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Executive Summary

Exploring the Concept and Characteristics of “People Alpha”

In the past, having a professional operations team and robust infrastructure differentiated leading hedge funds from their peers and allowed them to claim “operational alpha” before operational due diligence became an industry norm; we now believe that a new set of differentiators is emerging in the hedge fund industry.

We have found that across our survey population, hedge funds investing in superior people management outperform their peers, registering higher average investment returns than those firms that put less emphasis on these factors. We believe that these organizations can attribute part of their return stream to their ability to add people alpha.

- Numerous academic studies have demonstrated the connection between superior performance and an organization’s investment in its people. A 2005 Cornell University study showed that small businesses that invested in their human resource practices were able to achieve high levels of workforce alignment. These firms registered increases in their value per employee of up to $40,000; survival rates for IPO firms increased as much as 20%. When compared with their competitors, their level of financial growth and financial performance were higher than in firms where there was less emphasis on people-related practices.

- These academic studies also link the size and maturity of an organization to its depth of focus on people-related matters. As organizations mature, they face different types of crises that arise from their management style. They need to constantly reassess and evolve their approach; this requires frequent updates to the vision and goals of the organization, and new strategies to achieve those objectives. Larger and older firms, therefore, expend more focus on people management to ensure that they are keeping their workforce alignment high.

- In line with those findings, our analysis showed a distinct link between the size of an organization and its score in our people management framework. Smaller firms (with fewer than 50 people) all fell into the bottom half of our scoring grid, whereas the largest firms (with more than 150 people) all registered in the top half. Only with those firms that had between 50 and 150 people was there significant variance in terms of their focus on people management.

- Firms with between 50 and 150 people that fell into the bottom half of our people score underperformed firms of that same size in the top half of our analysis by nearly 600 basis points between 2009 and 2012. These results held up even when we adjusted and normalized AUM between the two groups.

Our scoring framework to evaluate a firm’s practices to create people alpha focused on 4 key pillars: Talent Acquisition, Talent Retention, Learning & Development and Performance Management. For each of these categories, we identified a set of standard and leading practices used today in hedge fund organizations.

- The largest gap between top- and bottom-performing firms was evident in their approach to talent retention. The two measures we used to assess talent retention were the development of the hedge fund’s culture and its benefits’ packages. Firms that placed more emphasis on their culture, in terms of formal off-sites for visioning and team
building, and that were willing to embed their values into their performance evaluation, scored the highest, as did those firms that offered extended benefits packages, flexible work arrangements and workplace perks.

- Firms that scored well in talent retention also tended to have more depth in their approach toward talent acquisition. These firms not only used the standard approaches toward sourcing talent; they instituted their own internship and diversity recruiting efforts to create breadth in their workforce. Additionally, these hedge funds elevated hiring and created firm-wide committees to oversee this process, instituted job-specific testing and carefully orchestrated new employees' on-boarding.

- The amount of emphasis placed on learning and development could be seen as a leading indicator for the likelihood of an organization growing and attracting assets. Small firms have little budget to invest in learning and development; however as their assets grow and they surpass 50 people, their assets have probably risen and their options to set aside resources for this function have improved. Those firms with between 50 and 150 people that invest in leading practices (such as on-line and leadership training, formal mentorship programs and coaching for the management and investment teams) demonstrate scores and performance much more in line with the industry’s large franchise-sized firms, whereas those hedge funds that do not invest in this capability actually show a lower performance than even the smaller firms.

- Finally, a firm’s approach to performance management ties these various people elements together. Having a robust process that includes peer reviews, separate performance and compensation discussions, and the inclusion of qualitative and quantitative factors in all employees’ reviews allows these firms to identify their leading talent for further training and development, as well as manage situations where an employee is proving disruptive. Measurements around employees’ adherence to the firm’s goals and having a defined path to partnership also help ensure the culture of the firm. These measurements also keep these principals front and center when evaluating potential hires and encourage a high performance standard that goes beyond just the fund’s investment returns.

As with operational alpha, people alpha is a short-term phenomenon that will allow market leaders to differentiate themselves for only a limited period. Over time, as the trend toward a more institutional audience continues, investors are likely to assess hedge funds’ adherence to excellent people practices as a standard part of industry due diligence. Discussions about what it takes to establish multigenerational hedge fund firms are already on the rise, and having a robust people management process lies at the heart of this strategy.
In recent years, a lot has been written about the upswing in operational due diligence in the hedge fund industry after the 2008 global financial crisis. A well-defined set of controls, along with a robust infrastructure and a team equipped to monitor risk, trading and operational data, has become a core requirement in the industry for hedge funds looking to attract institutional capital. Evaluating how well a hedge fund fulfills these functions is now a standard part of investor due diligence.

This proliferation of professional operations throughout the hedge fund industry has eclipsed the idea that some firms could enhance their returns through “operational alpha”. Claiming operational alpha pre-2008 was possible when there were only a subset of firms that had created institutional quality operations, but as the industry’s overall capabilities improved, the notion that a firm needed a professional operations team became an industry norm.

We introduce this paper with the reference to operational alpha because, in our advisory discussions, we have observed tremendous variation in how hedge funds handle their broad people functions. We wanted to conduct a study of the hedge fund industry to explore whether having a robust focus on these aspects of their organization creates any definable edge for these firms.

We concluded that the number of employees—rather than a hedge fund’s overall AUM—has the most impact on a firm’s people focus, with larger firms (more than 150 employees) pursuing the most comprehensive programs. On average, these firms outperformed the smaller firms that implemented fewer of the standard and leading practices that we identified as constituting a superior focus on people management. To some extent, this is intuitive because these large firms have been able to grow the size of their organization based

### Chart 1: Expanding Scope of Investor Evaluations and Ability of Hedge Funds to Claim Differentiation

- **Pedigree and Investment Process**
- **Opportunities to Claim Operational Alpha**
- **Opportunities to Claim People Alpha**
- **Operational Controls and Infrastructure**
- **People Management**

**2013-2017**

- **Early 2000**
- **2009-2010**
- **2018+**

Source: Citi Prime Finance.
on their ability to attract assets, and this ability to attract assets would be tied to performance over our 4-year assessment window.

