

# Building on Success

For Legg Mason's CEO **Raymond "Chip" Mason**, business success is about taking chances. But only years of experience, says Mason, will give students the confidence to know which chances are foolhardy and which ones are worth the risk.

by **Tricia Bisoux**

**Raymond "Chip" Mason's shrewd, often unorthodox business deals have built Legg Mason** from a small brokerage firm to a mighty force in finance. His two latest deals—last year's \$3.7 billion "asset swap" with Citigroup and the \$1.39 billion acquisition of the French hedge funds manager Permal—doubled the size of the company's asset management operations to \$868 billion. The firm is now the sixth-largest asset manager in the world.

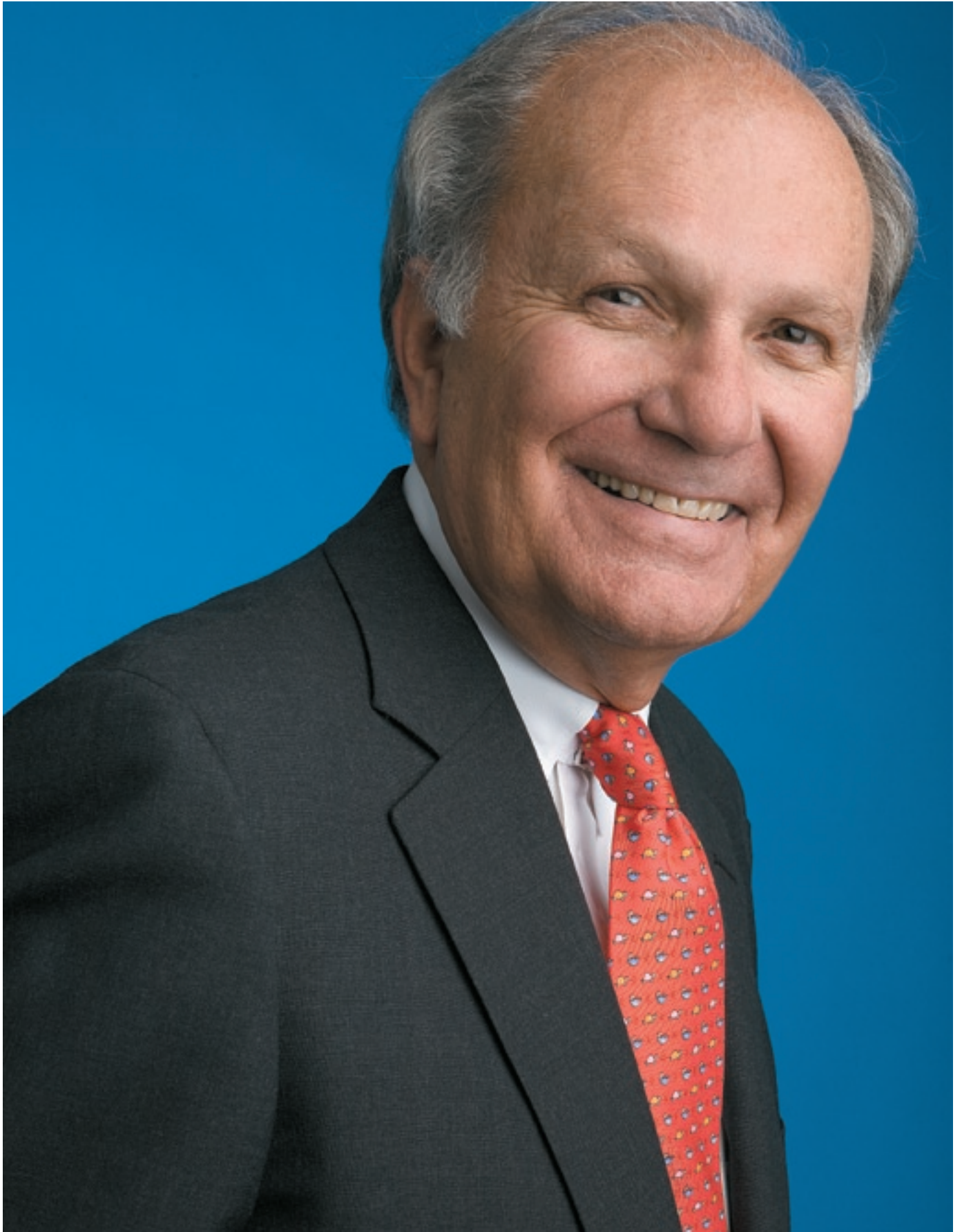
Many analysts view the "Citi swap," in which Citigroup offered its asset management division in exchange for Legg Mason's brokerage business, as an extraordinary event and possible harbinger of changes to come in the finance industry. With the mutual fund scandals of a few years ago still in investors' memories, firms like Legg Mason are choosing to manage mutual funds in-house or sell shares of them—not both. In this climate, says Mason, it made sense to listen to Citigroup's unusual proposal. Ultimately, he says, the swap "was the right thing to do."

