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Mellody Hobson: Diversifying Personnel as well as Portfolios

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MELLODY HOBSON

Diversifying Personnel as well as Portfolios

Mellody Hobson is president and co-chief executive officer of Ariel Investments, where she is responsible for firm-wid e management and strategic planning, overseeing all operations outside of research and portfolio management. Additionally, she serves as chairman of the board of trustees for Ariel Investment Trust. Beyond her work at Ariel, Hobson has become a nationally recognized voice on financial literacy and investor education. She is a regular contributor and analyst on finance, the markets, and economic trends for CBS News. She also contributes weekly money tips on the Tom Joyner Morning Show *and authors a column for* Black Enterprise *magazine. As a passionate advocate for investor education, she is a spokesperson for the Ariel/Hewitt study titled "401(k) Plans in Living Color" and the Ariel Black Investor Survey, both of which examine investing patterns among minorities. She is vice chair of the board of Starbucks Corporation and a director of JPMorgan Chase. Her community outreach includes serving as chairman of After School Matters, a nonprofit that provides thousands of Chicago teens with high-quality, out-o f-school-time programs. She is chair of The Economic Club of Chicago, co-chair of the Lucas Museum of Narrative Art, and a board member of The George Lucas Education Foundation. She is also a member of the American Academy of Arts and Sciences and The Rockefeller Foundation Board of Trustees, and she serves on the executive committee of the Investment Company Institute's board of governors. In 2015, Hobson was named to* Time Magazine's *annual list of the 100 most influential people in the world. She earned an AB from Princeton University's Woodrow Wilson School of International Relations and Public Policy. She has also received honorary doctorate degrees from Howard University, St. Mary's College, University of Southern California, and Johns Hopkins University.*

In June 2018, Mellody Hobson spoke with members of the Journal of Investment Consulting *Editorial Advisory Board about why diversification among corporate leaders and investment consultants is as vital as portfolio diversification. Taking part in the discussion were Margaret M. Towle, PhD, editor-in-chief of the* Journal*; Edward Baker, Mesirow Financial; Michael Dieschbourg, Hermes Stewardship North America; and Philip Fazio, Merrill Lynch.*

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Mellody Hobson

Margaret M. Towle: Mellody, we are interested in hearing about the major factors that helped to shape your career and bring you to where you are today, including not just your major achievements, which are many, but also your greatest challenges and disappointments. In addition to talking about their careers, some of our masters have included comments about their lives in general, so this is an open question.

Mellody Hobson: Thank you for having an interest in my ideas. In terms of the major factors that helped shape my career, I'll start with growing up. I'm the youngest of six kids, and in my house I was really young. My older siblings were a couple decades older than me, and as a result I'm technically an only child. They say if there are more than five years between you and a sibling, you're considered an only child. My closest sister was nine years older than me. The reason that matters is because I have a single mom, and I would describe our existence as feast or famine. There was actually no real feast; it's just that relative to the famine part of our lives, it sometimes felt like a feast.

My mom did the best she could, but she really struggled. She was in the real estate business. There were many times when our lights or water or phone were disconnected or we were evicted. My mom used to borrow gas from the gas station to get me to school. I gave a speech once in which I said, "Do you remember your first check? I remember ours because it was hanging on the wall at the grocery store because it had bounced." This had a dramatic effect on me.

My husband often says what happens to you as a child stays with you because at that point you don't have any advanced reasoning skills. Things seem huge when you're a child. My shaky foundation made me very curious about money and, more than curious, desperate to understand it. I didn't want to live the life as an adult that I had lived as a child, with such uncertainty and insecurity.

When I was seventeen years old, I met John Rogers, who had a dramatic effect on my life and my career. He was this wunderkind who had been picking stocks since he was a child. He also attended Princeton but eleven years before me. I knew he was doing something special around money, and I asked if I could be a summer intern at his firm, Ariel, between my sophomore and junior year at Princeton. I discovered the world of money management there and fell in love with it.

The next summer, I went to work at T. Rowe Price. I worked on the research side for a famous portfolio manager named Jack LaPorte,[1] and the company had a number of well-known analysts such as Roger McNamee,[2] who was running the firm's science and technology fund. I was the first undergraduate intern ever hired at T. Rowe Price. I was lucky because Ariel was a large shareholder of T. Rowe Price shares, and John convinced Jack LaPorte that he should hire me. So I had this unbelievable opportunity to see a giant firm up close at a young age.