What was more interesting—and not as intuitive—was our finding that when institutional-caliber firms (> $500 million AUM) with between 50 and 150 employees were compared head to head, those observing more of the standard and leading practices associated with superior people management posted better investment returns than their peers that did less to build out and support their people organizations. This result held true even when the AUM between those firms with a strong people focus and those with a less intensive focus was normalized.

Hedge funds with 50 to 150 employees are not yet large enough to make it untenable for them to operate with the legacy leadership and communication style they established as much smaller organizations. There is thus not as distinct an impetus to focus on people management. This leads to more differentiation between firms that do and those that do not focus on people management. As Chart 1 illustrates, this finding leads us to believe that firms of this size, with a strong focus on their people management, have a window of opportunity to claim to investors that they offer a superior option because of their ability to add “people alpha”.

As we will discuss, there are academic studies supporting the link between superior performance and excellent people management. It makes sense that as the hedge fund industry matures, this differentiator will become more of a focus in evaluating firms. Many investors already look at these functions in their due diligence, and we believe that evaluating a firm’s people management and employee turnover ratio will become a standard part of investor evaluations in coming years. The window to claim people alpha may thus be limited. Yet, in the meanwhile, we see an interesting opportunity for firms to differentiate themselves. This paper will explore the notion of ‘people alpha’ and lay out what standard and leading practices are emerging to claim this edge. Over time, these practices are likely to become the new industry norm.
To arrive at the findings for this report, we conducted 24 interviews with a diverse group of hedge funds, some of which we had tagged as doing interesting things in the people space and others that we randomly selected in order to ensure that we did not bias our findings. All of the funds that we interviewed had assets above $500 million. This was a cross-business effort within Citi between our Prime Finance Business Advisory team and the Private Bank Operational Due Diligence team.

Our view is that the benefits of people alpha will appeal to an institutional audience looking for a more professional, stable organization, and that these capabilities would matter less to other types of investors. Therefore, all of the hedge funds we interviewed were considered above the institutional threshold. Survey participant AUM ranged from $600 million to $25.0 billion; the firms we interviewed represented a total of $169 billion AUM as of the end of 2012—just over 7.5% of the total hedge fund industry. The breakdown of survey participants by AUM band is illustrated in Chart 2.

In order to draw meaningful conclusions about how an organization’s size impacts its focus on people, we ensured that the funds we interviewed offered a diverse profile. The number of people at our survey participants ranged from as few as 15 to as many as 1,000. If we exclude the firm with 1,000 employees (that was at least 2.5 times larger than any of the other survey participants), the remaining 23 firms had an average of 105 employees. The breakdown by firm headcount is shown in Chart 3.

Finally, we sought interviewees that would represent a very broad set of investment strategies. That way, when we evaluated the impact of their approach to human resources and broader people-related functions on their returns, our results would be less skewed by market trends that may favor one strategy over another in a given period. As will be discussed, we also looked at returns over a 4-year window (from 2009 through 2012) in order to further dampen bias. Chart 4 shows that our set of 24 hedge funds covered 11 different core investment strategies, with no strategy representing more than 29% of the sample set. Additionally, 71% of these firms described themselves as having a global investment focus and only 29% described themselves as having a U.S. investment focus.

Interviews with survey participants explored 4 key areas related to their people management: talent acquisition, talent retention, leadership and development and performance management. When the full set of interviews was complete, our team first synthesized the findings to identify what practices and behaviors constituted a standard offering, and then determined what represented a leading or best practice in each of the focus areas.
Chart 2: Survey Participants by AUM Band

- >$10.0B: 29%
- $500M to $5B: 46%
- $5B to $10B: 25%

Source: Citi Prime Finance.

Chart 3: Survey Participants by Headcount Band

- Less than 50: 25%
- 50 to 100: 25%
- More than 150: 25%
- 100 to 150: 25%

Source: Citi Prime Finance.

Chart 4: Survey Participants by Main Investment Strategy

- Equity Long/Short: 29%
- Multi-strategy: 17%
- Relative Value: 13%
- Event Driven: 13%
- Distressed Debt: 4%
- Credit: 13%
- Emerging Markets: 4%
- Global Macro: 4%
- CTA (commodity trading advisor): 4%
- Absolute Return: 4%

Source: Citi Prime Finance.
To create each firm’s “people score”, we drafted an evaluation template that listed a set of standard and market leading criteria for each of the 4 people focus areas. The inputs for this scorecard will be explained in depth as we explore the survey findings later in the paper. We then used a simple 1- to 10-point ranking approach as illustrated in the table below. Based on our approach, the lowest possible score a firm could receive was 6 points and the highest score was 60 points. Across the 24 firms evaluated, we had scores ranging from 16 to 54 points; the distribution of scores is shown in Chart 5 on the following page. We then divided the survey responses as evenly as possible to differentiate the top half of the firms from the bottom half. This framework was then used as the foundation for our analysis.

<table>
<thead>
<tr>
<th>POINT RANKING</th>
<th>STANDARD PRACTICES DEMONSTRATED BY EMPLOYEES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 POINT</td>
<td>Did not demonstrate any of the standard or market leading practices</td>
</tr>
<tr>
<td>2 POINTS</td>
<td>Demonstrated 1 of the standard practices and no market leading practices</td>
</tr>
<tr>
<td>3 POINTS</td>
<td>Demonstrated more than 1 standard practice and no market leading practices</td>
</tr>
<tr>
<td>4 POINTS</td>
<td>Demonstrated more than 2, but not all standard practices and no market leading practices</td>
</tr>
<tr>
<td>5 POINTS</td>
<td>Demonstrated all the standard practices, but no market leading practices</td>
</tr>
<tr>
<td>6 POINTS</td>
<td>Demonstrated all the standard practices and 1 of the market leading practices</td>
</tr>
<tr>
<td>7 POINTS</td>
<td>Demonstrated all the standard practices and 2 of the market leading practices</td>
</tr>
<tr>
<td>8 POINTS</td>
<td>Demonstrated all the standard practices and at least half of the market leading</td>
</tr>
<tr>
<td>9 POINTS</td>
<td>Demonstrated all the standard practices and more than half, but not all, of the market leading practices</td>
</tr>
<tr>
<td>10 POINTS</td>
<td>Demonstrated all the standard practices and all the leading practices</td>
</tr>
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Chart 5: People Scores Assigned to Each Survey Respondent
We define people alpha as the demonstrable benefit a firm is able to achieve in its return stream, relative to its peer group, that can be attributed to the firm’s superior focus on attracting, retaining, training, and measuring its people. We measured the relative performance of the 24 firms in our survey population and drew conclusions based on the relationships between these hedge fund organizations. This survey does not contain a sufficiently large data set to claim definitive proof of people alpha, but the findings were nonetheless compelling. Put simply, our conclusion was that firms where people feel personally vested in the culture—and the professional development of the people around them—achieve better returns than firms where there is less focus on these factors.

