# <u>ADVENTURES IN ENTREPRENEURSHIP</u>

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I believe there is a “mind set” for entrepreneurship.

Personal Philosophy: Man (woman) was meant to transition from the son (daughter) to the father (mother). Starting your own enterprise, leading it, loving it and nurturing others is the destination we were all meant to evolve to in life.

Risk: You can’t avoid it. You can hide under your bed or keep a job you hate. It will still come and find you. The best way to deal with risk is to accept it as a natural part of reaching out for joy, accomplishment and satisfaction. Good entrepreneurs take no risks they don’t have to, but do not hesitate to take risks when it is necessary to achieve their objectives.

I once heard a commencement address by the brilliant (and somewhat zany) Elizabeth Kubler-Ross, who, believe it or not, was an expert on death and dying. She said that when she talked with people who were near the end of their lives, their biggest regrets were that they had not risked more. I think she said they went out too often with their umbrellas and that they didn’t eat enough chocolate.

For me the desire was to come up with a business to start. The desire preceded the idea.

I spent twenty years climbing the corporate ladder in the investment management business. I climbed pretty high. I was President of Putnam, with hundreds of people working for me, (Putnam was much smaller in those days) and lots of status and financial comfort.

When I decided to start a new company, I laid my plans carefully and in order to control my own destiny completely, resigned, left and actually started the company all in twenty four hours. I had been loyal and cooperative at Putnam for thirteen years, but I felt I needed to completely control this event with no corporate compromises.

I had rented my office in another part of town in advance. I used to go in on quiet weekends before I resigned and play mind games. I stared at the telephone and repeated the mantra “This phone will never ring. Every call made on this phone will be out going” over and over again.

“Norton Reamer, Norton Reamer….I remember that name. Whatever happened to Norton Reamer?”

I imagined that I was a very small bug situated on the top of a very large statue. My job was going to be to crawl laboriously down from the top of that statue all the way to the bottom, then crawl through a thick rug which completely blocked my vision and find another very tall statue which I could climb laboriously to the top of.

It's important not to have illusions. If you expect little and get more that's fine. If you expect a lot and get less, that's not so good. Don't be under any illusions. "The game is worth the candle" but that doesn't mean the game will be easy.

When I ran Putnam I had two secretaries and a line outside my door. At the newly formed United Asset Management I had a "share office". Among other things it meant that I cued up (on my hands and knees, it sometimes seemed) to use a shared secretary.

The postage meter ran out of postage. I didn't want to send correspondence with stamps. It didn't look business-like. I called the post office. They told me to appear with a $500 check. I looked around for someone to bring the postage meter over. The only employee, who was me, had to do it.

As I approached the window at the post office the grate slammed down and an "out to lunch" sign appeared. I said (almost in a shout) "you can't do that to me - - I'm the President of the company." The window flew up! Hands reached out. My meter was filled, given back to me and the window slammed closed again. I stood there saying to myself, "Why did I say that and why did he do what he did?" I still don't know.

It looked like it was going to be slow (It only took a year to raise the first money, but it took almost three years to do our first transaction.)

I began to swim three times a week at the nearby University Club. I was going to outlast them. I remembered the story of the first post war Chancellor of Germany, Konrad Adenauer. He was known as "der Alte", The Old One. Some political commentators felt he got to be Chancellor because he outlived everyone else who was not a bad guy. If that's what it was going to take, I was going to be der Alte too.

By the way, what follows may be the most important part of this presentation. While devotedly doing my swimming, I discovered the "famous" (from my point of view) 90 – 10 rule, which has served me well ever since.

It goes like this. I enjoyed my swimming so much. Each time, I would enter the pool at 8:15 AM, emerge at 8:45 AM and walk to my office. One day I had to take an early plane, so I decided to go to the pool just when it opened at 6:30. The pool was almost empty at 8:15. It was packed to capacity at 6:30! Hence the 90 – 10 rule, it goes as follows:

Ninety percent of the world wouldn't dream of getting up early in the morning to go swimming. The other ten percent are all fanatics. The secret of life is to slip in between the ninety and the ten. 8:15 AM was the embodiment of that principle. 6:30

AM put you squarely with the fanatics. Check it out against other things that you do. See if it doesn't work most of the time.

