>8</sup> Norms established and deliberately put in place work in tandem with a set of unstated ones that are reinforced and continuously refined through group member interactions and behaviors.<sup>8</sup> Norms may promote productive—as well as counterproductive—action within a committee.

## Norms in Practice

According to Bain & Company, “a well-functioning committee system—like liberty—requires eternal vigilance.”<sup>9</sup> GEM believes that IC Chairs are typically best positioned to provide this vigilance and are instrumental in establishing and enforcing norms.

Strong preparation by IC members (reviewing all materials and submitting questions in advance of meetings), focus on a long-term investment horizon, and interest in ongoing IC member education, are a few examples of effective norms. GEM has put in place a number of practices to help ICs establish and enforce strong norms, including prep-calls with committee chairs and staff to ensure alignment on subject matter, the use of structured meeting activity plans to ensure effective agenda-setting, and making investment team experts available for subject-specific deep dives.

Preparation is a foundational norm. The Greenwich Roundtable articulates that reviewing performance summaries and materials is expected homework of IC members and that little time should be devoted to reviewing performance during meetings. Instead, committees should focus the “majority of their time on important topics that require them to think in terms of probabilities and outcomes.”<sup>4</sup>

Seth Mathers, who spent decades working with clients at AllianceBernstein, cautions that “most boards end up spending surprisingly little time on the issue of what they are there to achieve and spend a ton of time on little buckets, benchmarks for each of them, and the ones that are doing a little worse than [their] benchmarks. It’s sort of like someone deciding that they’re going to check every newspaper in the world for grammatical and typographical errors instead of understanding whether or not there’s fake news.”<sup>5</sup>

Keeping ICs focused on what is important and enforcing strong committee norms is one of the keys to IC effectiveness.

**Interested in learning more about investment committee best practices?**

Contact the GEM Team

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## endnotes

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1. Experts referenced are Greenwich Roundtable and Charley Ellis.
2. Susan S. Meier, "The Board Building Cycle."
3. Capital Allocators Podcast, "Ep.08 Charley Ellis."
4. Greenwich Roundtable, "Best Governance Practices for Investment Committees."
5. Ted Seides, "Capital Allocators."
6. Known as the Ringlemanneffect. See Donelson R. Forsyth, "Group Dynamics" for additional details.
7. Charles D. Ellis, "Best Practice Investment Committees," Journal of Portfolio Management.
8. Donelson R. Forsyth, "Group Dynamics."
9. Bain & Company, "Decision Insights -Committees that Work."

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The BridgespanGroup, "Right from the Start: What Your Board Needs in Three Easy Tables," <https://www.bridgespan.org/insights/library/organizational-effectiveness/right-from-the-start-what-your-board-needs>

The BridgespanGroup, "The Match Game," <https://www.bridgespan.org/insights/library/boards/match-game-phyllis-yale>

## important notes

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