

How the Riverbridge Investment Culture Leads to Client Success

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Relationship Management

Riverbridge was founded to practice investing in a way that keeps the focus on our clients' long-term interests. This mission forms the basis of our investment philosophy, which seeks out management teams committed to building enduring earnings power. Such companies eschew the short-term pressures of the stock market to lay solid foundations that support innovation and hone their strategic advantages, actions we believe are crucial to increasing future earnings. When we successfully identify companies making choices today that position them for greater strength tomorrow, our clients participate in the success of the compounding business.

For clients to participate in long-term business value creation, our investment team must exercise the same level of discipline we expect from our portfolio companies. As such, for the past 35 years, we have curated a culture and incentive structure designed to keep the quality of our overall portfolio as the centerpiece for all investment decisions. While a straightforward goal, a client-centric culture must be continuously cultivated, and the processes we deploy at Riverbridge are uniquely suited for that purpose.

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The simplest way we keep the investment team's focus on our clients' success is by basing their compensation on the overall results of the firm. Most of the team's compensation is variable, and the size of the variable compensation pool is based on the firm's profitability. Furthermore, all members of the team have a substantial portion of their net worth invested in Riverbridge's equity. Since the only way we earn the privilege of continuing to manage client assets is by delivering long-term results, we tie the team's success as professionals directly to the success of our clients.

Our incentives are also designed to keep the focus on the whole portfolio. A portfolio manager who only cares about their own work would not last long at Riverbridge, because each team member is primarily evaluated based on the contributions they make to their teammates' research and their incorporation of

others' perspectives into their own decisions. In the context of our unique champion and devil's advocate decision-making structure, this leads to a culture and set of behaviors that constantly work to make our portfolios better.

Champion and Devil's Advocate

Mechanically, Riverbridge's decision-making structure is designed to avoid two major pitfalls: internal team politics and confirmation bias.

Internal politics are addressed partially through our compensation and evaluation practices, but we also seek to eliminate convincing, cajoling, and horse-trading among the investment team by empowering every portfolio manager at Riverbridge to add a company to a portfolio without needing agreement from anyone else on the team.

Given our healthy respect for confirmation bias, however, we place two constraints on the champion of a portfolio holding. First, the maximum initial position size for a company is relatively small, one and a half percent in most strategies. If it was a mistake to own the company in the first place, it will always remain at or below that weight and will never have an outsized impact on the overall portfolio.

Second, in addition to the champion, every holding is assigned a devil's advocate. The title is a bit of a misnomer, as it is not the devil's advocate's job to create a bear case or be combative. The role is perhaps better thought of as a doctor providing a second opinion. The devil's advocate does his or her own research, probes the champion's thesis, asks questions, provides perspectives, and ultimately arrives at a similar or different view of the company. If the position is to rise above that initial one-and-a-half percent weight and therefore become more influential in the portfolio, both the champion and devil's advocate must agree it merits the larger position size.

In our view, quality businesses are identifiable from multiple angles, and every member of the Riverbridge investment team contributes a unique personality, point of view, and background to our process. When at least two people can see similar characteristics from their different vantage points, we are comfortable allowing the businesses they support to rise in importance in a portfolio.

Culture and Behaviors

The engine powering the champion and devil's advocate process is the behaviors and attitudes of our portfolio managers, all of whom have been at Riverbridge more than ten years and have demonstrated a commitment to our culture.

In this culture, every team member knows and is free to admit that, regardless of the depth and thoroughness of their research, they never have the full picture and would not be able to reliably predict the future even if they did. In turn, they recognize that their best decisions emanate from a commitment to the process and the team, not their own genius.

Each portfolio manager works to identify their blinders and biases and relies on their teammates to broaden their understanding and increase their objectivity. The champion may still make a decision their teammates disagree with, but they truly listen to and incorporate each other's knowledge, because they know it helps them make better decisions. And because the team is not competing for portfolio slots or trying to convince others they are right, the champion actually appreciates when their colleagues bring up what they cannot or do not want to see. There is no incentive to hang on to a company in lieu of a better opportunity, so there is no need to defend a company that is not panning out. In fact, in our culture, portfolio managers are rewarded for taking feedback, changing their minds, and admitting mistakes.

Our investment team genuinely desires to incorporate one another's knowledge and experience into their decisions.

The devil's advocate is also incentivized to maintain an open mind. They may not have made the same decision

as the champion of a position, but they know their teammate sought out and valued their perspective during research. Once a company is in the portfolio, the devil's advocate often begins to see what the champion understood about it, appreciating its merits. Because they did not need to be convinced or overruled up front, they are open and incentivized to change their opinion when a company demonstrates its quality.

As this plays out over time, it creates a powerful flywheel. Participants come to understand that their teammates see things differently than they do and often make good decisions. As a result, our investment team genuinely desires to incorporate one another's knowledge and experience into their decisions. Each portfolio manager can make a decision no matter what the others think, but the key is that they truly want to know what the others think. When we listen to each other, we all make better decisions.

Conclusion

There is a direct connection between the investment culture we foster at Riverbridge and the types of cultures we seek in our portfolio companies. Knowing we cannot predict the future, we do not expect management teams to be able to do so either. Fortunately, neither the investment team nor the companies we invest in need to be clairvoyant to succeed. What they do need is to be agile and adaptable, willing to see the world as it is, not as they wish it to be.

We position our portfolios behind businesses that understand their purpose and the value they bring to customers, as well as those who manage their finances conservatively so they can weather unexpected storms and seize unexpected opportunities. We believe investors and management teams focused on these characteristics are poised for long-term success.

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