The Importance of Workforce Alignment

This is not a new concept, and there has been much study on this phenomenon by the academic community. Some of the seminal works in this space include studies by Delery and Doty (1996) and Guthrie (2001). In 2005, Cornell University’s Center for Advanced Human Resources Studies published a study entitled, “Employee Outcomes: Human Resource Management Practices and Firm Performance in Small Businesses”. The study was conducted across a sample of 111 small companies ranging in size from 10 to 165 employees; average size was approximately 30 employees, representing a broad range of industries.

The study concluded that people management clearly impacts company performance. Small businesses that effectively managed their human resources showed increases in the value per employee of up to $40,000, and survival rates for IPO firms increased as much as 20%. Compared with their competitors, both their level of financial growth and their financial performance were higher than in firms where there was less emphasis on people-related practices.

"We think we have a good culture and good results because we work with people we respect. We want our people to grow, learn and feel like they have contributed."

→ $10 Billion AUM Hedge Fund with Greater than 150 Employees

In regard to these principles, there is little difference between hedge funds and the small businesses examined in the Cornell study. Hedge funds are basically small businesses that have a very specific product they create—investment returns. Hedge funds that have a more aligned workforce should be expected to create better investment returns.
Measuring People Alpha

In looking to test the people alpha hypothesis across our survey population, we found that the headcount within an organization was a key determinant of how much effort was expended on people-related factors. This is illustrated in Chart 6.

Firms that had fewer than 50 employees had the lowest people scores in our ranking methodology, whereas those with greater than 150 people had the highest scores. This held true across the board: 100% of the firms with fewer than 50 people ended up being in the bottom half of the scoring grid, and 100% of the firms with more than 150 people were in the top half. The reasons for this disparity will be explored in more depth later in the report.

Also in line with our hypothesis, there was a clear difference in the average rate of investment returns between those firms at the top and those at the bottom of our people score. To determine performance, we examined the main fund that the firm offers; if they offered more than one fund, we evaluated returns from the fund with the largest amount of AUM. Of those firms with fewer than 50 people, average 4-year returns from 2009 to 2012 were 9.3% versus 13.6% for firms with more than 150 employees.

Firms employing between 50 and 150 people showed a continuation of the pattern—they posted people scores in the mid-range of our examination and achieved an average 4-year return of 11.4%, which was better than smaller sized firms with lower people scores, but still below larger firms.

Making an assumption about people alpha from these findings is too simplistic; however, it would be more persuasive to look at similarly sized firms to understand the impact of their people scores. Chart 7 illustrates that our survey participants provided an excellent microcosm for this exercise. As shown, of the 12 firms that have between 50 and 150 employees, 6 were in the top half of our people scores and 6 were in the bottom half.

When we compare the firms across this universe, there is a clear differentiation in their investment returns.
returns. As shown in Chart 8, hedge funds with 50 to 150 people that fell into the bottom half of our people score posted an average 4-year return of only 8.6%, whereas similarly sized firms in the top half of our scores posted returns of 14.3%, a 66% increase.

The average AUM of the firms with between 50 and 150 employees in the top half of our people scores was also significantly higher ($6.5 billion versus an average of $5.4 billion registered by the hedge funds in the bottom half of our survey). As shown in Chart 6, there was a correlation between higher returns and higher people scores; therefore, it stands to reason that more assets would be awarded to firms with higher investment returns. Indeed, if we replaced investment returns with AUM in Chart 6, the results would look exactly the same. This raises a chicken or egg question: Is the superior performance of these firms a result of their asset size rather than their people score?

To explore that question, we examined the assets of the underlying firms. This is illustrated in Chart 9. As shown on the next page, of the survey participants in the bottom half of our analysis group, firms E and H have significantly smaller assets than the remainder of the funds. Similarly, firms K and W have assets that are noticeably larger than the other firms in the top half. If we remove these four firms from the analysis, it not only normalizes the asset levels between the two sets of funds, but it actually causes firms in the bottom half of our people score to have a higher level of AUM than firms in our top half.

Chart 10 presents the adjusted AUM and investment performance of the smaller subset of funds. As shown, the average AUM for the adjusted set of hedge fund firms in the bottom half of our people score is now $7.5 billion versus $4.8 billion for firms in the top half.

If the difference in investment performance can be attributed to having larger amounts of AUM, this shift in the average AUM of the analytic group should now result in firms positioned in the bottom half of our people score having higher returns than those in the top half. Rather than the change in asset levels reversing the pattern we noted earlier, however, the performance results are essentially unchanged. Average returns for firms in the top half of our people score are now 14.1% versus 9.2% for hedge funds in the bottom half, even though firms in the top half of our people score have a lower average AUM.

This analysis increases our confidence that the difference in the average returns between these two groups can in fact be attributed to their respective people scores. Obviously, with a sample size this small, our results should be seen as indicative, but this analysis, together with the body of evidence from prior academic studies, leads us to believe that there is indeed some validity to the concept of “people alpha”. 

**Chart 8: Comparison of Survey Participants with 50 to 150 Employees Based on People Score**

![Chart 8](source: Citi Prime Finance)
A professional leadership and developmental coach with Proteus International, a firm that actively works with hedge funds on aspects of their people management (including hedge funds in this study) explained why these firms may be able to achieve higher investment returns:

“Numerous studies show that organizations with strong leaders and engaged employees outperform their peers, but why? And more importantly, how can firms proactively create the environment where people unleash their capacity to create great results? People are looking for a healthy workplace where they have freedom to do their jobs, responsibility for outcomes and are recognized for their efforts. Just as a plant cannot flourish without water, sunlight and space, neither can a workforce thrive when it is neglected. So, how do you create the environment where people thrive?

