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Forbearance in Institutional Investment Management: Evidence from Survey Data

Amit Goyal , Ramon Tol, and Sunil Wahal

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We survey 218 institutional investors from 22 countries representing over \$4.1 trillion in AUM to understand the drivers of forbearance in the termination of external asset managers. Although asset managers are fired for a variety of reasons, including taking on too much or too little risk as well as organizational changes at the investment manager or institutional investor level, poor performance is by far the dominant cause. There is surprising tolerance for underperformance and holding periods for investment managers are unexpectedly long. Forbearance is important and we argue that performance evaluation should be multifaceted, akin to a Bayesian decision-maker who conducts continued due diligence and updates beliefs about returns with process information.

Keywords: forbearance; holding period; institutional managers; underperformance

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Institutional investors make asset allocation decisions that attempt to match the riskiness and duration of their underlying obligations but outsource the actual investment to external asset managers.¹ As part of its fiduciary obligation, an institution selects and then monitors its managers on a regular basis and, under various conditions, terminates the asset manager to transfer those assets to a different asset manager. This practice of selection and termination move extremely large amounts of capital. A repository of investment mandates from institutional investors reports more than 74,000 mandates between 1995 and 2021 (<https://www.fundmap.com/>). Even if the average mandate size is a modest \$25 million, that implies a transfer of \$1.85 trillion between asset managers over this period. Clearly, selection and termination are important.

We know that hiring decisions depend on the prior performance of the asset manager, the personal connections between personnel at the institution and the asset manager, and the recommendations of investment consultants (Goyal and Wahal 2008; Goyal, Wahal, and Yavuz 2022; Jenkinson, Jones, and Martinez 2016). But we know precious little about the firing process, in part because archival data on terminations are sparse.² Institutions are disinclined to report terminations lest their shifts affect the transition from legacy to target portfolio or their tactical changes are second-guessed *ex post*, or because termination

We thank Institutional Investor for conducting the survey on our behalf. Blue Sky Group did not provide data or funding for this research. Wahal is a consultant to Avantis Investors. Avantis did not provide data or funding for this research.

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may reflect poorly on their initial selection decisions. Asset managers are similarly disincentivized to report terminations for reputational concerns and for fear of triggering further client withdrawals.

From an institutional investor's perspective, there are costs and benefits to asset manager turnover. Excessive churn of asset managers generates numerous frictions, such as transition costs, that are ultimately borne by the claim holders of these institutions (retirees, students, charity recipients, as well as current and future citizens). On the other hand, and perhaps less well recognized, *not* terminating underperforming asset managers results in claim holders bearing the costs of prolonged poor performance. Decision-makers are frequently not claim holders: For instance, members of an investment committee for a pension fund may not be future retirees of the state or the citizens of a country whose sovereign wealth fund they help manage. This can generate a principal-agent problem in which the costs and benefits of asset manager turnover need not be directly tied to decision-maker incentives. Indeed, decision-makers may engage in manager turnover, if for no other reason than to be seen to be doing something. Compensation contracts can be (and sometimes are) designed to align the interests of decision-makers with their claimants to reduce excessive manager turnover. Regardless of the reason, it is important to understand the actual horizons and patience (or lack thereof) of institutional investors. Institutional investors are themselves interested in knowing how their peers think about evaluation horizons for reasons of both process and outcome. For instance, board members and trustees often ask questions about the evaluation and termination process, wanting to know whether their process is appropriately designed to improve outcomes. Asset managers also care about the determinants of firing decisions because their revenue model consists of fees multiplied by assets under management.

Absent archival data and following the pioneering tradition of Lintner (1956), we follow an inductive approach to learn about the termination process—directly surveying 218 institutional investors from 22 countries representing over \$4.1 trillion in AUM.³ Hearing directly from the horse's mouth could be problematic because respondents might not do what they say. As we describe below, both concerns are mitigated by the survey and distribution mechanism.

Respondents report surprisingly long holding periods for their active investment managers. In public equity and fixed income, over two-thirds of respondents report holding periods of longer than five years. In

contrast, for hedge funds, only 42% of respondents report holding periods of longer than five years. Regardless of this variation across asset classes, holding periods of this length run counter to the pervasive notion that institutional investors are impatient. For example, Donoho, Crenian, and Scanlan (2010) argue that institutional investors are impatient, focusing on three-year windows, and that this impatience harms realized returns. Mauboussin (2011) uses a simulation approach to show that short-term asset owners with ruthless firing rules perform much worse than loyal long-term asset owners. Anson (2020) echoes this judgment, suggesting that the frequent firing of active managers results in lower returns. The narrative that institutional investors are impatient with their external managers is also widely discussed in industry reports and publications, often eliciting governmental and regulatory interest (see, for example, Myners 2001; FCLT GLOBAL 2015, 2020; Bank for International Settlements 2003; and many others). Ellis (2012, p. 18) provides an eloquent description of the foibles of the investment process, including the much-maligned termination and selection process. Ennis (2020, 2021) describes the perils of excessive manager diversification, and Cornel, Hsu, and Nanigian (2017) argue against using performance to select managers.

Given this narrative, the survey asks about the reasons for termination. Respondents provide a variety of reasons, including excessive or insufficient risk-taking, organizational changes at the investment manager or the institutional investor, asset allocation changes, and disappointing performance. While issues related to risk and organizational events are important and acknowledged, underperformance is by far the dominant reason. Because this emphasis is somewhat expected, we ask how long the institution would tolerate underperformance before terminating the investment manager. Much less is known about the tolerance of underperformance, but it is important: The topic is often discussed by institutional investors, board members, and advisory committee members.