United Asset Management was a one person start up. Unusual, I think. I would guess that more normally it would be at least a small team. The obvious immediate people needs I saw were a financial person and an administrative assistant. I hired the administrative assistant relatively quickly but a year later when I hired a treasurer, (who by the way stayed with UAM for its entire twenty year life, eventually becoming CFO), the administrative assistant quit because, she later confided in me, she had an ambition to become the company "bookkeeper".

Equally important, I felt it was crucial in an intangible business like ours to create a reasonable image of solidity. This I tried to do in various ways mostly having to do with the written word: tombstones, correspondence, newspaper articles and speeches.

I felt I had two major tasks initially: spreading the word - primarily to investment management firms who might want liquidity and were ready to sell to achieve it, but who did not like the kinds of transactions, almost entirely with large financial institutions, which might destroy their independence and initiative. The other obvious high priority was raising capital. It's amazing how little was needed at the outset. It was due to the relatively miniature size of the investment management industry in those days.

Before I started United Asset Management I had approached an old friend at Allen and Company, now well known for their media company connections (the fabulous Sun Valley Conference being an example). Allen had come up with a couple of hundred thousand dollars in seed money within a few months of my starting the company for what I believe was twenty percent of the stock.

More importantly they committed to help me raise the initial capital that we thought would be needed. Believe it or not, our goal was only $5,000,000 which, as a matter of fact, I had trouble spending on deals at first.

In the event, we actually raised $8,000,000 and I probably did most of the work myself. The two key decisions were these: First I decided that the best source of capital would be people close to or actually part of the investment management industry itself. If I'm allowed to pat myself on the back, I'd say that turned out to be a brilliant decision. You might think about that in your industry, too. Who is better equipped to understand and get excited about your great idea than someone who understands your industry well?

In that regard, conventional venture capitalists hardly ever invested in service industries in those days. In the end, our first round of fund raising only had one venture capital firm in it and that was headed by a business school classmate of mine whom I would guess initially believed in me more than in the idea.

The second key idea came from an almost chance encounter with a friend who was a partner in a British brokerage firm called Rowe and Pitman. That firm eventually became part of S.G. Warburg which eventually became part of one of the big Swiss banks. My friend was eager to show British investors that he could come up with exciting V.C. ideas in the U.S.

What I came to realize was that whereas the investment management business was regarded almost as a profession in the U.S., the British already understood that it was really a business. In other words the British "got it" before most people in the U.S.

As a result, more than half of UAM's equity was raised in the U.K. from: the London office of the Kuwait Investment Company, a British property firm (!) and a couple of Scottish investment trusts.

Incidentally, in the early 1980s I spent one Fourth of July calling on investors in Edinburgh (after all they were working and we in the U.S. were not).

By the way, on that same trip I noticed that London real estate prices were remarkably low and realized that the pound was selling at only $1.10. I bought a flat in the Chelsea section of London that I own to this day.

Spending the money we received was another matter. It took three years for UAM to do its first transaction and that was a remarkably small one.

It also taught me that paying attention to the details is important. The British investors represented by my British broker friend wanted to negotiate a provision in our capital raising arrangements whereby they could withdraw their money after three years if we had not reached a certain revenue level. As I recall, the revenue level was $4,000,000. I negotiated it to four years.

At the end of three years we had only $2,000,000 in revenues and the investor's money would probably have been gone. At the end of four years we had $22,000,000 in revenues, more than five times what was required to meet their bogie.

UAM continued to be religiously overcapitalized, that is, we never had any close calls in available equity or debt funding in general. That probably resulted in some unnecessary dilution, but as I think all of you know, the biggest cause of death of start ups is running out of cash.

I got a lucky break in the very first year of UAM's existence and I grabbed it with both hands. Since I had had some standing in the investment management community from my Putnam days, I was invited to give two speeches to the Boston Security Analysts Society: one within two months of starting the company and the other four months later.

I used these speeches to communicate <u>first</u> the conceptual logic behind UAM and <u>then</u> the very unusual way we planned to operate which at the time I called profit sharing, but which in fact turned out to be "revenue sharing".

These speeches gave me the opportunity to articulate in clearer terms than I had before, important conceptual and operating precepts that crystallized my own thinking, expressed them to others and gave me two printed documents which I could circulate to the industry….. and I sure did.

Incidentally, preparing this speech reminds me that I have to search my moldering piles of papers to see if I can find those two "historic" speeches again.