The people who were running T. Rowe Price joked that John sent me there to get trained to go back to Ariel, and that's exactly what happened. My senior year of college I accepted the offer John had given me the summer I left the firm. He said, "We really want you back." I was noncommittal at first because I didn't know where I wanted to end up, but after a lot of soul searching and interviews on Wall Street, I chose to work up close with John as opposed to being layers away from the action.

So I went to this small firm in Chicago. I think at that point I was the eighteenth employee, and we had something like $1.6 billion under management, maybe just $1 billion. We were small. That was a curious choice to some people, but not to me, because I was comfortable with the risk-taking having grown up the way I had. I really liked the entrepreneurial environment, and I knew I could learn a lot from John.

To summarize the things that shaped my career, it was growing up without money and being worried about it; it was meeting John and getting my first exposure to stock market investing as an intern; and then coming inside the firm full-time. These were pivotal events for me.

On my first day of working full-time at Ariel, John took me out to lunch. I was twenty-two years old; I knew nothing about nothing. He said: "You're going be in rooms with people who have big titles and make lots of money, but it does not mean their ideas are better than yours. I always want to hear your ideas." This gave me license to be a contributor. John invited my perspective and my ideas from day one. This really empowered me, and from the beginning I felt that Ariel was my firm too.

There was another pivotal moment in addition to my landing the job. In 1994, our mutual funds were distributed by the Calvert Group. We had a joint venture with them, and my early work was acting as a liaison between our two firms. I went out to see what at that time were called brokers to tell them about the Ariel funds. I also traveled with Calvert's wholesalers to get them excited about Ariel's mutual funds because they were selling a whole suite of products. I was just this pipsqueak working as an Ariel cheerleader.

I went to John Rogers and said, "We should leave Calvert." And he said, "Tell me about this." I said, "I think we should start our own mutual fund company and take the funds with us." The funds were set up so that half the board members had been appointed by or suggested by John, and half the board members had been suggested by Calvert. It was truly a joint venture. They did the distribution; we did the asset management and shared the fee.

But from being out and about with Calvert's brokers, I felt that potential investors were receiving different messages from us. Specifically, we were talking about patient, long-term value investing, and the brokers were talking about other things. It felt jumbled to me. Lo and behold, John said: "I think you're right. Present this to the board of directors."

I was twenty-five-years old. I went to the board and did a presentation asserting that we should leave Calvert, our funds should be converted from load to no-load funds, and we should self-distribute. This hadn't happened before, and there wasn't a lot of precedent for it. But the board went for it. Then they said, "Now you have to go to Calvert and ask for a divorce."

The day John and I flew to Calvert's headquarters in Maryland, he was nervous. We took Bob Solomon, our lead director from the company, with us. When we got to the building in Bethesda, John said, "I want to make a phone call." In those days we didn't walk around with cell phones, so he went to a payphone in the lobby of the Calvert Group and called his former basketball coach at Princeton, Pete Carril. I was standing next to John, wondering why he was making this call but realizing he had a lot of anxiety about this meeting.

John said, "Hello," and his coach said: "What's wrong? You're breathing heavy." Just from "hello." And John said: "I'm about to do something I never would've imagined. I'm asking someone for a divorce, and this is hard for me because I believe in loyalty." And the coach said, "I know you are always the kind of person who does the right thing." Then we went to the meeting, and it was one of the hardest meetings of my life. People were stunned and very unhappy with us. Ultimately, they told us the board would decide.

We went to the board—half us, half them—and the board did something that also surprised us. They said: "You have four weeks to work out the terms for an exit, and if you don't, all bets are off. Both of you could lose these funds." That was a sobering moment. John gave me a look of panic and anguish, as if he was thinking: "What was I thinking listening to this twenty- five- year old? I'm about to lose $400 million in assets."

We worked out the separation deal and officially left Calvert on Labor Day. How we did it was riveting and thrilling and terrifying all at once, but we got through it.

Margaret M. Towle: Well that shows the grit and determination you had even as a young woman. You've achieved a lot, including getting through the divorce from Calvert, but what has been the greatest challenge or disappointment of your career?

Mellody Hobson: I put the challenges in two buckets—what you can control and what you can't. I'll start with what you can't control. Without question, 2008 was a year that rocked Ariel. We were on our backs. We'd underperformed our benchmark dramatically. We were down 48 percent that year. It was the worst year in the history of our firm, and we lost a lot of clients. Every single day someone fired us. Every day.