The responses are interesting and surprising. In public equity, almost two-thirds of institutions are willing to tolerate underperformance for three years or longer. In fixed-income and hedge funds, there is slightly less tolerance, 56% and 50%, respectively. Notwithstanding these differences across asset classes, this tolerance is strikingly large and goes against the grain of the common narrative that institutions are “trigger-happy.”

From both an economic and practical perspective, it is useful to ask whether variation in the tolerance for underperformance is related to the structural

features of an institution. The use case comes from institutional features that can improve decision-making. For example, if decision-making is inordinately influenced by external (political) appointees, improvements can be made by shifting procedures to internal decision-makers who bear the consequences of their actions.

Some of the features we have in mind are inherent to the institution and unchangeable, such as size. Others can potentially be changed, such as the locus of control in decision-making: internal (such as a CIO) or external (such as a politically appointed board). Still others are decision variables (which are also changeable) such as the tolerance for tracking error or the use of single or multi-factor benchmarks in assessing performance. We find that across all three asset classes, the tolerance to underperformance is negatively related to the use of a multi-factor benchmark, suggesting that greater precision in performance measurement allows investors to be less forgiving of poor performance. Tracking error tolerance is positively related to tolerance for underperformance, but only for equity mandates. Interestingly, the locus of control is unrelated to tolerance to underperformance.⁴ Finally, there is also some variation in tolerance to underperformance across the geographic domicile of an institution. The well-known results of the Globe Project (<https://www.globeproject.com>), which generalizes and expands Hofstede's (1980) seminal study, suggest that performance orientation differs substantially across cultures (see also Gelfand 2011); standard narratives of cultural norms suggest that North American institutions are relatively impatient with respect to underperformance. However, we find the opposite to be true. In other words, the survey belies the commonly held view that North American institutions are trigger-happy.

The above results beg the obvious question: How should an institution think about the "optimal" tolerance to underperformance? A classical statistical perspective can provide partial guidance. We can say that a statistically confident (say, at the 95% level) belief about outperformance depends on three parameters: level of outperformance (α), standard deviation of the outperformance (tracking error, σ), and the number of periods (T). Given these three parameters, one can form a "t-statistic" using the information ratio as $t = \sqrt{T}\alpha/\sigma$. It is well known (see Merton 1980) that what is important is the number of periods (number of years) rather than the frequency of the data (daily or annual). Assume that $\alpha = 2\%$ and $\sigma = 4\%$, both annualized. Then, one would

need at least 16 years to infer that the under- or out-performance was not merely due to luck. Lower levels of underperformance and/or higher tracking error would necessitate longer periods for similar conclusions.⁵ Of course, such a frequentist analysis is naïve. A more refined Bayesian approach would update prior beliefs of underperformance based on the arrival of new information about the asset manager. Such information could be evidentiary, including the time series *sequence* of returns, outflows (which can exacerbate underperformance because of liquidity effects due to shareholder runs), trading costs, and so on.⁶ But soft information about personnel departures, changes in ownership structure, and other such factors are also important. To the extent that our survey data reflect the wisdom of crowds, it appears that institutions err on the side of longer evaluation horizons, beyond the oft-cited three to five years. Our normative prescription, therefore, is that performance evaluation and termination should be long-lived (and, it almost goes without saying, multifaceted with detailed and continued due diligence). Also important for the prescription is a recognition and understanding of the incentives of decision-makers. For example, a CIO that selected an investment manager may be less likely to fire the manager for a variety of behavioral reasons, especially the escalation of commitment fallacy. Investment committee structures that resolve such issues are potentially useful to engender better decision-making.

The Survey Instrument and Process

We design the survey instrument to be descriptive and causal, rather than open-ended and exploratory. It consists of a series of 17 required questions and 10 optional questions.⁷ The optional questions allow participants to divulge information on identities, team composition, background, and experience. The results that follow are largely based on the required questions. The required questions are organized around the following six subgroups for their active investment managers:

- Background information on the institutional investor.
- Frequency of evaluation.
- Reasons for termination.
- Average holding periods.
- Tolerance for underperformance.
- Reasons for hiring.

An online copy of the survey questions is available at <https://www.dropbox.com/s/7hI0pkwjmqso0gc/Survey.pdf?dl=0>. Depending on the subgroup and the specific line of inquiry, the questions are either ordinal-scaled (e.g., rank the reasons for hiring by importance) or interval-scaled (e.g., how much tracking error are you willing to incur?). The survey is distributed via an email sent from the head of global investor relations of Institutional Investor. The email links to a database that is automatically populated as respondents complete the survey.

Because the survey represents a collaboration between academia (Goyal and Wahal), a practitioner (Tol), and the press (Institutional Investor), a reassurance of confidentiality is important to encourage investors to participate. We take several steps to ensure that data are secure and remain confidential. The raw data reside in Institutional Investors' database and cannot be accessed by the authors directly. Only data cleansed of identifiers by Institutional Investors' data scientist is provided to one academic (Goyal) for detailed analysis. For confidentiality reasons (to avoid having access to data from peers), at no point is the industry participant (Tol) provided access to the data, even in redacted form. Rather than ask specific questions that might be used to identify the institution, we use interval-scaled questions to extract useful information while accommodating confidentiality considerations. For example, rather than directly asking the assets under management, we offer eight asset size groups (less than \$500 million, between \$500 million and \$1 billion, etc.) that participants can choose.⁸ Surveyed institutions are told of these procedures in the introductory email and informed that their responses are privileged.