Clarity of vision and strategies is key; people want to know where they are going and have a voice in how they are supposed to get there. Then, true buy-in and engagement is fostered when those in charge lead in a manner that causes people to respect them, trust them and want to follow them. Luckily, there are leadership behaviors and management skills that can be learned such as giving recognition via appropriate feedback, apportioning responsibility and accountability through delegation, and providing development opportunities. Top firms also often operate via high performance teams that create a sense in being “in it together” and collaboration. We have all witnessed the decreases in productivity at siloed organizations with poor communication and a “every man for himself” culture.

Through agreed upon roles and processes, effective teams are able to do more in the same amount of time than less efficient teams since there are fewer bottlenecks, side meetings, and back and forth e-mail diatribes. Organizations that invest in creating a great culture through skilled leaders and highly effective

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> “We like to think we hire good people and we can screen carefully for culture. We try to create an environment where the best thinkers want to work.”
> ~ $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

> “We have a very high retention rate. We attribute this to the fact that we have set up an environment with a great culture where people enjoy what they are doing. We value continuity.”
> ~ $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

> “We feel that you can attract and retain talent if your firm is perceived to be a good place to work. We have had success based on the longevity of people here.”
> ~ >$10 Billion AUM Hedge Fund with 50 to 150 Employees

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Chart 9: AUM for Survey Participants with 50 to 150 Employees

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<thead>
<tr>
<th>AUM</th>
<th>Fund E</th>
<th>Fund S</th>
<th>Fund O</th>
<th>Fund F</th>
<th>Fund H</th>
<th>Fund P</th>
<th>Fund K</th>
<th>Fund M</th>
<th>Fund U</th>
<th>Fund W</th>
<th>Fund X</th>
<th>Fund N</th>
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Source: Citi Prime Finance.
teams attract the best talent, and that talent wants to stay. At firms with a great ‘people culture’, employees stretch themselves; the workplace becomes a place where people want to be; retention levels at these firms are really high. This means there is more resident expertise in these firms and less resource being drawn away to cover or train replacements for employees that have left.”

Many of the hedge funds that we interviewed for our survey echo these sentiments and discussed how important creating the right environment was to their success. In these statements they very much linked attracting and retaining talent to their culture, and they attributed much of their success to having a stable and satisfied workforce.

**Organizational Maturation and People Management**

Organizational development theory provides good insights as to why firms that invest in building out their people management tend to be the ones better positioned to claim people alpha. Findings presented in this section also help to explain why people scores tend to rise in line with the size of the hedge fund organization.

In a 1972 Harvard Business Review article entitled, “Evolution and Revolution as Organizations Grow”, the author notes that the birth stage of a company is seen as a period of creativity. The characteristics of the organization are as follows:

- The company’s founders are usually technically or entrepreneurially oriented and they disdain management activities; their physical and mental energies are absorbed entirely in making and selling a new product
- Communication among employees is frequent and informal
- Long hours of work are rewarded by modest salaries and the promise of ownership benefits
- Control of activities comes from immediate marketplace feedback; the management acts as the customers react

This description clearly fits the launch mentality of nearly all hedge fund organizations. The article goes on to note that as these organizations grow, however, they experience a leadership crisis. “All of the foregoing individualistic and creative activities are essential for the company to get off the ground. But therein lies the problem. As the company grows, larger production runs require knowledge about the efficiencies of manufacturing. Increased numbers of employees cannot be managed exclusively through informal communication; new employees are not motivated by an intense dedication to the product or organization. Additional capital must be secured

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**Chart 10: Comparison of Full vs. Adjusted Population of Survey Participants with 50 to 150 People**

<table>
<thead>
<tr>
<th>AUM</th>
<th>People Score</th>
<th>4-Year Average Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottom half</td>
<td>Top half</td>
<td>Bottom half</td>
</tr>
<tr>
<td>$5.4B</td>
<td>$7.5B</td>
<td>$6.5B</td>
</tr>
<tr>
<td>$8.6%</td>
<td>9.2%</td>
<td>14.3%</td>
</tr>
</tbody>
</table>

Source: Citi Prime Finance.
and new accounting procedures are needed for financial control."

The analogy of a hedge fund moving from a launch to a more institutional footing can easily be applied to this description. This leads to the next “directional” stage of organizational growth. The characteristics of this evolutionary period are described as follows:

- A functional organization structure is introduced to separate manufacturing from marketing activities, and job assignments become more specialized
- Accounting systems for inventory and purchasing are introduced
- Incentives, budgets and work standards are adopted
- Communication becomes more formal and impersonal as a hierarchy of titles and positions builds
- A new business manager is installed and this new manager and his key supervisors take most of the responsibility for instituting direction, while lower-level supervisors are treated more as functional specialists than as autonomous decision-makers

The pattern of moving from a new organizational phase to a crisis once that model becomes entrenched is again repeated. The crisis that emerges from the directive organizational model is one of autonomy. The study notes that “although the new directive techniques channel employee energy more efficiently into growth, they eventually become inappropriate for controlling a larger, more diverse and complex organization. Lower-level employees find themselves restricted by a cumbersome and centralized hierarchy. They have come to possess more direct knowledge about markets and machinery than do the leaders at the top; consequently, they feel torn between following procedures and taking initiative on their own.”

It is this crisis that prompts the organization to move onto the next phase of its evolution: delegation. The 5 phases of growth are shown in Chart 11, and the characteristics of each phase and the related crises that prompt an organization to evolve are highlighted in Chart 12.

These changes occur as the size and the age of the organization increase. The parallel to hedge fund development remains relevant through each stage, particularly for those large global firms that operate in multiple regions and that must deal with escalating amounts of regulatory, legal and cultural complexity. Each phase requires a new assessment of the organization’s goals and vision, and a renewed understanding of the strategies to get there. Each phase requires leaders to assess their own skills and those of their managers. All iterations of the organizational structure require a proactive approach to effectively manage and motivate people in order to maintain workforce alignment. Upgrading skills and ensuring commonality of purpose are critical to ensuring that the organization has employee buy-in.