My enthusiasm was unbounded and probably obnoxious. I told the UAM story to everyone. I spent a lot of time on airplanes. I believe I averaged about 200,000 miles a year throughout my UAM career. If you happened to be sitting next to me on one of those airplanes, you got the UAM story. It's remarkable how polite people, who obviously could not have cared less, were in the face of this unprovoked onslaught.

I developed my banking contacts, which traced to my Putnam days, and got surprisingly creative responses from bankers whom I would previously have guessed were the heart of conservatism. UAM never seemed to have problems having adequate bank financing, to the point where we probably didn't make enough use of more imaginative and possibly lower cost alternatives.

Interestingly enough, my ex-wife, who decided to opt for liquidity rather than family values at the time UAM was sold, predicted that "networking" would be crucial to a successful start up. I scoffed at that idea at the time, but it was 100% correct.

Doing deals was tough at first. Keep in mind this is a company that ultimately did 55 transactions, amassed $200 billion in assets under management and revenues of $1 billion a year. But any new idea is strange and eminently forgettable. By that I mean it doesn't really make its way into someone's consciousness until he's heard it two or three times, he's seen it in the press, he's noted several people who've already done deals, etc. etc.

It's a classic catch twenty two. Nobody wants to do a deal with anybody who hasn't done a deal. You just have to work at it and work at it until you get enough pickles out of the jar so that the rest start coming out freely.

It took almost three years to do the first deal. The second deal, not in our original plan, was actually a start-up and it became modestly successful fairly quickly. Then in early 1984, about three years after we got going, things really began to happen. We reached $12 billion in assets under management at the end of 1985, $56 billion at the end of 1990 and $139 billion at the end of 1995 on the way to a peak of about $200 billion.

Early in the game we developed a concept which I referred to earlier as "revenue sharing". It turned out to be crucial to the development of the company and is illustrative of the range of innovation and attention to detail that can be necessary in a successful start up.

Revenue sharing itself has taken on a life of its own in that it has now been used in a wide range of management relationships between parent companies and subsidiaries or divisions throughout the investment management industry. It is a technique whereby ownership of an investment management firm is translated into a claim on a percentage of top line revenues.

This approach, which only works in an industry where profit margins are high and most of the expense structure is variable, is a wonderful way to participate in the profits of an investment management firm without interfering with the freedom or control of the management.

It's amazing how this theoretical construct devised in the very early 1980s has survived to this day, albeit in only one industry. Revenue sharing has even become the core element in a new company I started with substantial institutional backing a couple of years ago called Asset Management Finance.

The fact that I've started this new company, incidentally reflects a belief of mine that "retirement is hazardous to your health". I would prefer never to retire and while I don't think of myself as a serial entrepreneur, if that's what it takes, I'll keep on doing it as long as I can. The demands and challenges, physical as well as mental, of hard work are, I believe, the greatest fountain of youth mankind has ever invented.

Enough philosophy. We kept on doing deals. We kept on maturing into a larger company and eventually, in 1986, we went public. That is an experience everyone should have, but probably only once.

Let me give you a new definition of <u>fear</u> in a commercial sense. Fear is driving to a large printing plant in South Boston at 2:30 AM and finding it is fully ablaze in lights and then discovering that your prospectus is the only job in the shop.

The lawyers who work for underwriters are a strange breed. They don't want to work in daylight. They only seem to get going at 9 PM and when the dawn breaks they presumably retreat to a hole somewhere to hide until "overtime" is in effect once again.

We had an adventure. Probably everyone has an adventure, but here's mine: We were held up by the SEC, who didn't like our accounting (which was in fact not developed by a "schemer" such as me) but was constructed in the only way PriceWaterhouse felt was acceptable.

They held up our offering for days until I was finally about to order all our accounts into the crazy system that they seemed to prefer, when somehow they gave in before we did and the offering went forward. By then it was late August and of course everybody who might sell it or buy it was at the beach on vacation.

I learned something about telephones with that offering. I was staked out in a nice hotel in New York waiting for the call from First Boston (now part of Credit Suisse, of course) that they were ready to price the deal.

What I discovered to my horror during this interminable wait was that in 1986 even nice hotels often had only one telephone line into a room. We didn't have cell phones yet so it meant that if you were waiting for a call, you couldn't make one. I examined the ceiling, the floor, the view from the window, my finger nails, etc, afraid to block the line to our salvation. The call did eventually come and we did go public.