The survey was distributed via email using Institutional Investors' distribution list derived from their database, which consists of approximately 6,135 organizations around the world. The list includes thousands of very small organizations including local union funds, community foundations, and city and county pension systems. While the survey was sent to all organizations, we did not expect responses from the vast majority; our primary interest was in institutional investors with large pools of capital who have formalized selection and termination processes. The survey received more than 150 responses within a month. The staff of Institutional Investor then selectively followed up to improve participation. These follow-up attempts were directed to enhance participation from particular types of underrepresented institutions (e.g., sovereign entities such

as wealth funds or central bank reserves) or those from underrepresented geographic areas (e.g., the Middle East). The survey was closed in July 2021, and at that time had responses from 218 respondents. In aggregate, these respondents represent more than \$4.1 trillion in assets. BCG reports total institutional assets of approximately \$61 trillion, implying that our survey respondents represent about 6.5% of the total (<https://www.bcg.com/publications/2021/global-asset-management-industry-report>).

Respondent Characteristics and Asset Allocations

There are 11 different types of institutions targeted by survey: private retirement funds, public/government retirement funds, insurance companies, endowments, multi-employer retirement systems, foundations, healthcare organizations, financial institutions, sovereign wealth funds, central bank reserve funds, and family offices. We consolidate these into four groups, labelled Endowments and Foundations, Financial Institutions, Private Funds, and Public Funds. The respondents are domiciled in 22 different countries, which we classify into three regions: Europe, North America, and Rest of the World (RoW).

Panel A of Table 1 reports the number of respondents, average assets under management, and total assets under management across investor type and geographic domicile. Because assets under management are generated from interval-scaled questions, we use the midpoint of each interval scale (and the minimum and maximum for the first and last interval scale) to estimate values. Across all respondents, the average institution has almost \$20 billion in assets. Summing across all institutions, the aggregate assets managed by all respondents is more than \$4 trillion. Clearly, these are sizeable institutions, both individually and jointly. The distribution of the number of institutions across the type of investor is relatively even, with a reasonable sample size in each category. Endowments and Foundations are, on average, relatively smaller than the other categories. There is a roughly even split between North American and European institutions; the rest of the world only includes 20 institutions, although as evidenced by their average and total size, some are quite large.

Panel B reports asset allocations across each of these grouping between equity, fixed income, and hedge funds. On average, equity, fixed income, and hedge fund allocations represent 41%, 34%, and 8% of

Table 1. Number, Size, and Asset Allocation of Survey Respondents**A. Size (in \$billion)**

	No.	Average	Total
All	212	19.7	4169
Endowments and Foundations	42	9.8	412
Financial Institutions	46	28.7	1319
Private Funds	78	11.7	916
Public Funds	46	33.1	1522
Europe	93	19.0	1767
North America	99	16.9	1670
Rest of the World	20	36.6	732

B. Asset allocation (in %)

	No.	Equity	Fixed Income	Hedge Funds
All	211	41	34	8
Endowments and Foundations	42	55	12	15
Financial Institutions	45	26	56	6
Private Funds	77	40	35	8
Public Funds	47	44	32	3
Europe	92	35	45	3
North America	99	49	23	11
Rest of the World	20	29	40	9

institutional portfolios, respectively. We do not report statistics on the residual “others” category, so the reported allocations do not sum to 100%. There is variation in allocations across types of investors, the largest of which is from Financial Institutions, which have substantially lower allocations to equity (26%) and larger allocations to fixed income (56%). Across geographic domiciles, the largest allocation to equity and hedge funds is from North American institutions.

Evaluation Horizons and Terminations

Approximately 70% of respondents evaluate their managers at least quarterly, and 95% do so at least annually. These evaluations are qualitative and quantitative and often involve written factsheets or reports on the manager and investment strategy. Unsurprisingly, these data suggest continued due diligence in the investment process and fulfilment of fiduciary duties. Of course, the regular evaluation does not necessarily imply asset manager turnover, so we start with an analysis of reported holding periods.

Table 2. Percentage of Respondents Reporting Various Holding Periods

	Equity	Fixed Income	Hedge Funds
Less than 3 years	2.5	3.7	6.1
Between 3 and 5 years	29.4	30.5	51.4
More than 5 years	68.1	65.8	42.6

Table 2 shows the frequency distribution of responses to an interval-scaled question that asks about the average holding period of an institution. In equity, more than 97% of respondents report holding periods of greater than three years, and more than 68% report holding periods of longer than five years. The reported holding periods for fixed income are quite similar. Even in hedge funds, more than 94% report holding periods greater than three years, but here only 42% of respondents report holding periods of greater than five years.

It is useful to compare these responses to published recommendations and “guides” to evaluation. For example, the Bank for International Settlement

(2003) points out that asset manager contracts are “at will” (and therefore subject to termination at any point) and, consistent with the Myners (2001) report, suggests that there is “pressure to shorten investment horizons” (p. 21). FCLT Global, a nonprofit explicitly interested in focusing capital on the long term suggests that “evidence suggests that short-term switches by asset owners from one asset manager to another have tended to destroy value” and therefore explicitly argues that “True asset performance should be measured over at least a full market cycle—often five years or more.” Holding aside the debate on the meaning and relevance of a market cycle, our data suggest that at least a reasonable fraction of institutional investors have to hold periods that are not excessively short; for both equity and fixed income, over 60% of the respondents claim to have a holding period more than five years.