We lost relationships that I had worked on for a long time, relationships that meant a lot to me personally, as well as to the firm. I realized that my sense of self was wrapped up in the reputation of Ariel, so I felt great self- doubt. I was deeply sad that we had disappointed people and knew that we had to just get through it. There was nothing else we could do. We were working so hard—I mean just crazy—and I remember reading a poem that said sometimes you have to know when you can't do any more. I had to accept that, and that was deeply humbling.

I will never forget this experience. It's imprinted in me the way I think Depression- era babies carry the imprint of that period. It's actually something I want to remember. We talk about it in our firm as a part of our legacy, because I think it brought us together and made us a better firm despite the fact that it was incredibly painful. But I don't want to make it about us because, as I told you, I felt as though we disappointed other people.

Every day I woke up thinking this is someone's kid's college education or the money for their first house or their retirement, and we did not fulfill the Ariel promise, which historically we had insulated on the downside. We did many postmortems on that period to try to understand what worked and what didn't. Ultimately, we were able to stick to our core beliefs and also improve. That set us up for this past decade in which we've been ranked number one against our peer groups by both Lipper and Morningstar since the market bottomed.

As bad as it was, it also was an amazing time for Ariel in many ways. For one thing, there was no tension in our firm. I know people find that hard to believe because usually when you go through a challenging period like that you expect people to be in bad moods. The way I've described it is if your mom was in intensive care, you wouldn't be sitting in the room arguing with your sister. You'd know that would be inappropriate.

There was a calm that came over our firm. John would say things to me like: "I'm really sorry. These were my stocks, and it was my decisions that put us in this position." And I would say to him: "No, John, it's my fault. If I had explained this better to our clients, they wouldn't have left." It was a period when we both took on 100- percent accountability for the outcome, and there was no blame. That was a proud moment for us.

The one other point I want to make about challenges or disappointments is that, as a leader, you need to acknowledge the people failures. I think there were times I just failed people and I could've been better. It took that situation for me to become better at being an empathetic and compassionate leader. I was always hard driving—never a yeller, never someone who would disparage another person—but my work ethic and my expectations could exhaust others. When I look back, I believe there were times I could've done things differently with people, and that is a disappointment.

Margaret M. Towle: Just one other background question. A large number of readers of the *Journal of Investment Consulting* are advisors and consultants. You've been in the industry for a number of years, and you've had a chance to work with consultants and to see changes in the industry. What do you see as the appropriate role of investment consultants today, both on the institutional side and the wealth management side?

Mellody Hobson: I believe the best investment consultants are those who have a point of view. That may sound obvious, but that's not always the case. The best consultants and advisors I've observed have a vision; they don't just react to what a client wants. They are truly advising the client, as opposed to "advising" in quotes. Some advisors are not willing to do this; they take the path of least resistance in the hope of keeping their jobs.

The consultants who have been standouts for us at Ariel have deep knowledge and deep expertise, and you know what they stand for. But that's hard to do. How do you break out of the pack and distinguish yourself in the world of giving advice? The same is true for investment managers. How do you break out of the pack when thousands of us are out there chasing returns? You have to be different.

Margaret M. Towle: We had the opportunity to watch your TED Talk, in which you assert that the first step in solving any problem is not to hide from it. One issue that's been discussed quite a bit recently is gender and racial equity, as well as the general concept of diversity, or lack thereof, within the industry. Let's start with a question from Ed Baker.

Edward Baker: I believe most people in the investment business would like to see more diversity in the industry and in particular more women and more people of color. What do you think the industry should do to encourage an increase in the number of women and people of color?

Mellody Hobson: I gave a speech at the *New York Times* DealBook Conference called "Waiting for a Corporate Kaepernick."[3] It was obviously a nod to Colin Kaepernick, who started taking a knee to protest police brutality against unarmed black men. I recognize how controversial that issue is, and I purposely waded into it because I wanted to make the point that Colin Kaepernick has sacrificed a lot for his beliefs and principles. Specifically, he was forced to give up a job he had trained for his whole life.

In corporate America, I'm not seeing that same kind of fight around the issue of diversity. We read annual reports for a living at Ariel, and we'll see pages on policies about diversity and inclusion, how this is what the company strives for and how diversity is a core part of its fundamental values. Then we get to the back of the report and see the key leaders or executive team, and there's no diversity. This does not make sense to us.

What I was trying to emphasize in this speech was that when you ask corporate leaders about diversity, they say, "We're working on it." I put "working on it" in quotes. I've heard this response for my entire career, but there's no other area in corporate America that you can work on for decades and not show progress and still have your job.