As Mason continues to guide the company through the biggest transition in its history, he ironically also prepares it for a future without him as CEO. The company recently chose James Hirschmann as president and Mason's eventual successor. Once the company acclimates to its new identity as a global fund manager, Mason plans to retire knowing that Legg Mason has the right talent and direction for the future.

Mason began his career as a broker in 1959 after earning a bachelor's degree in economics from the College of William and Mary in Williamsburg, Virginia. He worked for his uncle's brokerage firm for three years and then started his own. In 1970, he merged his company with Legg and Company, based in Baltimore, Maryland. He has served as Legg Mason's CEO ever since, building a reputation of impeccable ethical conduct and innovative strategies that have led to steady and substantial growth for his company. In 2004, he was named CBS Marketwatch's CEO of the Year, not only for delivering blockbuster returns for investors, but also for staying far above the fray of the mutual fund scandals.

A staunch supporter of education, Mason chairs the board of trustees at Johns Hopkins University and serves as a trustee on the Johns Hopkins Medicine executive committee. He also serves as a senior advisor to the College of William and Mary's Business School Foundation. He has been a generous supporter of business education, making a \$4 million donation to his alma mater last year. In November 2005, the business school at the College of William and Mary was renamed the Mason School of Business.

Mason emphasizes that a solid education is vital to any manager's success, but it must be accompanied by a steady accumulation of solid experience. After all, the future is coming with a vengeance, he says, and business students must be capable of quick, effective, and creative decision making. More important, he adds, it takes many years and many lessons learned to know which deals to make, what strategies will win, where the ethical lines are drawn—and when it's time to move on.



**The recent \$3.7 billion “Citi swap” has sparked a lot of attention in the press, not only because of its size and rarity, but also because it allowed both Citigroup and Legg Mason to focus on a single business. Why did you think this was a good move?**

It was a difficult decision for me. I wasn't quite sure it was the right thing for the company because of the intensity of it, the size of it, the scope of it. It caused us, essentially, to leave behind the brokerage business. Even though the brokerage was only 25 percent of our business, it still was a longstanding, large part of our business. But I think it was the right decision for the stockholders.

**Because it allowed you to avoid even the appearance of conflicts of interest?**

Much has been written about whether brokerages can sell their products directly without conflicts of interest. Frankly, I really don't think it's that big a deal, but it really doesn't matter what I think. What matters is what shareholders think. The shareholders believe that this arrangement is in their long-term interest, and I do, too.

**The Legg Mason/Citi deal will certainly be studied in business school classrooms. What are the most important things that students should learn from it?**

Well, I think they ought to wait a year before they study the deal, unless they want to do it without any answers. With deals like this, analysts have expectations that are, at least in my opinion, too aggressive. This is an enormous change-over, just from a systems standpoint, and we have to be very careful in terms of what we do, how we do it, and when we do it. This is not a business where we have room for error. It's not enough that we're proven right in a few years; we have to be right one second from now.

In a year, it will be much easier for a business school and its students to begin to understand the complexities of this in a case study. They'll know more about what went on and how it turns out.

**What did it take for you and your managers to make this transaction successful?**

For something like this, we needed people who've been in the business 20 years. It's critically important to have people with the ability to make judgments, sometimes almost on the fly. Without people who are experienced in the business



and who know what the pressure points are, something like this would be incredibly difficult.

**Since the mutual fund scandals, how have you adapted Legg Mason to a climate of increasing transparency?**

We try to make sure everything we do is done in a way that's transparent; but, really, the finance industry is probably the most transparent business that exists. There's no other product you can buy and know the company's profit or markup. You can't buy cars that way, you can't buy food that way. But in this business, you know what you're being charged to the penny.

The thing is, much has been made of the mutual fund scandals; but, in fact, much of what happened in those scandals was not illegal. Fund managers may have been promoting their own interests, but many of them had not broken any laws. Some even stated what they'd done in their prospectuses. Their only mistake was poor judgment.