The survey then asks an ordinal-scaled question regarding the reasons for termination. Respondents are presented with reasons for termination and asked to rank order them separately for equity, fixed income, and hedge funds. We collapse these reasons into the following three categories: performance-related, risk-related, and organization-related reasons. The first category includes either absolute or benchmark-adjusted underperformance. The second category includes excessive or insufficient risk-taking. The last category includes allocation changes and organizational changes at either the manager or institution level.

Table 3 shows the average rank ordering of each of these categories, where 1 is the least important reason and 5 is the most important reason. The average ranking suggests that all three categories are relevant for termination. But with a score of more than 3.5, performance-related termination is clearly the single most important reason for termination, irrespective of the asset class. Not reported in the table, we find that the difference in the importance of

performance-related reasons to the other reasons is statistically significant. Please note that our survey responses rank the reasons for termination in order of importance. Therefore, the participants do not say, and our results do not imply, that performance is the only reason for termination. Rather they illustrate the preeminence of underperformance in manager termination.⁹

Given the (expected) importance ascribed to performance, the survey drills down using an interval-scaled question about the tolerance for underperformance. Respondents are presented with four choices (less than 1 year, 1–2 years, 3–4 years, 5 years or longer) and asked how long they would tolerate underperformance. The results are summarized in Table 4.¹⁰ In equity, more than 66% of respondents are willing to tolerate underperformance for more than three years. This declines to 56% for fixed income and 50% for hedge funds. But despite this asset class variation, the tolerance for underperformance is remarkably high.

Who Are the Decision-Makers?

It is interesting to consider whether termination decisions are taken by the same individual(s) who are responsible for the selection. For example, one might think that a committee that was responsible for the selection of a particular manager might be less likely to terminate the same manager. Unfortunately, we do not know this information.¹¹ We can, however, shed some light by examining who makes the termination decision.

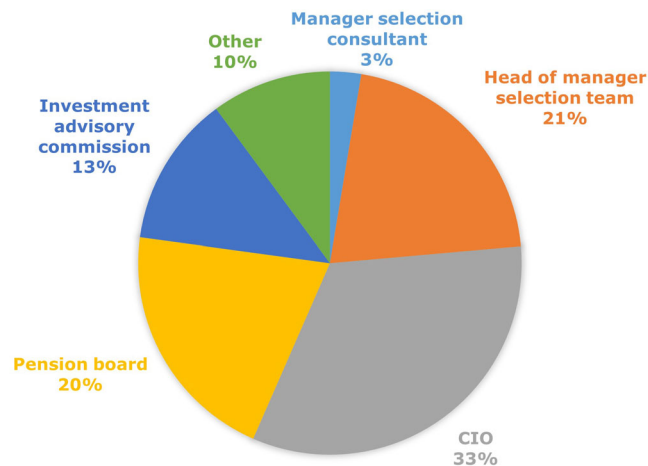
Figure 1 is a pie chart that shows who takes the final decision when terminating an investment manager. The single largest decision maker is the CIO (33%), followed roughly equally by the head of the manager selection team (21%) and the pension board as a collective unit (20%). Interestingly, investment consultants are rarely responsible for termination decisions.

Table 3. Average Reasons for Termination on a Scale from 1 (Least Important) to 5 (Most Important)

	Equity	Fixed Income	Hedge Funds
Performance-related	3.59	3.52	3.64
Risk-related	3.05	3.04	3.13
Organizational-related	3.03	2.95	3.03

Table 4. Percentage of Respondents Reporting Tolerance for Underperformance

	Equity	Fixed Income	Hedge Funds
Less than 3 years	33.8	43.4	50.0
More than 3 years	66.2	56.6	50.0

Figure 1. Who Is Responsible for Terminating Managers

Regression Estimates of Forbearance

At a minimum, the data suggest that surveyed institutions are far more patient with respect to underperformance than is widely believed. However, institutions are far from homogenous. From an economic perspective, one might argue that the “deep” objects of interest (as opposed to institution-specific characteristics) are decision variables such as the tolerance for tracking error and sophistication in assessing risk and return. To explore this, we examine the variation in stated tolerance for underperformance in a simple regression framework.

The dependent variable in our logistic regressions is an indicator variable equal to one if institutions are willing to tolerate three or more years of underperformance and zero otherwise. We have three primary explanatory variables of interest. First, we include an indicator variable for whether the institution uses a multi-factor (versus single-factor) benchmark in assessing underperformance. The underlying idea is that the use of a multi-factor benchmark may be related to sophistication in assessing risk and return. To the extent that multi-factor benchmarks permit more precise estimates of performance deviations, their use may be positively correlated with stated patience. Second, we include indicator variables for a medium or high tolerance for tracking error. These variables are defined based on survey responses to the tolerance for tracking error separately for the three asset classes. To level the playing field across asset classes, we define the tolerance to be high if the stated tolerance is greater than 6% in equity and

hedge funds and greater than 4% in fixed income (because of the lower volatility of fixed income). The tolerance is defined to be medium if the stated tolerance is between 4% and 6% in equity and hedge funds and between 2% and 4% in fixed income. The omitted category is low tracking error tolerance (less than 4% in equity and hedge funds and less than 2% in fixed income). We expected higher tracking error tolerance to be positively related to the tolerance for underperformance. That is because higher tracking error increases the risk of a large drawdown, which requires more time to recover.