You cannot be a chief executive officer (CEO) who is working on better earnings. You can't be a chief marketing officer who is working on better sales but doesn't achieve them over a long period of time. So my first thought is that an idea without effort is not good enough. We have to acknowledge that this language must go away. I quoted Yoda: "Do or do not. There is no try." There is no try anymore at diversity. So within the "do or do not," what are our options?

One of our options is to make sure ownership of the goal is at the top. If diversity is important to you, you have to structure incentive plans around this concept. I say "if" because I believe some people say diversity is important, but it's not really at the top of their list. They think it would be a nice to have, but it's not perceived as a need.

At Ariel, the point we're trying to make is that the world is changing in real time. We all read Scott Page's book *The Difference: How the Power of Diversity Creates Better Groups, Firms, Schools, and Societies.* All the data show that if you're trying to solve a difficult problem, the best way to approach it is with a diverse group of people. There is also the fact that if you want to go after specific customers who reflect the way the world is changing, having all of those individuals represented inside the firm is in the best interest of the organization. You want team members who are able to understand the unique perspectives and opportunities that are out there.

We think diversity can be a competitive advantage for companies that decide to get serious about it. Portfolio managers get paid on the basis of performance. Marketing people in the investment management industry get paid on the basis of what assets they bring in. Achieving diversity should also be tied to incentives.

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Our whole industry is based on the idea of portfolio diversification. Yet this kind of diversification is not represented inside our organizations. There's been this idea of the Rooney Rule, which originated in the National Football League and which states that job interviews will include diverse candidates, though no quota or preference is given to hiring minority candidates.[4]

In my DealBook speech, I told a story about the CEO of a publicly traded company who came to me saying that all of his direct reports were white and he wanted some diversity on the senior team. The company had a communications position open, and the CEO informed the headhunter that he wanted diverse candidates to be interviewed for the position. The headhunter and the head of human resources (HR) came back with a slate of candidates consisting exclusively of white males.

The CEO asked, "What about my request didn't you hear?" They said, "Well, we can't find anyone." So the CEO told his team: "The job will go unfilled. We're not going to have a head of communications." The general counsel, the chief financial officer, and the head of HR panicked. They said, "We can't run a company without a head of communications." In addition, the headhunter's firm realized it was not getting paid because its pay would have been based on the salary of the person hired. Suddenly a bunch of diverse candidates appeared, and the CEO had options.

I also like to talk about John Skipper, the former president of ESPN, who told me he had pushed the idea of diversity in the network's corporate ranks, and yet a senior person came to him and asked, "Do you want me to hire the diverse candidate or the best person for the job?" And Skipper's response was simply, "Yeah."

His response was fantastic because that didn't need to be a binary decision. Again, it's all about leadership and ownership. In the investment management industry, we pay attention to scores. Just like in sports, we wake up every single day and know the score. Our scores let us know we're accountable, and I don't understand why we aren't willing to score ourselves and provide incentives around diversity in the same way.

Edward Baker: I'd like to ask a related question concerning ethics, which we know is important in our industry. Do you think there are differences between men and women in terms of their approach to ethical issues in our industry and, if so, can you elaborate on that?

Mellody Hobson: I'm not sure I think that there are differences around ethics. There are differences around a lot of things—perspectives and experiences that I believe ultimately round out a discussion and make it better. People generally look to women for the softer skills and to men for the harder skills, but if you watched John Rogers and me working together, you'd see that I can be a lot tougher than John on certain things. We don't fit the stereotypes. Still, there have been times when I believe being a woman helped me navigate certain types of negotiations or situations in a way that I don't think a man would have had the same tendency to do.

Michael Dieschbourg: I want to follow up on your thought process there. A lot of studies now show a correlation between significant female representation on boards and companies' higher returns on equity, invested capital, and sales. In addition, when you consider groups, especially racial minorities, research conducted by economist Gary Becker demonstrates that discrimination against racial minorities in any marketplace by any group reduces the group's own real income as well as those of the racial minorities.[5]

If you think about addressing this issue by leapfrogging, building diversity from the bottom up is difficult. You've been successful at the board level. How do you suggest we as an investment industry open more doors in senior management and boardrooms to create opportunities that are broader in ethnicity, experience, and diversity of opinion and gender? If people wait to move up through an industry that's overly dominated by white males, leapfrogging from the top down might achieve change faster.

