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FACE TO FACE

Neuberger's culture, private ownership key sources of competitive advantage, CEO says

By DOUGLAS APPELL

George Walker — the only CEO **Neuberger Berman** has known since the firm was reborn in the crucible of the global financial crisis — cut his money management teeth at Goldman Sachs in 1995 just as Goldman was issuing a report that, in Walker's telling, has continued to define the way a lot of people think about the industry.

A key prediction of that report — "The Coming Evolution of the Investment Management Industry" — was that mid-sized asset managers would prove vulnerable to competition from bulge-bracket competitors and boutiques alike, and ultimately face a choice: either grow into "one of the 20-25 large companies that will dominate the industry" or settle for competing over the long term as a niche player.

Thus far, at least, Neuberger Berman has prospered while avoiding both outcomes.

Founded in 1939, the firm recently crossed $500 billion in client assets. That's up from $158 billion at the time of its April 2009 management buyout from a bankrupt Lehman Brothers, and the firm has averaged 4% organic growth — ex-market gains — over that span, boosted by an expanding array of public and private market capabilities.

Buck Ennis

George Walker is chairman and CEO of Neuberger Berman.

In a Jan. 22 Face to Face interview with *Pensions & Investments* at Neuberger's New York headquarters, Walker insisted the middle ground Neuberger has continued to occupy on the industry's size spectrum is something to celebrate rather than fear, while the firm's private ownership and focus on building a culture capable of harnessing the enthusiasm of employees should remain big competitive advantages going forward. (Questions and answers have been edited for clarity, conciseness and style).

Q: Did that famous Goldman report give you any qualms about taking the helm of a mid-sized money management firm?

A: I haven't read the piece in 15 years but I remember the thesis and boy, it was good for the merger business. It created a sense in all of us that, oh my gosh, we must act now, because this is going to happen fast. (But) change in this business takes a lot longer than people think.

Q: But you didn't fear a competitive handicap?

A: I think (the Goldman report) conflated active and passive. There's the passive business, which is scale driven, and there's the active business, (which) in my mind is all about excellence — whether it's small, medium or large, excellence will prevail. (At the height of the financial crisis) I wasn't looking 15 years ahead. I was just trying to protect clients and troops in the midst of the GFC. I couldn't look 15 minutes ahead at the time, let alone 15 years.

Q: Looking back now, does Neuberger's position on the size spectrum suit you?

A: I love our spot — large enough to be able to be relevant as a strategic partner to the largest, most sophisti-

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cated investors in the world … yet nimble and entrepreneurial enough to be able to continue to deliver alpha to our clients (and do) niche-y things.

Q: You seem singularly focused on Neuberger's culture.

A: I'm trying to figure out, are people proud to work at the firm and what some people call enablement — is the firm getting the very best from me or am I not able to fully contribute because … the technology stinks? Or my boss is a jerk? Or some work practices don't make sense? Or I'm in the wrong role, for whatever reason?

Q: You've talked about "measuring" Neuberger's culture.

A: Things I look at that correlate with strong culture (include) retention rates … particularly for senior investors. (Meanwhile) we're launching our employee survey in the next week or so. We do it periodically, every 18 months or so. We ask, I think, 83 questions. I will read all 2,800 responses.

Q: Do the responses lead to change?

A: All the time. You'll see it in the six to 12 months after we do the survey. There will be 10 different things that will be changed — oftentimes (touching on) individual team dynamics. For example, a few cycles ago one particular team scored very low on how comfortable they felt disagreeing with their boss. So, I got on a plane and went and visited with the leader of the team and the people on the team … and that changed.

Q: How much importance do you ascribe to that kind of fine-tuning?

A: We're a people business. Those are our assets. It's not machines or a brand. We're a team and so how we get the best out of our individuals and how we function as a team and how we deliver for clients is absolutely fundamental to what we do.

If you get it right, it's an enormous source of competitive advantage and if you get it wrong it can be disastrous.