Third, we include indicator variables for the locus of control in the termination decision. The survey contains a question that asks respondents to identify the decision-makers from a list of options. We use these responses to classify decision-makers into three categories: (a) external consultants, (b) internal experts, including the manager selection team and/or chief investment officer, and (c) external appointments, which include pension boards, investment advisory commissions, and other such entities that may not have specific investment experience and may be political appointments. We include dummy variables for (a) and (b), with (c) being the omitted category. On the one hand, one might expect that a decision-maker (internal or external) may be less likely to terminate a manager because it reflects poorly on the original selection decision. On the other hand, termination also gives the decision-maker something to do, essentially validating their importance in the organization. As a result, we do not have a strong prior belief with respect to the locus of control. Finally, since institution size is often a catchall for

institution-specific characteristics, we also include indicator variables for medium-sized institutions (\$1 billion to \$10 billion in assets) and large-sized institutions (greater than \$10 billion in assets), with small institutions as the omitted category.

Table 5 contains the regression estimates. Given the differences across asset classes, we estimate separate regressions for equity, fixed income, and hedge funds. The table reports the coefficients and the associated *t* statistic in parentheses below the coefficient. To assist in interpreting the coefficients, in the bottom part of the table, we report the baseline probability of tolerating more than three years of underperformance and how this probability changes when we

change some indicator variables. We note that sample sizes are small, and we lose observations in some circumstances (e.g., when an institution does not invest in hedge funds or does not respond to some questions). Notwithstanding this caveat, the regressions contain two interesting results and one interesting “non-result.”

First, we find that the use of a multi-factor benchmark is negatively related to tolerance for underperformance. In equity, the baseline probability is 65.3%, which declines by –12.0% (a change of more than 18%) when institutions use multi-factor benchmarks. The equivalent declines in fixed income and hedge funds are 26% and 31%, respectively. These are economically meaningful quantities.

Table 5. Logit Regressions of Tolerance for Underperformance

	Equity	Fixed Income	Hedge Funds
Intercept	0.015 (0.03)	0.328 (0.73)	–0.758 (–1.26)
<i>Size of institution</i>			
Medium	0.311 (0.67)	–0.199 (–0.44)	1.001 (1.61)
Large	0.317 (0.66)	0.202 (0.42)	–0.010 (–0.02)
<i>Benchmarking</i>			
Multi-factor	–0.553 (–1.67)	–0.668 (–2.04)	–0.730 (–1.79)
<i>Locus of decision-making</i>			
Internal experts	0.306 (0.94)	0.436 (1.39)	0.400 (0.98)
External consultant	–	–0.246 (–0.17)	0.119 (0.08)
<i>Tracking error tolerance</i>			
Medium	0.235 (0.62)	–0.167 (–0.47)	0.287 (0.50)
High	1.078 (2.74)	0.350 (0.84)	0.569 (1.18)
No.	192	186	129
Pseudo- <i>R</i> ²	0.055	0.037	0.077
<i>Frequency (in %) of tolerance for the underperformance of more than 3 years</i>			
Baseline	65.3	57.5	51.2
Change due to multi-factor benchmark	–12.0	–15.9	–16.4
Change due to medium tracking error	5.5	–3.9	6.5
Change due to high tracking error	22.4	7.9	12.9

Note: Logit regressions are shown where the dependent variable is equal to one if the survey response is that the tolerance for underperformance is greater than 3 years and zero otherwise. The independent variables are dummy variables corresponding to the size of the institution, benchmarking, locus of decision-making, and tracking error tolerance. We run the regressions separately for equity, fixed-income, and hedge funds. The number of observations in each regression is denoted by No. The bottom part of the table reports the baseline frequency (in %) for tolerance for underperformance greater than 3 years and how this frequency changes. Change is measured from single-factor benchmark to multi-factor benchmark and from low tracking error to medium or high tracking error.

Second, in equity, a high tolerance for tracking error is positively related to tolerance for underperformance. Relative to institutions with low tracking error tolerance, the impact is as much as 33% (22.4/65.3). Tracking error tolerance is unimportant in hedge funds, likely because assigning strategies to a unique benchmark is difficult and/or because appropriate benchmarks are not widely available. Tracking error is also unimportant for forbearance with respect to fixed-income managers.