Mellody Hobson: I agree with you 100 percent. I have a swim coach, who at the beginning of my lessons makes me wear gloves that are like mittens so I can't use my hands when I'm swimming freestyle. Halfway through the lesson, I'm allowed to take my gloves off, and he says, "Mellody, use your power for good." I always think about this metaphor in my life at Ariel. Use your power for good. We can demand diversity in our industry in one very specific way.

We have the vote. We hold the proxy, and we can say we're not voting for an all- white male board. We can withhold our support for the company and get its attention. This is something that some public funds investors have taken to heart, but on the other hand, we keep hearing company leaders say, "We're working on it." When you ask them if they're really serious, they'll often reply, "Well, in the scheme of things, that's not as important as X, Y, or Z." Then I say, "Well, then you're not really serious."

We don't advocate for a specific person; we just say, "This is going to be important to your success as a company." So this power is in the hands of the industry, and companies can collectively or individually change the boardrooms of America.

We used to own a company called Longs Drugs, which was the largest drugstore chain in California and Hawaii. Their shareholder report called their customers "Mrs. Customer," but the only woman on their board was Mrs. Long. When she passed away, John Rogers said to the company: "You can't be successful without having women on your board. Your lack of diversity is a problem for us because it makes us wonder about your judgment on other things." This became an issue that the company took to heart because Ariel was a large shareholder. We have done this with numerous companies in which we had ownership.

There are many companies to which we've said, "We need to see diversity on your board," and they have responded to us. At one point we owned almost 30 percent of Sotheby's. We said, "You need diversity," and they added a black director to their board. We don't advocate for a specific person; we just say, "This is going to be important to your success as a company." So this power is in the hands of the industry, and companies can collectively or individually change the boardrooms of America.

One other significant factor is that the feeder pipeline for public companies is private equity. We've been asking private equity companies, "How diverse are your boards?" because those are the boards that end up taking the companies public. Those private company boards that no one can see need to be diversified in a serious way, and institutional investors can ask those questions.

Michael Dieschbourg: Great answer. Among the investment vehicles your firm focuses on are small- and mid- cap companies. From an environmental, social, and governance (ESG) standpoint, what you're doing—trying to bring about change—has been adopted by some of the larger institutions. I'm thinking of the United Nations–supported Principles for Responsible Investment, for example, and what that international network of investors has put together. But most ESG research focuses on large companies that can respond to questions versus small- or mid- sized companies that might not have somebody who's responsible for dealing with these issues. How do you engage with the smaller companies? Because you're not investing in private equity, how can you pressure small- and mid- sized companies to diversify their boards to get the desired result?

Mellody Hobson: First of all, we meet with companies on the domestic equities side, on the small- and mid- cap side, before we invest in them. We often follow them for years waiting for an entry point where we can buy them, so they're companies that we know, and they know what Ariel stands for. Our turtle logo lets them know we're the patient investors.

Many companies applaud Ariel buying their stock because they know we're long- term investors who won't be trading in and out of their shares, who won't run for the hills if they miss a quarter. That's just not how we invest; we take a long- term view. We have companies in our portfolios that we've owned for decades.

Our dialogue with these companies is strong and frequent. We speak with them every quarter. When you've talked with a management team every quarter for a decade, you know one another. Before we buy stock in a company, we tell them the things that matter to us. We talk about how we are buying them for focus and that the way they allocate capital is going to be really important to us.

We don't like random acquisitions that, as Peter Lynch would say, "diworsify" the business.[6] We talk to companies about diversity issues and make sure they have diverse boards because we think that's what twenty-first century companies should be. Those are table stakes required for a company to be even relevant let alone excellent. We make all of this very clear.

Have we bought companies that did not have diversity on the front end? Yes. And then while we owned the stock, have we advocated for changes? Of course we have. Typically, we do that quietly behind the scenes. We're not activists at Ariel, but we end up being big shareholders, and companies listen to their big shareholders. Our point of view around these issues becomes hard to argue with, and they respond. We engage with them in an up- front and direct way, and we have a reputation.

They want us as stockholders because they know we're going to be there long- term. We typically are the top two or three shareholders of the company because we have concentrated portfolios and we take big positions. So if you're a company's largest shareholder and you've asked its management team why its board isn't diverse, and then you ask them again the next quarter, and again the next quarter, they'd better start having some good answers because, otherwise, they just look bad.