People focus so much on strategy. Strategies are easy to copy. Cultures are really hard to copy. Neuberger has had a pretty terrific run over the course of the past decade and a half. How much of that has been great strategy versus how much of that has been culture? I would say more of it is a function of the culture that we've built and improved, as opposed to that we picked a radically different strategy than our peers.

Q: Did Roy Neuberger, who founded the firm in 1939 and died in 2010 at the age of 107, play a big role in defining that culture?

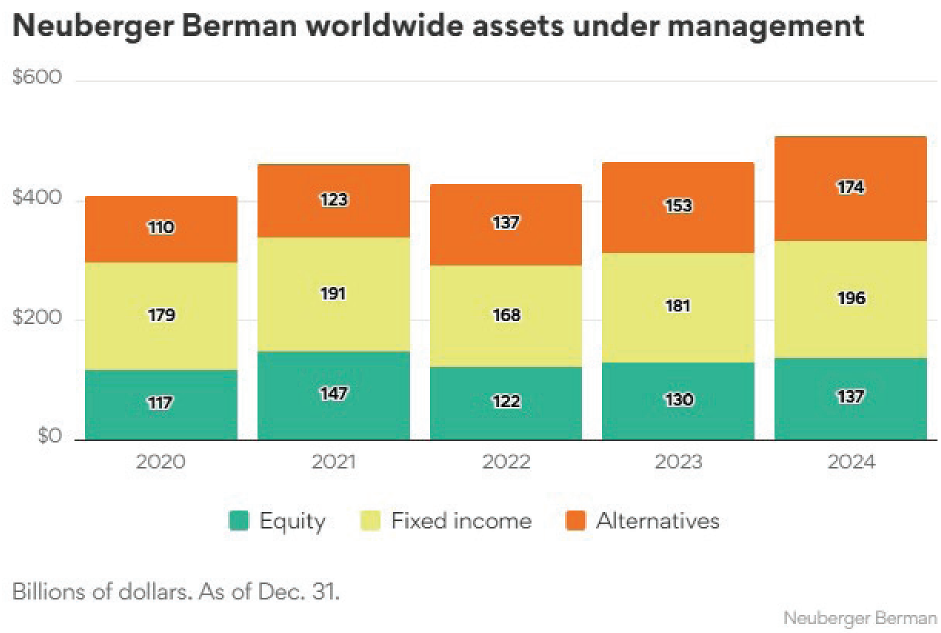
A: What Roy did, I think, particularly well was he stepped down as being CEO relatively quickly … and as owner and founder (worked) to build a firm that really supported its portfolio managers (and) its investment teams. I think that was absolutely definitional.

Q: After 16 years at the helm, are you still having fun?

A: I love what I do. I'm proud to work here. I'm excited about where we're headed. I'm 55 — relatively young, I think, so feel like I've got another decade plus — a lot left in the tank.

Q: Some observers question whether recent senior executive departures at BlackRock are a function of long-time president and CEO Larry Fink's continued reign at the $11.6 trillion behemoth he led the way in building. Could extending your stay at the helm lead to similar turnover?

A: The CEO matters more in a top-down driven firm. We're a bottom-up driven firm and we function more as a partnership — super collaborative. If I got hit by a bus, the firm wouldn't miss a beat.



Q: No power-hungry, egomaniacal money managers at Neuberger?

A: Not that I've found over 18 years, but perhaps somebody will shock me in the future.

Q: Neuberger Berman, a private company for most of its long life, went public briefly in 1999. Are you wedded to remaining private going forward?

A: Our structure is an enormous source of competitive advantage in terms of keeping people. Most of our competitors have to take 40% of pretax revenues and give it to public shareholders or a corporate parent. The fact that we take that same 40% and give it back to our employees — either in the context of compensation or in the context of returns or in the context of additional investment — is huge. Anyone who has managed more than one person knows that if you had just x percent more — 3% more, 5% more, whatever it is — you could make everybody happy. As a leader, having 40% more … makes the race a little less fair.