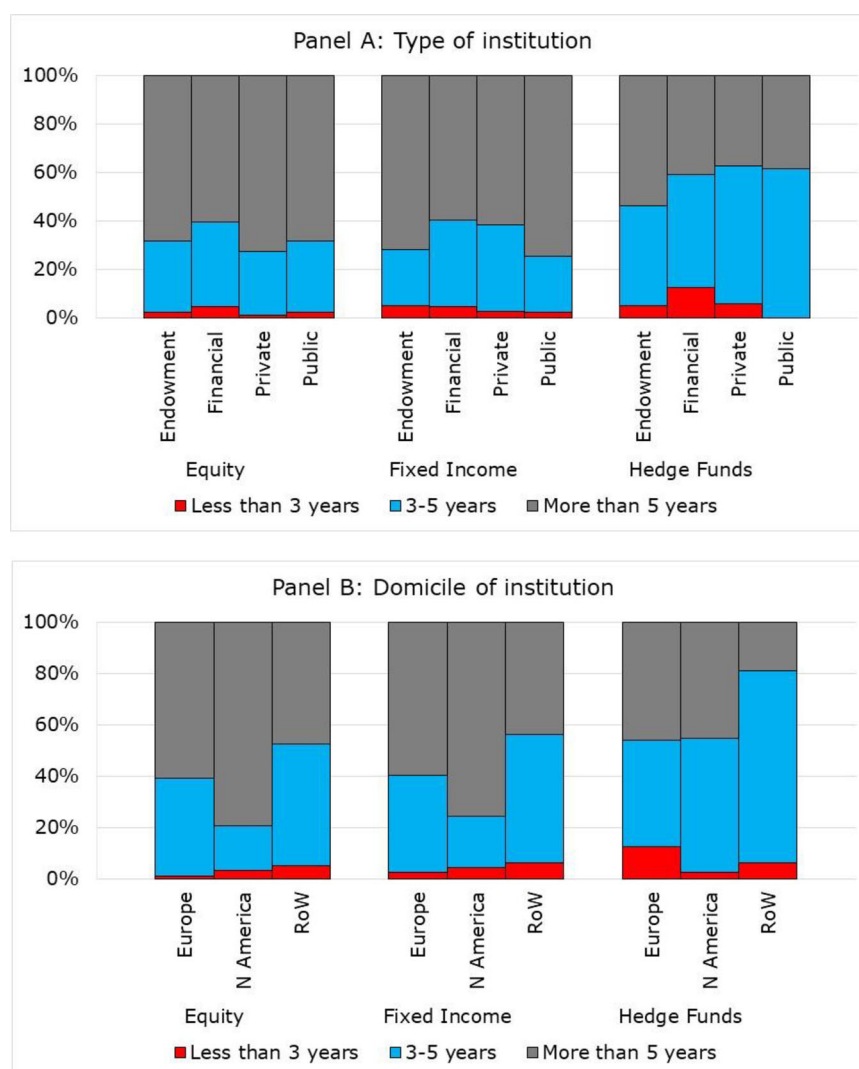
Finally, there is a non-result that is interesting, at least to us. We expect variables that proxy for the locus of control (external consultant or internal experts) to be important to forbearance because of

differences in agency costs. However, we find that the coefficients on the variables that proxy for the locus of control are statistically indistinguishable from zero. This implies that, consistent with the off-setting arguments described above, whether the decision-makers are internal or external, or the nature of their expertise, has no influence on forbearance.¹²

Logos, Ethos, and Pathos

The above regressions attempt to link forbearance to decision variables in an economically motivated framework. But it is also useful to examine

Figure 2. Holding Period before Termination



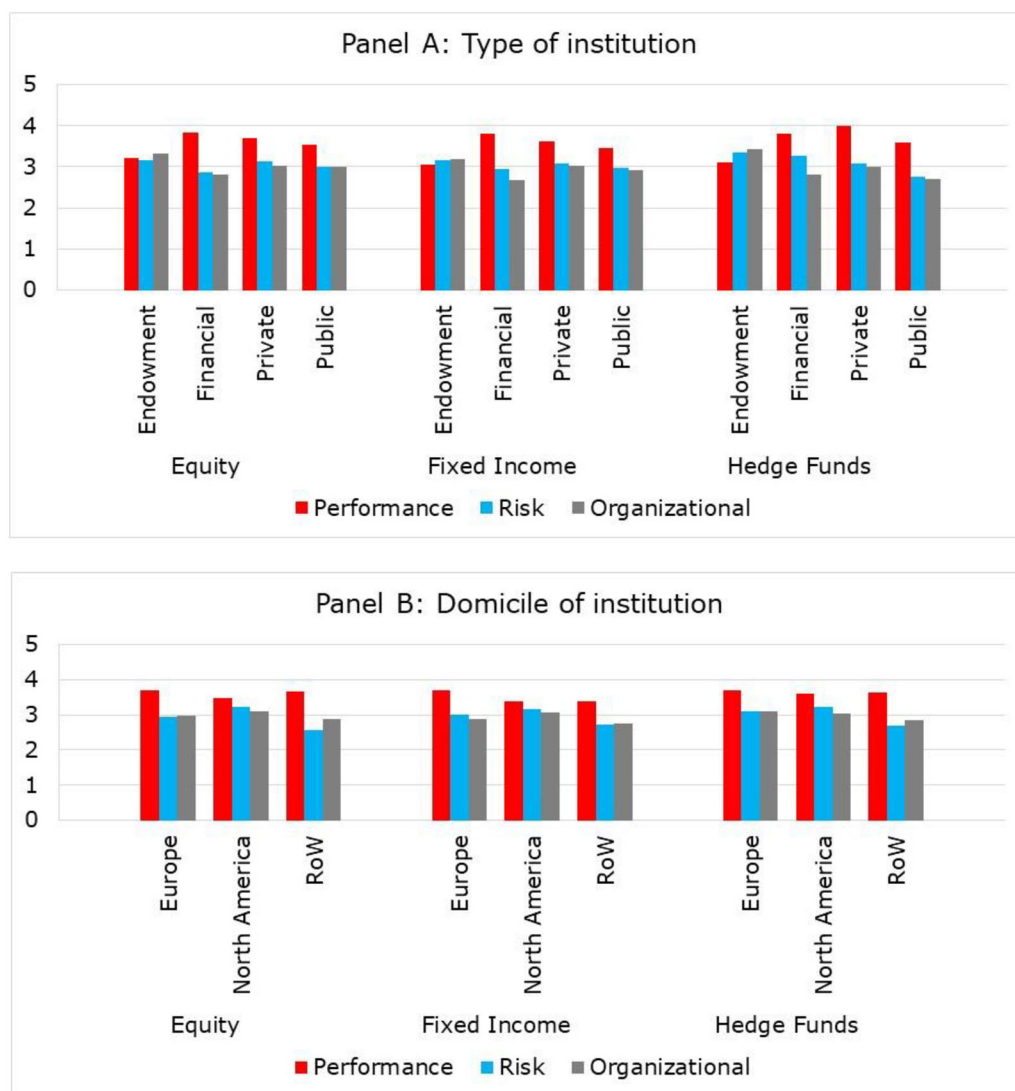
Note: We plot the unweighted percentage of respondents reporting their holding period before termination as in Table 2. We tabulate the responses separately for different types of institutions in panel A and the domicile of institutions in panel B.