This is why larger firms will, by their nature, have higher people scores than smaller firms—challenges brought on by their own growth will have forced them

Chart 11: Five Phases of Organizational Growth

<table>
<thead>
<tr>
<th>PHASE 1</th>
<th>PHASE 2</th>
<th>PHASE 3</th>
<th>PHASE 4</th>
<th>PHASE 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crisis of Leadership</td>
<td>Crisis of Autonomy</td>
<td>Crisis of Control</td>
<td>Crisis of Red Tape</td>
<td></td>
</tr>
<tr>
<td>Growth through Creativity</td>
<td>Growth through Delegation</td>
<td>Growth through Coordination</td>
<td>Growth through Collaboration</td>
<td></td>
</tr>
</tbody>
</table>

to confront and spend increased amounts of time on these issues, and to have developed strategies for dealing with and managing through their own organizational advancement.

If they do not address these issues, key problems can occur. Organizations can become overly tied to one entrepreneurial individual and fail to lay the foundation for a sustainable business model, or organizations may become too bureaucratic and insular, in which case interactions become more impersonal. In the latter case, the organization may become more political, and meeting specific targets becomes more important than quality. Either path is likely to degrade workforce alignment and lead to disaffected people who are more likely to leave.

### Chart 12: Characteristics of the Five Phases of Organizational Growth

<table>
<thead>
<tr>
<th>Organizational Characteristics</th>
<th>Management Focus</th>
<th>Organization Structure</th>
<th>Top Mgmt. Style</th>
<th>Crisis that Leads to Next Evolutionary Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PHASE 1 CREATIVE</strong></td>
<td></td>
<td></td>
<td></td>
<td>Founders find themselves burdened with unwanted management responsibilities but hate to step aside</td>
</tr>
<tr>
<td>Founders are entrepreneurially oriented &amp; disdain management activities</td>
<td>Make &amp; Sell</td>
<td>Informal</td>
<td>Individualistic &amp; Entrepreneurial</td>
<td></td>
</tr>
<tr>
<td>Communication among employees is frequent &amp; formal</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long hours of work are rewarded by modest salaries &amp; promise of ownership benefits</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management acts as customers react</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PHASE 2 DIRECTIVE</strong></td>
<td></td>
<td>Efficiency of Operations</td>
<td>Directive</td>
<td>Lower level employees feel restricted by a centralized hierarchy - market knowledge rests at lower levels &amp; individuals want to take more initiative</td>
</tr>
<tr>
<td>Capable business manager installed</td>
<td></td>
<td>Centralized &amp; Functional</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing separated from marketing-job assignments become more specialized</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounting systems, incentives, budgets &amp; standards introduced</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More formal communication &amp; hierarchy</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Top management sets direction; lower level supervisors treated as functional specialists</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PHASE 3 DELEGATED</strong></td>
<td></td>
<td>Expansion of Market</td>
<td>Decentralized &amp; Geographical</td>
<td>Top executives sense that they are losing control - demands for greater autonomy from lower-level managers that want to be able to take more initiative</td>
</tr>
<tr>
<td>More responsibility given to field managers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit centers and bonuses are used to motivate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Top executives at headquarters manage by exception &amp; give most of their focus to expansion &amp; new acquisitions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Communication from top is infrequent, usually by telephone or brief visits to field locations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PHASE 4 COORDINATED</strong></td>
<td></td>
<td>Consolidation of Organization</td>
<td>Line-staff and Product Groups</td>
<td>Lack of confidence gradually builds between headquarters and the field-Procedures take precedence over problem solving</td>
</tr>
<tr>
<td>Decentralized units merged &amp; evaluated on return of invested capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formal planning procedures are established and intensively reviewed</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Numerous staff hired and located at headquarters to initiate company-wide programs of control &amp; review</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditures are carefully weighed and parcelled out</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PHASE 5 COLLABORATIVE</strong></td>
<td></td>
<td>Problem Solving and Innovation</td>
<td>Matrix of Teams</td>
<td>TBD</td>
</tr>
<tr>
<td>Cross-functional teams set up &amp; focus is on innovation &amp; solving problems</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Headquarters’ experts are dispersed &amp; combined into teams</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Matrix structures used to assemble teams for specific problems</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decisions made on real-time information</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incentives are aligned to team’s performance</td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>
We have explored the broad concept of people alpha and why this factor becomes more critical over time as an organization grows. We will now explore how those hedge funds that excel in people management operate and identify standards and best practices that can be applied by other firms to enhance their own approach.

Chart 13

Our framework is built around four pillars: talent acquisition, talent retention, leadership and development, and performance management. This is illustrated in Chart 13. We will explore each of these pillars to understand how they contribute to an organization’s ability to achieve people alpha and to explain the standard and leading practices that were factored into our creation of a people score.

We will also assess our survey population against each of these areas and examine how their scores differ by the size of their organization, and in the case of firms between 50 and 150 people, how those in the top half of our people analysis differed from those in the bottom half.

Talent Acquisition: Identifying the Best Talent and Fit for the Organization

We assessed firms across two categories in order to assign their people score with regards to talent acquisition. The first was the sophistication of the firm’s recruiting effort. The second was a broader view on their approach to sourcing candidates for new and expanded roles. The total score possible within talent acquisition was, therefore, 20 points, 10 points for each of the categories. Chart 14 shows the scores of our various survey respondents in regard to this measure.

As shown, there is a distinct difference in scores between those firms with fewer than 50 people and those firms that had more than 150 people. Smaller firms had less formalized approaches for identifying and reviewing candidates, whereas larger firms had more procedures and checks in their process to filter and assess candidates. Similarly, smaller firms had a less dynamic approach to sourcing candidates, as they typically ran lean organizations and had little role specialization. Larger firms had expanded their reach both externally and internally to fill new positions with a greater diversity of talent, and had developed more sophisticated networks and partnerships to source new employees.

Across our analysis group of survey participants with between 50 and 150 employees, there was a distinct split in this score. Those in the bottom half registered a performance almost exactly in line with smaller firms, illustrating that they had done little to upgrade their talent acquisition or sourcing approach despite the growth in their number of employees.

In contrast, those in the top half of our middle analysis group showed significantly higher scores, much closer to the average of larger firms with more than 150 people. This emphasizes the fact that enhancing their talent acquisition strategy and approach is one of the first areas addressed by firms looking to

“\"We prefer to grow junior talent especially on the investment staff. Our view is that working at other places will taint you. If we hire someone out of school, there are no predispositions.\"”

— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“\"We find that enthusiasm is more important than talent. If someone is enthusiastic, they can build the skills they\'ll need.\"”

— $1-$5 Billion AUM Hedge Fund with Fewer than 50 Employees
The first approach, which we describe as “home-grown talent,” is when a hedge fund hires young candidates into its organization and trains them into their roles. Firms that adhere to this philosophy stress that they want a clean slate in order to imprint their employees into the company’s methodologies and practices. They worry that individuals who join with too much experience from another firm will end up being a disruptive force and that over time they will prove to be a poor fit for the organization.