In most business endeavors, you know when the rules are going to change, and then you can adapt to the new rules. But in this business, the rules are always changing. Finance firms are moving billions of dollars every day; they're moving them in large chunks, across continents. Coping with changing regulations is tough, so we must constantly decide what our disclosure rules must be. We've got to hire a lot of people from the SEC to go into our legal department. We've got to hire the best law firms to comb through areas where there are potential conflicts of interest. We've got to find areas where we could run into trouble without even realizing it.

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**Some might say that the regulations are a necessary evil, to keep people honest.**

Well, there will always be somebody who’ll try to make a dollar dishonestly. But I’ve found that people like that are rare; they stand out, especially in a business like finance, where everything depends on your name, your reputation, and your word. Very few people have intentionally put their reputations at risk. They know that whatever money they’d make through dishonest means, they’ll pay back 25 times over.

**Do you screen for ethics when hiring your employees?**

If we find anything in the backgrounds of our applicants that gives us any question, we don’t hire them. We ask as many questions around ethics issues as we can, to get people of integrity. And, once they’re hired, we preach to them. In talks I make here, I tell people, “I don’t want to see any chalk on your shoes.” That is, if they even think they’re crossing the line—if they even question that something is wrong—they either shouldn’t do it or they should ask somebody about it.

**What do you think business schools should do to make sure their students understand that?**

There’s the age-old saying, “You show me somebody who’s never done anything wrong, and I’ll show you somebody who hasn’t done anything.” That’s very true, but there are people who get chalk on their shoes all the time. There are people who don’t know how far from the line they should stay. Some say, “I’m a foot away, and that’s enough.” Others say, “I’d stay four feet away if I were you.”

But they shouldn’t come that close. Students shouldn’t even work at a company walking that line. The company students are in, and the company they keep, becomes extremely important to their long-term good. Business schools should let students know that if they get caught at the wrong company doing the wrong things, their careers will suffer and they will personally suffer. Students need to have confidence in the companies they’re working for. In turn, companies must be more and more concerned about their employees’ personal ethics. The more often that’s said, the better.

**Your management style seems to reflect your trust in most people’s ability to make the right decisions.**

**When Legg Mason acquires a new business, for example, it normally allows it to maintain its name and independence. You give managers pretty free rein in decision making. Why have you taken this decentralized approach?**

It may have been more accidental than planned. It started in the mid-1990s when we realized that, by looking for the best businesses to bring into Legg Mason, we had created something unique. But with each acquisition, we discovered that we got substantial resistance if we tried to merge that business into our operations—we risked losing the best people. However, if we let each new acquisition continue to operate as its own unit, where the people still had a big say, we had virtually no loss.

In general, asset management companies typically try to combine all their businesses into one. As a result, a company is often constantly fighting problems that it didn’t have before an acquisition. For instance, at one point we were going to try to market for all of our companies jointly; but we immediately had problems. The people who were receiving a lot of business were tickled and thought that marketing was doing a great job. But the people who weren’t getting new assets were convinced that the marketing people didn’t like them or understand their product. So, we started letting certain managers market on their own, and their attitudes changed overnight. Once decisions were under their control, it was their fault if something didn’t work. That was one of those trial-and-error experiments that proved to work.

**Through Legg Mason’s acquisitions, you’ve gained many managers who are legendary, including Bill Miller, the only manager whose fund has beat the S&P 500 for 14 years running. Was that acquisition of talent also accidental, or was it another part of your strategy?**

Once we started acquiring businesses, we knew we also were acquiring legendary capability. We were developing into a very big firm; and, once Bill Miller came on, we had the “Bill Miller” style. But Bill had gone away from deep value, so we went out and bought a deep-value manager. Then, we had no qualitative capability, so we got a qualitative manager. Then, we got Bruce Sherman at Private Capital, who was considered one of the best in the private-client business. Once we figured out exactly what we were doing, we deliberately sought the best managers in their fields. We tried to balance what we had.

In that way, we developed a series of managers who all had different styles, so they seldom competed with each other. They actually talked to each other. Because we let their companies continue to work independently, they felt they were still in their old units. The positive competitive spirit, the *esprit de corps*, and the drive to prove they could succeed all stayed there. It solved a lot of issues.

## **“Whenever I see people with a number of moves on their resumes, immediately red flags go up. How long will they stay?”**

### **You also view globalization as an integral part of Legg Mason’s strategy, and you’ve noted that Brazil is an especially important market for your future plans. Why?**

Today, South America is like the U.S. was 30 years ago—the banks do everything. There are no conflicts of interest. But we think that these things will change over time, and we need to be anchored in that market.

If you look at the future of the world right now, you look at China, then India, and then Brazil. They are the three most logical countries in the world that have the capability, the resources, the population, and the land mass to become the next world powers.