heterogeneity outside of these decision variables. For instance, it may be that a large endowment behaves differently from a pension fund, not because one employs a CIO whereas the other uses a politically appointed board, but because the ethos of one is fundamentally different from another. Or it may be that the pathos associated with forbearance is quite different across geographic boundaries and cultures. For example, an extensive literature in psychology pioneered by Hofstede's (1980) seminal cross-cultural study suggests that performance orientation varies considerably across cultures. In other words, a

U.S.-based institution might regard performance quite differently from a Swiss-domiciled fund.¹³

To explore this, we show graphically the percentage of respondents with holding periods less than three years, between three and five years, and more than five years across types of institutions (Figure 2A) and domicile (Figure 2B), separately for equity, fixed income, and hedge funds. In equity and fixed income, Financial Institutions have slightly smaller holding periods than the other three categories. Variation across domicile is far greater: Somewhat

Figure 3. Importance of Reasons for Terminating Managers

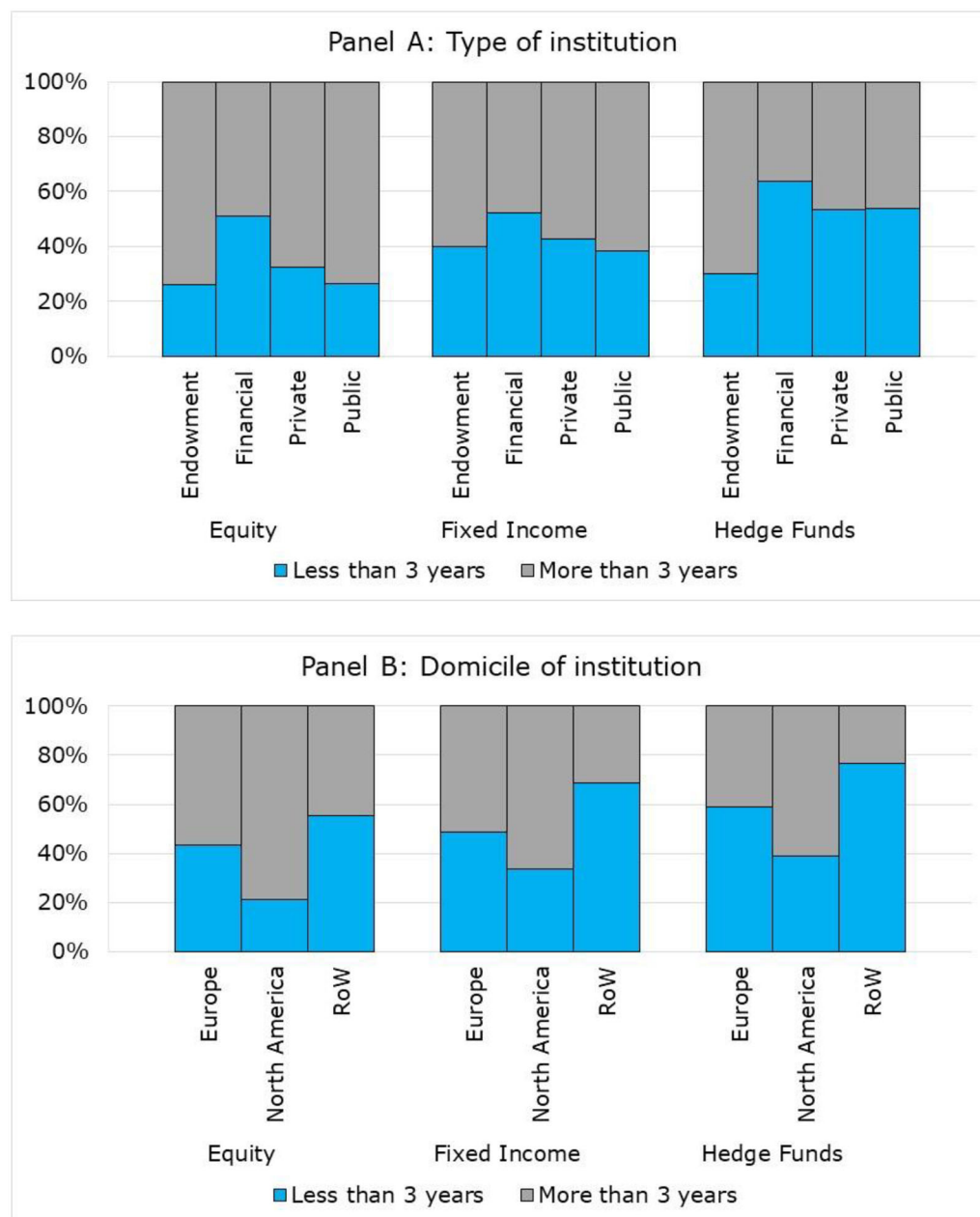


Note: We plot the importance of reasons for termination on a scale of 1 to 5 where 1 represents least important and 5 represents most important, as in Table 4. We tabulate the responses separately for different types of institutions in panel A and the domicile of institutions in panel B.