For single-manager firms or organizations that had a limited number of portfolio managers, growing their own talent was especially important for the investment staff. At these firms, many interviewees felt that learning their firm’s approach to portfolio management was foundational and that those coming from another organization would be more likely to fall back on their predisposed ideas. The interviewees believed that there may be certain biases or impressions that these candidates would have, and that this could negatively impact the way that they formulate their investment approach.

Firms that adhere to this path for their investment team often expand the philosophy to cover their non-investment staff as well; the difference is that they will still tend to hire experienced senior leads for noninvestment areas and then encourage those leads to hire junior people to fill out their teams. Many interviewees stated that they like to bring on junior people and have an opportunity to train these individuals up through their organization. This allows them to understand their talents and develop their aptitudes in a manner that incentivizes them to grow with the organization and align their values and ideals to the firm’s unique culture.
The second approach to building out an organization can be described as “plug and play”. This is when firms actually prefer to hire experienced candidates in both investment and support roles who already possess the skills needed to get the job done in their respective function. Many interviewees cited the benefit of being able to target individuals who have been tested in market conditions and have already had to confront challenging situations. This would allow them to add value immediately and bring a broader range of insights to bear in developing out the organization.

This was the preferred approach for building out investment talent at multimanager and platform firms. These organizations tended to want tested portfolio managers, and the team that supported them, to come as a single unit. These units tended to remain somewhat independent and insular in these organizations, providing fewer options for bringing on and developing a general pool of more junior talent.

For noninvestment roles, the firms that adhered to this model cited their desire to bring in individuals with high degrees of specialization. They noted that many support roles in their organization require specific knowledge and expertise across both their business and portfolio support areas. Bringing on experienced candidates limited the need for these firms to focus on formal training and also allowed them to operate their organization with fewer resources, helping to constrain the size of their overall organization.

Given their investment approach, it makes sense that firms following the ‘plug and play’ model for adding talent were most often the larger firms in our dataset and were older firms that had gone through a number of stages of growth and development. We also found that many hybrids between the two approaches existed and, as with most studies, there are exceptions to the two distinct philosophies.

“We hire people who have experience so there is no formal training needed. They can hit the ground running.”

— >$10 Billion AUM Hedge Fund with 50 to 150 Employees

“We hire PMs to fill a specific need. They need to have experience and track record.”

— $1-$5 Billion AUM Hedge Fund with More than 150 Employees

“On the non-investment side it’s harder to hire at the junior level because of the expertise that’s needed.”

— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“For investment staff to a large extent we like to home grow our talent. Our view is that working other places can taint investors. However, for most of our non-investment roles, we prefer to hire candidates that possess the skills needed for the job.”

— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

### Chart 15: Scoring Framework for Talent Acquisition

<table>
<thead>
<tr>
<th>TALENT ACQUISITION (20 Points Total)</th>
<th>SOPHISTICATION OF RECRUITING (10 Points)</th>
<th>SOURCING OF CANDIDATES (10 Points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>STANDARD PRACTICES</td>
<td>• Pre-screening of resumes</td>
<td>• Internal Referrals</td>
</tr>
<tr>
<td></td>
<td>• Phone interview of candidate</td>
<td>• Word of Mouth</td>
</tr>
<tr>
<td></td>
<td>• Broad set of interviewers</td>
<td>• Prime Broker Talent Organizations</td>
</tr>
<tr>
<td></td>
<td>• Systematic collection of feedback</td>
<td>• Recruiting Firms</td>
</tr>
<tr>
<td></td>
<td>• Interviewee consensus</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Candidate due diligence &amp; background checks</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Formal offer with risk terms</td>
<td></td>
</tr>
<tr>
<td>LEADING PRACTICES</td>
<td>• Firm-wide hiring committee</td>
<td>• Internship Programs</td>
</tr>
<tr>
<td></td>
<td>• Job specific testing</td>
<td>• Focused Diversity Efforts</td>
</tr>
<tr>
<td></td>
<td>• Formal employee on-boarding process</td>
<td></td>
</tr>
</tbody>
</table>
Scoring Framework for Talent Acquisition

Within our talent acquisition category we explored two main topics; within each topic, the survey participants were following both standard practices and a number of differentiated and leading practices. Given the importance of sourcing and attracting the individuals of the highest possible quality into a firm, we assigned a total of 20 points (or one-third of the total score potential) to this category, essentially overweighting it within the scoring framework.

Chart 15 at left shows the main activities and practices that we used to score the category; by using the 1-10 methodology explained in Section I, we were able to differentiate firms that had varying levels of sophistication in this area.

Sophistication of Recruiting: Standard Practices

There were a number of consistent and standard practices that the majority of survey participants adhered to in their recruitment programs.

Nearly all survey participants discussed their hiring process as beginning with a review of potential resumes and prequalification or prescreening of likely candidates by either a partner or the hiring manager. Selected resumes would then be returned to the organization’s internal recruiter/human resources director to set up a phone call with a candidate to get a sense of him or her as a person. If there was no dedicated recruiting or HR function within the firm, the partner or hiring manager would set up the call.

The individual would then be brought in to meet with a broad set of internal interviewers. This set would include the lead and other team members in the area where the individual would be placed. The purpose of this is to evaluate the candidate’s capabilities and to include a cross-functional representation of individuals from across the firm—typically of a similar level of seniority to the candidate—to assess the candidate’s cultural fit. The majority of survey participants noted that they would often spend several months getting to know a candidate and have many people involved in the hiring decision. They felt that taking their time was essential to ensure that they selected the right person, because making a wrong decision could have a negative impact on the firm from both a monetary and cultural perspective.

Feedback would be collected on the candidate on an ongoing basis and if strong objections to the candidate emerged from anyone during the set of interviews, there might be a decision made to halt further discussions at that point. For those candidates who made it through the interview process, all the interviewers would typically be brought together at the end of the process and be asked to reach a consensus on whether or not to make an offer. This process of feedback and gaining consensus was methodical and systematic with the majority of survey participants across all size bands.