If a company doesn't respond to our requests to diversify its management team or its board, that puts other aspects of its judgment and credibility into question for us. When we actively engage in this discussion, that leads to better outcomes for these companies for the reasons you've cited. The data show that companies with gender diversity on the board outperform, especially if the board includes more than one woman, and we believe racial diversity is equally important.

Philip Fazio: My question relates to ESG, and particularly to G, because that's where you're focusing now. It seems to me that the Russell and MSCI ratings cover some of these governance issues. Should we as an industry be supporting or even guiding these rating agencies in addressing diversity not only in management but also at the board level? I'd like your perspective on this because there's quite a bit of research showing that companies focused on ESG issues tend to perform equally if not slightly better, which is a theme I think you're hitting.

Mellody Hobson: The answer is yes, but I would go a bit further. We are finding that when people talk about diversity, they are defaulting to gender only. From my perspective, the number one beneficiary of diversity initiatives in the United States has been white women. At Ariel we're saying that diversity includes diversity of thought, diversity of racial, ethnic, and sexual backgrounds. We think all of these perspectives make for a better society. On the other hand, we don't want this to become a check- the- box exercise because that elicits pushback, especially in the United States.

People in the United States don't like quotas. We don't like rules like that. So how do we create a sense that diversity is in a company's best interest and therefore the right thing to do? When you talk about diversity simply as the right thing to do, it feels too soft and fuzzy for people.

So the conversation has to be about data, which is why I rely on Scott Page's book *The Difference*. He was the first person to create a mathematical formula for diversity. But in addition to the available data on ESG factors, the conversation needs to include the concept of enlightened self- interest.

Margaret M. Towle: That's an excellent point. We need to encourage the academic community to study not just gender diversity but the multiple dimensions of diversity that you mentioned. Gary Becker's research caused a lot of controversy because people did not separate his conclusions from his recommended solutions. His recommendations for quotas or affirmative action were especially controversial.

Mellody Hobson: I'm a believer in affirmative action; I don't want to even suggest that I'm not. But once you go down that path, that becomes its own political hotbed, and then you've lost the argument. It becomes an excuse not to try to diversify because you're arguing over methods and tactics versus the actual larger issue.

Edward Baker: There's a related issue that has to do with competition. I think we all believe that competition is a good thing and that having more women and minorities in decision-making roles increases the competition for white men. What are your thoughts about this? Do you think competition should be openly encouraged and the best person should win, or should affirmative action programs be used to influence decisions about diversity?

Mellody Hobson: Here's the problem. The reason that the field of sports is great is that the rules are the same for everyone. In basketball you can't move the free throw line when the black person is shooting versus the white person or when the male player is shooting versus the female player. The rules are the same for every player. In real life, that's just not true, so the idea of competition becomes letting the best man or woman win. This situation appears to be a meritocracy, but I haven't found any institution where that is actually true.

I remember having a debate with someone from Silicon Valley who insisted that his organization was a pure meritocracy. I said, "You assume that people don't become friends, that someone doesn't think, 'Well, John isn't doing a great job here, but he's got four kids, and I really like him so I'm going to give him his full bonus.'"

That's the way the real world works, contrary to what people might think. I also remember a conversation I once had with Lou Susman, who was the vice chairman of Citigroup and whom I worked with closely at one point. That conversation is another one that's seared in my brain. We were on a plane, and I was talking about trying to get Ariel noticed inside his organization. At one point I said, "All things being equal, we would hope we could win."

He looked at me and said: "Mellody, I'm going to teach you a lesson that is going to change your life. All things are never equal. And if you believe that is true, you are very naïve. There are always extenuating circumstances or extra considerations. All things are never equal. Ever." This—from a white male. It affected me profoundly. A white male explained this to me, plus he gave me examples.

He said, "If my kid walks into an investment firm at the same time you walk in and you both went to good schools, my kid is going to have an edge just because of his relationship with me." So when you ask how this can be handled in a way that ensures the best man or woman wins, you have to acknowledge that other factors are taken into consideration, and often those are subconscious biases.

A simple example would be that if you apply to Princeton and you're not a legacy, your odds of getting in now are not good. These days Princeton accepts only about 5.5 percent of applicants. But if you're a legacy student, your odds are much higher. So all things are not equal. In this example, the decision may be based solely on who were your parents. My daughter has a better shot of getting into Princeton than I did just because I'm her mother.