unexpectedly, North American respondents report much longer holding periods than their European or ROW counterparts. When we parse out the reasons for termination (Figure 3A), Financial Institutions again stand out as being far more willing to terminate for underperformance than for other reasons. And as before, North American institutions are also

less sensitive to underperformance than their counterparts (Figure 3B). Perhaps most importantly, financial institutions are less tolerant of underperformance than other types of institutions (Figure 4A) and North American institutions are much more tolerant than institutions from other domiciles (Figure 4B).

Figure 4. Tolerance for Underperformance



Note: We plot the unweighted percentage of respondents reporting their tolerance for underperformance, as in Table 5. We tabulate the responses separately for different types of institutions in Panel A and the domicile of institutions in Panel B.

Conclusions

We survey 218 global institutional investors to primarily learn about their patience and fortitude with respect to external asset managers. The survey reveals several aspects of the institutional investment process that seem surprising to us. First, holding periods for the average asset manager are quite long, frequently longer than five years. Second, institutions are surprisingly tolerant of underperformance. This forbearance is related to sophistication and tracking error tolerance, but not to the locus of control. Finally, North American institutions are relatively more patient than their European or ROW counterparts and financial institutions are less tolerant of underperformance than other types of institutions.

Editor's Note

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An interesting avenue for further study would be to explore differences across regions and types of institutions.

If one believes in the wisdom of the crowds, the fact that institutions appear to have longer-than-expected holding periods suggests that decision-makers are cognizant of the costs associated with impatience. Our view is that given the noise in the return-generating process, forbearance is important for institutions to meet their objectives. From the institution's perspective, it would be advisable to systematically track the performance of terminated managers to assess the efficacy of their own decision-making process.

Notes

1. Aubry and Wandrei (2020) indicate a steady decline in internally managed assets since the 1980s and a concomitant increase in the use of external asset managers.
2. A minor exception is Goyal and Wahal (2008), who hand collect a small sample of terminations. They find that depending on the horizon, post-termination excess returns are either indistinguishable from zero or slightly positive. Indirect evidence is also present in Del Guercio and Tkac (2002) via the flow-performance relationship in pension funds.
3. The use of surveys in practitioner-oriented journals is common and has experienced a resurgence in refereed academic journals. See, for example, Bender, Choi, Dyson, and Robertson (2022); Choi and Robertson (2020); Das, Kuhnen, and Nagel (2020); Kuhnen and Miu (2017); Kuchler and Zafar (2019), and Liu, Peng, Xiong, and Xiong (2022).
4. This could be because of a lack of statistical power or because of a mismatch between the survey respondent and the decision maker.
5. See also Greene and Marlo (2013), who find that likelihood of short-term underperformance is surprisingly high even for managers with long-term outperformance.
6. By the sequence of returns, we mean the sign and magnitude of each monthly return, as opposed to the compounded holding period return over the longer horizon. See also Philips, Yashin, and Stein (2003), who claim that their CUSUM method can identify true over- or underperformance much more quickly.
7. Although our focus is on terminations, the survey also asks about the importance of various reasons for selection. Interestingly, institutions are relatively "hard-nosed" in their selection decisions, focusing primarily on performance, the details of the investment strategy, and competitive differences across investment managers. Despite the widespread marketing jargon with respect to culture, it plays the least important role in manager selection. Even more interesting and surprising is the lack of sensitivity to fees: It is the second least-important reason in selection decisions, perhaps because competition between asset managers within an investment style is intense.
8. While some might view assets under management as relatively innocuous, such figures are often closely guarded by sovereign entities.
9. Cornel, Hsu, and Nanigian (2017) argue against using performance to select managers. Donoho, Crenian, and Scanlan (2010) and Anson (2020) also urge patience with respect to underperformance.
10. The results are summarized into using a three-year breakpoint to reflect common institutional practices. We can report that in equity, fixed income, and hedge funds, the percentage of respondents that would tolerate less than 1 year of underperformance is very small: 3%, 6%, and 7%, respectively. The equivalent percentages for the 1–2 year interval are 31%, 37%, and 43%, respectively.
11. It would also be useful to know whether the person(s) responding to the survey are the ones making the termination decision. Unfortunately, we cannot know this for confidentiality reasons.
12. It is possible that the person(s) who responds to the survey is not the same person with termination right, and this mismatch is responsible for the lack of statistical

significance of the locus-of-control variables. Because we do not know who responds to the survey, we cannot rule out this possibility. In addition, it is possible that there is variation related to size in the tolerance for underperformance within institution-type subgroups. Given the limited sample size, there is little power to detect this.

13. The notion here is one of national or ethnic culture at the level of the institutional investor, rather than company culture. Ellis (2004) asserts that organizational culture is perhaps the only enduring factor in investment performance. Hsu, Ware, and Heisinger (2015) argue that blame, which they argue is related to company culture, has a significant negative effect on performance.

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