“ We have a formal ten step process for recruiting which can last between 2 to 6 months...This is a consistent well defined process and it’s completed for every hire.”
– $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

“ Our process begins with qualifying resumes and then an HR phone screen before we bring a candidate in. We then have them meet at least 5 people before being hired.”
– $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“ We have a genuine interest in getting to know the candidate in depth. Hiring can be anywhere from a 2 to 6 month process unless there is a pre-existing relationship with the heads of the firm. Hiring contracts are usually issued with risk guidelines. Hiring is consensus driven with everyone given a say.”
– $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

“ The hiring process starts with someone recommending a person and sending a resume. A partner makes an initial decision of yes/no and then the resume is passed on to the head of HR who will do some background work on the individual. If it’s still interesting, we will have the candidate come in for an interview...The candidate will meet 3-5 senior level personnel over a couple of days. These are serious interviews. If someone does well, HR does background checks and begins the offer. There’s a little negotiation and then a formal third party background check.”
– >$10 Billion AUM Hedge Fund with More than 150 Employees
If there was agreement to move forward with the candidate, the recruiter/human resources lead—or the hiring manager, if there was no one fulfilling that role at the firm—would begin his or her due diligence and checks on the candidate. In some instances these were informal checks, and in other instances a full background check would be commissioned. If there were no red flags, a formal offer would then be drawn up and submitted to the candidate.

Adhering to this formal process was seen as a critical success factor in talent acquisition, but firms were quick to note that they reserved the right to act in a less formal manner if the need arose in a special situation. These situations most frequently came down to the speed at which the organization needed to move or the instances where a candidate was well known to seniors at the firm. Barring any exceptions, the typical recruiting process lasted from 2 to 6 months.

**Sophistication of Recruiting: Leading Practices**

Beyond the standard practices cited above, some interviewees described additional activities and approaches that began to emerge as leading practices in the area of recruiting. These leading practices helped to raise the organization’s overall level of sophistication and control and could be cited as differentiators.

Market leaders have all created a formal hiring committee to oversee recruiting as part of their firm-wide governance. This committee is generally a small group which includes management from various areas. Our interviewees stated that these groups meet weekly to discuss any current hiring needs, including new roles as well as replacement for existing roles. The team will also discuss candidates who are currently in the pipeline, and whether they would like to continue meeting with the candidate or whether they should continue seeking additional talent. This hiring committee generally has final say prior to extending a formal offer to any individual.

Another aspect of the recruiting process that emerged as a leading practice was the use and implementation of job-specific testing as part of the recruitment lifecycle. This took two different forms: either a subject-specific test based on a real market scenario or a personality test based on an external profiling model.

The last practice performed only by the leading firms, was the implementation of a formal employee on-boarding process once the candidate had accepted the employment offer. This took a number of different forms but was always owned by the human resources team, who would coordinate meetings and reviews. The new employee is provided clear orientation to the firm standards and culture and is provided a detailed timeline and description of how he or she will be on-boarded. Expectations are set with an early series of meetings with key individuals; processes and standards are laid out and benefits are clearly explained. In a few select cases this process was also automated, using workflow technologies to coordinate information exchange and progress throughout the process.

As the employee comes on board, a series of review meetings are set up with partners of the firm to check on both the new employee’s satisfaction with the process and his or her understanding of the firm’s values and direction. Open access to senior

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“**We have a hiring committee which consists of Business Development, our Chief Risk Officer, Director of Research, President and our Founder. This is the group that manages our hiring process and ultimately we reach a consensus on who we hire.**”

— $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

“**We recently put in place a hiring committee and this seems to be well received throughout the firm.**”

— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“**Our hiring committee’s goal is to meet weekly. We discuss new open requisitions that people are asking to fill. Each request needs to state whether it’s a new hire or a replacement and explain the reason why the hire is necessary. The regional head needs to endorse it. Once the requisition is officially approved then we discuss the hiring process.**”

— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“**Hiring decisions are not made in a vacuum or once all of the information is gathered. We meet every two weeks to discuss where we are in the process, what the inputs are and what the latest information or data points are. There is a lot of discussion and debate around that. We want to ensure that we are all moving forward together as a committee and that our work results in a decision.**”

— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

1. https://www.calipercorp.com/
Exploring the Concept and Characteristics of “People Alpha”

By far the most frequently mentioned approach for finding candidates was through internal referrals from employees who were already a part of the firm. Many interviewees said that by encouraging internal referrals, they were able to get candidates who had been prescreened to a certain extent. Individuals recommending candidates already knew and understood the culture of their firm and would only put forward candidates that they believed would be a good fit.

While most firms relied on and valued recommendations from their staff, very few offered incentives for referrals. Although this is a common practice in consulting and in other types of growth companies, the concept is still one that has not gained traction in the hedge fund industry. Some funds are exploring the idea, but the consensus was that those recommending individuals do so for the incentive of making their fund more successful, which would benefit the organization as a whole.

The next most preferred method was through word of mouth. The interconnectedness of the financial services industry means that nearly everyone at a hedge fund will be engaged with a broad set of counterparties and service providers. Moreover, there are many industry forums and functions where hedge fund employees have an opportunity to meet their peers at other organizations. Through these encounters, most individuals at hedge fund organizations begin to build out a trusted network outside their firm. Soliciting this network for

leaders is provided during the initial acclimatization to the new work environment so that any questions or concerns are quickly addressed. Progress with the on-boarding and a discussion of how the new employee is integrating into the firm are monitored by human resources and discussed with the hiring committee, all with the intent of identifying issues early and correcting any misconceptions or misunderstandings about expectations and career fit within the firm.

The combination of a formal hiring committee, candidate testing and formalized on-boarding practices all stood out as practices implemented by the firms we identified as market leaders; within our scoring methodology, these practices accounted for the difference between a score of 5/10 and scores closer to the 10/10 potential for sophistication of recruiting within talent acquisition.

Sourcing of Candidates: Standard Practices

There were four standard paths used by hedge funds in recruiting to build out their organizations, regardless of whether their core philosophy veered toward home-grown or plug and play talent. These are highlighted in Chart 16.