If I could be assured that these types of subconscious bias did not exist, I would be all for that, but I've been in too many rooms where that was not the case. Here are another couple of examples. Before I became the Mellody of today, now that people have a better sense of me, I've been at tables with colleagues who had lower titles than mine, and the men in the room wouldn't make eye contact with me. John Rogers would say something like, "You know this decision is going to come down to Mellody," and the people would still call John back every time. He would have to say: "Gotta go to Mellody. Gotta go to Mellody."

You get really annoyed in situations like that. It's upsetting to be in a meeting and have someone think you're not important enough to deserve eye contact.

Once John and I made a presentation to a potential client, and my only contribution was the introduction. The chief financial officer called us back at Ariel on a Saturday, and when I picked up the phone, he said, "What are you doing there?" I said, "Well, we work all the time." And he said, "I just want to give you some feedback on the meeting." I said: "Well, John is here. Let me put you on speaker."

So we're on speaker phone and he said: "I just want you to know, John, the board thought you were excellent; you were really great. But Mellody came across a bit much." I just introduced us and didn't say anything else. For me that's restraint.

Edward Baker: We could try to use quantitative criteria to choose people, but we know the importance of cultural and personal fits and esprit de corps. Still, I think people need to understand that the corporate framework is greatly enhanced by diversity and especially by having women in the mix. I've seen that clearly in my experience.

Mellody Hobson: You also know from the people you went to school with that the smartest people in your school do not necessarily become the most successful. There are all sorts of attributes that lead to great outcomes—there's creativity, there's grit, and there's resilience. Success isn't just about who has the highest IQ.

Philip Fazio: The theme of this governance issue seems to be culture, and culture is challenging. It seems to me that leadership and incentives need to be geared to broadening culture to include not only women but diversity of international perspective, race, age, and so on. I would hope that international companies are well- positioned in this area. So I'd like to hear your thoughts about cultural change.

Mellody Hobson: I think culture trumps everything. The culture of an organization is fragile, and it takes a lot of work. The organizations that have built great cultures are the ones that stand out, and that's happened in the management industry and in lots of other industries. There are the famous stories about Sam Walton, who was so frugal that he required corporate employees to share a hotel room when they were traveling.

I remember going to Walmart to pitch business, and the woman who greeted me asked, "Can I get you something to drink?" I said, "Sure, I'll take a diet soda." She led me to a vending machine and said, "Our soda is only 20 cents." I thought to myself, "This is in the DNA of this company." Then we went to the office of the head of human resources, and the chairs for guests were folding chairs.

I realized that these employees had drunk the corporate Kool-Aid. That said a lot about the organization, but that kind of commitment is hard to achieve, especially at scale. In the investment business, you've seen cultures that are highly defined. I think Ariel has one. I've read about the culture of companies such as Dodge and Cox, which seems unique, and there are other organizations with well- defined cultures.

I think BlackRock has a specific culture. There are cultural differences among some of the big investment banks. So you're right to home in on the cultural issue. The problem is that it's a difficult phenomenon to give a prescription for. Culture often depends on how the organization and its leadership started. My philosophy is that you cannot be a jerk and work at Ariel; I don't care how smart you are. That is a cultural decision we make.

In other organizations, you can yell at people, you can call them names, you can do all sorts of stuff and still be successful. That's not what we want at Ariel. When we hire someone, we use interviewing teams. Lots of people will interview a candidate before that person is hired because we think a bad cultural fit can really rot an organization. One of the questions we ask ourselves is, "Would I want to get stuck in an airport with this person if my flight was canceled or delayed?"

There have been instances in which we've all said: "No, couldn't do it. This person would grate on me." Someone once told me that when you interview a job candidate, you should identify whatever most annoys you and magnify it a thousand times because people are on their best behavior during an interview. These are cultural lenses through which I think about an individual who is going to join our family. We're not just a team; we're a family.

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Margaret M. Towle: There's been a big debate recently about the proliferation of passive management instruments such as exchange- traded funds (ETFs). From your firm's perspective, where do you think we are currently in the cycle of active versus passive management and as we look ahead to the continuing debate on this subject?

Mellody Hobson: At Ariel, we feel pretty strongly that we're late in the cycle, partially just because of the bull market we've had. It's been well- telegraphed that passive management will do less well in a difficult market environment. When you've got a roaring bull market, everyone says you can't underperform. That's the big selling point of passive management in this kind of environment. But what people forget is that you can't outperform either. So in a down market, if you consider behavioral finance and how people react when they lose, that should change the game for what we've been seeing in terms of the flows in passive management.