### **Do you see areas such as Africa at the end of this development?**

One of the keys to making a country’s economy work is to have a stable government. The problem in areas like Africa is the instability of various governments. As the governments get more stable—and South Africa, which seems to be prospering, may be the first—more investment will go to Africa. Parts of that continent have incredible natural resources.

But it comes back to the rules. Without stable governments, there won’t be long-term development because companies are afraid of the rules. China is currently coping with that issue. In China, certain areas have no laws. Or, if there are laws, officials can change them anytime they want to. Businesses don’t want to see that. Most businesses are saying, “Show me the line, tell me what the rule is, and I’ll comply with it. But don’t make it gray.”

### **Do you think business students are graduating with sufficient understanding of the complexities of the global economy?**

Business schools are doing more and more to place students into the world that exists now, but there’s only so much they can do. Business schools have to teach the fundamentals, but it’s difficult for a business school to take a student much farther than that. Once students have learned the basics, then they have to enter the workforce and learn the business. Even then, it will take a good ten years before they’ll know enough about the business for a company to let them be the ultimate decision makers.

### **I know that you’re looking to your own retirement in the next couple years, with Jim Hirschmann soon to take over as CEO. When a CEO has been with a company since its inception, shaping it over decades, many worry about what happens to that company when its CEO**

### **steps down. How have you planned for Legg Mason’s continued success when you’re no longer leading it?**

The top people here have been here for a while, and they’ve been running parts of the firm for some time. They have a strong knowledge of the company, what we do, and how we do it. They know that we’ll be dealing with governments all over the world, with pension funds all over the world. In our current status, we’re as global as anybody.

Jim’s knowledge of the global side of the business is 20 times greater than mine. He has lived it; he travels the world. You know, I go to New York every six or seven days, but that’s how often Jim goes to Hong Kong or Singapore! Jim represents the new kind of manager who truly understands what globalization is about in the asset management business. A CEO today has to be prepared to live that kind of a life. And a CEO who’s retiring has to find someone with the skills to handle the challenges that are coming.

### **Do you know you can move on when the company has evolved beyond you?**

If the company’s going to move forward, you have to. With the Citi deal, for instance, more than once I just walked away thinking, “I’m not going to do this.” For me, going through this swap, at this stage of my career, was not a good idea.

But the fact was, the deal had great potential; I had to pay attention to it. It solved a lot of issues at one time. I had to think, “If I want to set the company up for the future, where is it going to go?” It needs to be dealing with markets all over the world, and it needs to be recognized as a world leader. We had to have the horses to win. We had to have the systems, compliance, and legal infrastructures to make the company work all over the world. I knew we could build the company by degrees over five or six years. Or we could take the opportunity with Citi. With this deal, that part of the plan was already done.

### **You’ve been with the same company throughout your career, through all of its incarnations. Most students today will be at several companies over the course of their careers.**

They shouldn’t be. They should try to get into one company and stay there.

### **That’s an unusual view, given the rate of change in today’s market.**

You know, people almost always hurt themselves with too many moves. They’re usually going after more money. But after they make, say, four moves, they look back and see

“Frank Jones” who stayed put at their original company. And then they find out that Frank Jones is now ahead of them. He’s been there a long time, he knows everybody, and he has become a reliable source for the company.

**It comes back to staying long enough to know the business.**


Whenever I see people with a number of moves on their resumes, immediately red flags go up. How long will they stay? Companies know that new people have to be retrained and retriggered. They have to be introduced to everybody; they have to learn the system. Companies want people who are loyal, who work hard, and who have honesty, integrity, and intelligence. They want people who’ll stick with them, who’ve been there since Day One. It’s amazing the trust a person can build up with a company over time.

If you see people who’ve been with a lot of companies, who are opportunistic, there’s a question mark there. You may hire them, but you do look at them with a sharper eye than you

do other applicants. It doesn’t mean that people shouldn’t make any changes, but they shouldn’t make many. When they change jobs too often, they only hurt themselves.

**What do you think is most essential for business schools to teach students today?**

Some may disagree with me, but I’ve always thought that a knowledge of economics broadens a person’s thinking. Students need to know how general econometric trends operate. I think there’s not enough of that in business schools.

Otherwise, business schools do a pretty good job. In finance, they’ve become more global, more concerned with transferring assets across borders. They’ll need to continue looking at that global environment. As we envision what’s coming in the next 20 or 30 years, companies and investors won’t care what country they’re in. They’ll say, “I’ll obey that country’s laws, but it doesn’t matter to me where I am.” As we advance toward that, it’s going to change a lot of what we do. 



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