Another great benefit is people are able to take a much longer-term point of view, so the challenges that peers face in terms of having to deliver, for equity portfolio managers who are measured on daily, weekly, monthly, quarterly, annual performance, is just a very different lens than an employee-owned firm makes decisions about.

Q: Speaking of long-term, it seems as if a combination of domestic economic challenges and geopolitical tensions have taken the bloom off the China rose, a market Neuberger has been at the forefront of, among foreign managers investing to build a business there. Does China still burn bright on Neuberger's radar screen?

A: It's obviously tricky given the political conflict but I believe we are a force for good, and for us this is a super long-term investment. We had no expectation that the business would be large or profitable anytime soon. The challenges that the Chinese economy and markets have faced mean that any prospective financial returns are yet more distant than originally envisioned.

Still, I'm pleased with our progress, with our fund management company (in Shanghai) investing about 18 billion renminbi ($2.5 billion) of Chinese money in China — modest but growing. We continue to help the most sophisticated Chinese institutions invest globally. But business helping global investors invest into China has been fairly hard hit, given the geopolitical tensions.

It's hard to build into struggling markets but I think it makes us better investors. I'm quite proud of what we're doing. Our being able to co-exist is in all of our long-term interests. I'm comfortable where we stand but I have no expectation that it will be large or profitable. I just want it to be good.

And if you look at what our focus has been and what our focus will be, a lot of it is around green funds. The Chinese are quite serious about their commitments on the climate change front.

Q: Speaking of climate change, Neuberger appears to be taking an increasingly lonely stance with its sustained focus on stewardship, including ESG and diversity, equity and inclusion-related issues, even as many competitors have grown wary of leaving their heads sticking out above an increasingly politicized parapet.

A: The politicization of (ESG) has been unfortunate. We're a leader in stewardship and sustainability. It's important to us. We have huge investments around it. (And) we're at a super interesting moment where you see many (money management) firms walking back their commitments to engagement.

I haven't gotten my head around how does capitalism work when nobody's behaving like an owner? If owners don't engage and behave like owners, I worry that's going to create a whole series of long-term systemic issues. So, we're doubling down on stewardship. We think it's really important. We think we do it really well. We care tremendously at the same moment that many firms are going the exact opposite direction.

We're the only firm, broadly, that's pre-announcing proxy votes, showing our work so people understand. It's very hard to tell from a yes, no what's really going on, so we try to explain why we voted a certain way.

Q: Have you had to pay any price in the market for that stewardship stance?

I'm not sure we're getting tremendous commercial benefit from it. I do get angry phone calls but we think it's the right thing to do. We think that's our role. We take our fiduciary obligations incredibly seriously.

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Neuberger Berman expanding alternatives, building out global footprint

By DOUGLAS APPELL

Neuberger Berman has continued to evolve in response to the needs of big institutional asset owners around the world, but CEO George Walker is fond of pointing out what hasn't changed for the firm, including its commitment to go global and its focus on building out private markets capabilities.

Q: Looking at the steady stream of teams and capabilities Neuberger has added over the years, the phrase "permanent revolution" comes to mind.

A: Frankly, very little has changed. We picked our North Star (and) stayed true to it. We knew what we wanted to build. When we started off, 98% of our revenues were domestic and we wanted to build a global firm. We've made huge progress in our rankings in Japan and China but we still have a long way to go on that journey.

Q: Next stop?

A: In the short term, we're focusing a lot on the GCC (the Gulf Cooperation Council region) where we've not achieved a similar level of success but want to. It has some of the most sophisticated investors in the world and there's no reason we shouldn't have the same level of success there that we've had in markets like Canada or Japan or the Netherlands or Italy or Germany or Switzerland. We will be investing materially to accomplish that over the course of the next 20 years.

Buck Ennis

Neuberger Berman's George Walker.

Q: And Neuberger's private markets journey?