We saw a little of this in the beginning of 2018 when some of the movement into passive management slowed down. But people also forget that passive and active management must coexist if the market is to have equilibrium. The world can't go all passive and expect the stock market to work; it's just not possible. One thing that is happening now relates to the behemoth companies of the financial services world—for example, the

Vanguards, and the BlackRocks. They're growing fast, they're huge, and they're cheap. They are the "Amazons" of the investment world.

These organizations will continue to play a significant role in the future of the investment management and mutual fund industries, but they are commoditizing the market. Commoditization makes anything that's different stand out, and this creates opportunities for managers like us, managers who are looking for value, who are willing to buy orphaned securities. So in this growth- fueled market that's been commoditized by passive management, value has become more conspicuous.

Despite the fact that this has been a painful period because the flows have been congregating on the passive side, this has also been a period that's created opportunities for a manager like Ariel. Consultants who bow to the pressure around passive are dis- intermediating themselves from the business. Why do you need a consultant if you're only going to buy the market? I think the consultant's relevance will improve in a more volatile market when the passive decision isn't the obvious one.

Margaret M. Towle: Do you have any concluding thoughts about topics we didn't cover?

Mellody Hobson: I want you to have a sense of my optimism. I'm never a glass- half- empty person; I always see a glass half-full. I think our industry is filled with dynamic and smart, thoughtful people who will ultimately see the merits of advancing with the issues we've discussed rather than simply thinking about them. I believe they'll get past wanting diversity to happen and actually make it happen.

I also think there's a lot ahead for us as the industry continues to evolve and change. Changes can be for the better or worse. Some things that have happened in recent years are not good—for example, holding periods becoming shorter and shorter. I just read that the average holding period for an ETF is eighteen months, which I do not believe is a good thing for investors.

Despite some less desirable changes, a lot has happened to improve competition and fees. We just need to understand that when our interests are aligned with certain outcomes related to governance, we can help ourselves and at the same time improve results for our clients.

Margaret M. Towle: This was a great discussion, and we hope it will be a step to ward increasing awareness about the need for diversity in our industry. Thank you so much for your time.

Mellody Hobson: Thank you. Talking with you was my pleasure.

ENDNOTES

1. John H. "Jack" Laporte, Jr. (1945–2013) was a portfolio manager at T. Rowe Price. He managed the New Horizons Fund for more than twenty-two years, quintupling the size of the multibillion-dollar fund over that period.
2. Roger McNamee began his career in 1982 at T. Rowe Price Associates, where he managed the top-performing Science & Technology Fund and co-managed the New Horizons Fund. In 1991, he launched Integral Capital Partners, the first crossover fund (combining later-stage venture capital with public market investments), in partnership with Kleiner Perkins Caufield & Byers and Morgan Stanley & Co. In 1999, McNamee co-founded Silver Lake Partners, the first private equity fund focused on technology businesses. In 2004, he and his partners launched Elevation Partners, an investment partnership focused on the intersection of media/entertainment content and consumer technology. http://www.elevation.com.
3. See "Where Is the Corporate Kaepernick?" (November 9, 2017), https://www.nytimes.com/video/business/dealbook/100000005543933/mellody-hobson-corporate-kaepernick-dealbook.
4. The Rooney Rule is a National Football League policy that requires league teams to interview ethnic-minority candidates for head coaching and senior football operations jobs. It is sometimes cited as an example of affirmative action, though there is no quota or preference given to minorities in the hiring of candidates. The policy was established in 2003, and variations of the rule are now in place in other industries. https://en.wikipedia.org/wiki/Rooney_Rule.
5. Gary S. Becker (1930–2014) pioneered study in the fields of human capital, economics of the family, and economic analysis of crime, addiction, discrimination, and more. He received the 1992 Nobel Memorial Prize in Economic Sciences "for having extended the domain of microeconomic analysis to a wide range of human behavior and interaction, including non-market behavior." https://www.nobelprize.org/prizes/economic-sciences/1992/becker/facts/.
6. Peter Lynch is an American investor, mutual fund manager, and philanthropist. As manager of the Magellan Fund at Fidelity Investments between 1977 and 1990, he averaged an annual return of more than 29 percent. Lynch coined the term "diworsification" in his book with John Rothchild, *One Up on Wall Street* (1989). Diworsification is the process of adding investments to one's portfolio in such a way that the risk-return tradeoff is worsened. Diworsification occurs from investing in too many assets with similar correlations that add unnecessary risk to a portfolio without the benefit of higher returns. https://www.investopedia.com/terms/d/diworsification.asp.

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