I found being a public company wasn't really that bad. That's probably because I never fully understood it. I probably wasn't as good at analysts' conference calls, road shows, etc. as I should have been, but I really didn't mind being a public company CEO. We certainly weren't trying any shenanigans so it didn't bother me in that way either.

We always had a large short position in our stock. I suppose it was because we were always doing deals. One day an analyst asked me if the large short position bothered me. I couldn't restrain myself. I blurted out "It would, if I thought they knew more about the company than I did".

We never seemed to have any dramatic earnings surprises or the ensuing disasters in our stock, but our growth did slow in the late 1990s when hot growth companies with high multiples and little in the way of earnings drove the market. Perhaps inadvertently we had accumulated too many Value managers. The result was that the market thought we were dull as dishwater and we never got the multiple that I, for one, thought we deserved.

By late 1999 our directors got really nervous about the slow growth of some of our value firms, about the level of the stock market and maybe about the 19 year tenure of the CEO. They decided they wanted to sell the company.

This was one of the great traumas of my life. The power slips from your hands very rapidly. The engine of progress and growth grinds to a halt. The confidence, joy and affirmation dissipate. The bankers arrive. The birds of prey alight to pick over the carcass of your baby and strange other bad things seem to happen.

I suppose anyone with such emotional attachment to his creation should have it put into sounder hands, but I somehow feel that we were unduly influenced by the moment and didn't have the persistence to see it through, even if under new leadership.

After all, should a company generating $200 million of after tax operating cash flow have been sold for $1.5 billion? A company in a growth industry? I don't think so.

But amazingly and wonderfully, life goes on. You can attain new family values. You can observe, understand, absorb and respond to what is going on around you and there are new contributions and satisfactions to be made and achieved every day. The investment management industry continues to experience exciting and potentially rewarding change. Let's talk about what's happening now.

The giant investment banks and brokers who were trying to absorb a vast segment of money management, especially that which served the public, have discovered that they don't have the right culture to succeed and their clients don't trust them when they sell a product which they also manufacture.

Just in the last few months, we've seen the result. Merrill Lynch has disgorged its entire money management operation, in return for major ownership of BlackRock, of course. Giant Citicorp has sold its money management operations to Legg Mason. By the way, these two moves have created two new members of the trillion dollar club.

Amusingly, back when UAM started, no one thought that more than $50 billion could be managed in one organization. That was the size of JP Morgan at the time. It was clearly silly. After all, it all depends on how you organize it. Today, Bill Gross alone manages far more money than all of JP Morgan did 25 years ago.

But all of this rumbling at the top is creating a vast umbrella under which exciting ferment is unfolding at the middle and the bottom. Money managers are experiencing a great new Independence Movement. After all, the formation of thousands of hedge funds represents the decisions of tens of thousands of investment professionals to go where the freedom is greatest and the financial rewards are most attractive.

At the same time, institutions and very wealthy individuals seem to dominate the market place as never before. Since the crash of 2000, which seems to have taken some of the steam out of the retailization of the money management business, the most creative decisions for hiring new money managers have been made by endowments, super high-net-worth individuals and families and other institutional and institutional-like investors.

These organizations seem to value independence and creativity in their money managers as never before. They have organized to a level they and their consultants had never before achieved to ferret out these money managers with remarkable efficiency. Through it all, amazingly, on average, fees have continued rising. After all, the one certain aspect of a hedge fund is that they charge more.

In the end we may experience considerable "regression to the mean" in performance from these thousands of new hedge funds, but I don't think we're going to regress to the mean anytime soon when it comes to the drive for independence.

About two years ago an investment banker I knew well brought me an idea which used my old friend "revenue sharing" in a new way, basically to <u>finance independence</u>.

Starting this company, (It's called Asset Management Finance. There are now ten of us primarily in New York and we have raised $115 million in equity and near-equity plus $100 million of senior debt) has been one of the most terrific experiences of my life.

I think we've created a financing vehicle which can be used by independent firms to stay independent almost perpetually, if they choose to do so. It also can be used to assist divestitures and spin-offs of established investment management subsidiaries of large financial institutions.

For me, it's the culmination of a dream. I think UAM made selling your firm more palatable and less culturally intrusive than anything which had gone before. Asset Management Finance has now made it possible to take an existing investment management entity out of a large (and stifling?) institution or achieve liquidity for principals of independent firms without their giving up any ownership and control or incurring any fixed principal debt.

I wish you all such joy!

Thank you.