A: We now have, depending on how you slice and dice it, $175 billion in various flavors of alternatives. We started with a fund-of-funds business, then added a secondaries capability, then a co-invest capability, which is now a huge part of what we do, then private debt, then capital solutions, and still much more to do. We will continue to find one or two new things a year where we think we can drive real value for clients, that we'll embrace, and a lot of that is, frankly, clients taking us there, (building) on deep partnerships.

Working closely with important insurers, understanding what they need, helping them solve problems — that's taken us to new spaces like private placement debt, something we were not doing five years ago and now have a terrific team. We've become quite a large manager for insurance companies, at $75 billion.

Q: When it comes to partnerships with big institutional asset owners, is it a case of the more, the merrier? Or does the time consuming nature of those relationships force you to pick and choose?

A: There's no doubt that a lot of the ways that we've grown are perhaps limiting, in the sense that we're not making widgets that are infinitely scalable. We're not the biggest by far. We don't aspire to be the biggest. We want to have really great relationships, to really deliver for clients, to really invest in their success. And if that (excludes us from) the ranks of the largest firms, that's fine. We don't celebrate AUM. We cannot have an infinite number of close partnerships with major insurers or sovereign wealth funds or pension plans. It's a different business.

Our relationship with clients is deeply consultative. I just had lunch yesterday with the CIO of one of the largest plans in the world, thinking through what they're trying to accomplish with their fixed income investing, a lot of which they do in-house, but there are spaces they're not pursuing where they recognize there's alpha. How can we do that? What opportunities do we have to collaborate? We're very comfortable partnering for a period and then getting fired as they build in-house capabilities. For most managers, the more (big clients) manage in-house, the less opportunity for them. For Neuberger, the more money they manage in-house, the greater the opportunity for us to collaborate.

Q: Will public and private markets continue to be seen as two different animals or will the distinction gradually disappear?

A: The world has always viewed them as sort of radically different but I never have. I think the lines are absolutely blurring.

At the end of the day, it's just investing. We have a number of mandates … where people are saying 'we'd like to invest in credit and here's our liquidity needs. You figure out where we should invest' — joint public and private, grounded in what are the liquidity needs and the return objectives of those clients. Most investors have far more liquid portfolios than their behavior would suggest they need.

There is an unnamed client that we are partnering with — one of the largest defined contribution plans in the world — where we are managing a private markets portfolio that fits into (their) target date funds.

Q: Do you see target-date funds as the best way to get private investments into DC plans?

A: I do. If you ask me to predict, I think the way it will be introduced will be as a portion of a target-date fund, such that the investor can decide 'do I want totally liquid or do I want something that's illiquid but priced daily, weekly, monthly.' So, I think we have to make it simple and clear, and that it's likely to be a small part of a larger thing rather than a discrete, standalone option.

Otherwise, we're doing a lot of work on packaging and how we deliver strategies to people. So, we've upgraded our product development capabilities and our marketing capabilities. You see it in permanent capital vehicles and active ETFs and things like that. We brought on a terrific guy from McKinsey, Kevin Cho, who has a great team and who's been laser focused on it, because when it was 5% of our time, we just weren't getting the job done.

Q: A year or two ago, you seemed to be sounding the alarm about the inexorable growth of the U.S. national debt, saying the longer we wait to address it, the more dangerous it will become. But now, despite a new administration in Washington seemingly poised to add trillions of dollars to the debt, recent outlook pieces on Neuberger's website have sounded fairly sanguine about the coming year. How to reconcile?

A: I think it's one of, if not the top, long-term challenge facing the country. But in the context of the long end of the curve moving significantly, it's a relatively low probability event in the short term. It is like a 50-year old who is smoking four packs a day. I don't expect that they will die of lung cancer in the near term but I know it's really bad and that this will not end well.

It's a behavioral finance problem. Democracies around the world have not done a great job of dealing with long-term challenges. We do a much better job of focusing our attention on the fires that are raging today and a disappointingly poor job of tending to the forest and clearing the underbrush and doing the unrecognized that's that will make the country better for our kids and our grandkids.