Survey participants stressed that their preference was to first use methods where individuals making the recommendation would have direct knowledge of the candidate and no direct expectation of being compensated for making the introduction. Only later in their process would they consider using broader methods that might net a wider candidate pool, but create more obligation on the hedge fund to compensate the recommender in some way.

Chart 16: Standard Paths Used by Hedge Funds in Recruiting Talent

1. Internal Referrals
2. Word of Mouth from Trusted Network
3. Prime Broker Talent Organizations
4. Recruiting Firms

Source: Citi Prime Finance.
recommendations can often yield strong candidates who also, to some extent, have been prescreened.

Leveraging their prime brokers, and using those relationships to access those teams’ prime broker talent organizations, was another popular way to source talent in situations where internal referrals and word of mouth were not bringing in the right individuals. Many interviewees stated that prime brokers are the counterparts that often have the deepest understanding of the firm’s business. Prime brokers also have a broad sense of how their firm operates in relation to other hedge funds that they deal with and would thus have a general sense of their culture. These services are provided as a value-add to the hedge fund, and survey participants did not feel a direct obligation to compensate their prime brokers for use of these services. Instead, they saw this as part of their overall relationship building and noted that using these teams often allowed them to get a good sense of the broader market.

For hard-to-source roles, or in those instances where none of the other methods have produced the desired result, survey participants indicated that they would seek candidates from recruiting firms. The benefit of using these firms is that they have an extensive network of contacts across the broader market and can many times offer introductions to candidates who may otherwise be reluctant to speak with a hedge fund.

Several survey participants noted that they have built up good relationships with recruiting firms and that they spend a significant amount of time helping to educate the recruiter about their organization and culture. The recruiter can thus help to presell the hedge fund to potential candidates. Several firms, particularly multimanager firms, rely primarily on recruiters, although many other firms are hesitant to incur the cost of sourcing a candidate from these organizations. They often take a retainer fee for a search and then charge an additional fee for candidates who they successfully placed; this fee is equivalent to a percentage of the candidate’s first year’s salary.

“Internal referrals are always preferred because we have someone vouching for the individual who understands our culture. Prime teams generally have a sense of the market and our culture so they too tend to be good resources. We have also posted jobs on industry boards, but we really try not to use search firms.”
—>$10.0 Billion AUM Hedge Fund with 50 to 100 Employees

“We prefer to hire through word of mouth. It’s a lot easier when you go through people you know.”
—$1.0-$5.0 Billion AUM Hedge Fund with Fewer than 50 Employees

“We find internal referrals are the best way to hire but we will use recruiters if we are not able to find the right person through word-of-mouth.”
—>$10.0 Billion AUM Hedge Fund with More than 150 Employees

“We use recruiters because they know our group well and they understand the industry landscape.”
—>$1.0-$5.0 Billion AUM Hedge Fund with More than 150 Employees

Sourcing of Candidates: Leading Practices

We identified two aspects of the sourcing process outside of the standard channels that indicated a differentiated approach to creating a broad and diverse sourcing pool. With fierce competition for the best talent in the hedge fund industry and a unique set of skills and personality required to succeed in the hedge fund environment, the early identification of talent was an important component of a leading hiring program.

A number of survey participants discussed the establishment of internship programs in partnership with the leading business, finance and engineering schools. Internships are most typically offered to individuals who would become a part of the investment team. The criteria for gaining an internship is rigorous and presents high barriers to the candidates, with senior members of the firm often involved in the selection process.

Investment teams review possible candidates and narrow down the selection using phone interviews and case studies to determine whether a candidate would be a high performer within the organization. Hedge funds that described internship programs talked about partnering with the leading schools, and they were all focused on identifying the high performers early on in their careers.
This indicates a shift in approach by the industry. Junior investment professionals are typically targeted after they go through the investment banking analyst programs at the leading investment banks and are thus two to four years into their careers. Moving down the cycle indicates an increased maturity, as well as a focus on building organizational depth within a company.

The second aspect of sourcing strategy that emerged as a leading practice was the implementation of a more formal approach to ensuring employee diversity. For an industry that has traditionally been overrepresented by a single demographic (white males), this represented another interesting shift in maturity and growth that has been an important factor in other industries as they evolve.

There are numerous studies on the positive impact of having a diverse workforce (culture, gender, and ethnicity), but there are different opinions and studies linking diversity to company performance. In 2002, the MIT Sloan School of Management published a study by the nonprofit organization called Building Opportunities for Leadership Development (BOLD) entitled “The Effects of Diversity on Business Performance” which outlined the effects of diversity practices on business performance.

The study provides a detailed description of the difficulty in measuring the relationship between diversity and financial business performance but does outline clear results linking diversity to innovation and creativity, as well as to employee satisfaction and turnover. More diverse firms also tend to avoid ‘groupthink’ and bring additional points of view into decisions, but poorly managed diversity programs can be disruptive to interactions and performance.

While it was not the objective of our survey to focus on diversity, we did hear a lot of commentary on the subject and picked up a highly divergent set of thinking regarding its importance.

All hedge funds interviewed for the survey underscored their appreciation for diversity; they were committed to fostering equal opportunity employment and avoiding any discrimination in their hiring or employee practices. Many also expressed concerns about the optics of the industry and highlighted the diverse nature of their existing work force to illustrate the depth and breadth of individuals who contributed to their culture.

There were only a few firms, however, that actively considered and tracked candidates through a diversity lens during the recruiting process and sought to build candidate pools that included a broader set of diverse individuals; most firms were unwilling to elevate diversity as a factor in their recruitment and hiring decisions. Consequently, we identified having a diversity focus in sourcing candidates as a leading practice in our scoring framework so that those firms that were actively managing this aspect of their organization would be recognized for their efforts.

“ We have been successful with our internship programs. For interns we solicit resumes at the leading 3-4 business schools and get resumes that way. Then we send to analysts on the investment team to narrow the list to 15-20 resumes. We have a phone interview and bring that list down to about 12 candidates and have them do a case study and present us with the results. Then invite 3-4 people back for interviews. These are really case by case hires with no quotas that we need to reach.”

~ $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

“ Our preference is to bring junior people up throughout our organization. We bring in junior people typically post business school who have interned here and we bring them back full time. We have hired both of the interns who were here this summer.”

~ $1-$5 Billion AUM Hedge Fund with Fewer than 50 Employees

“ We have been successful with our internship programs. For interns we solicit resumes at the leading 3-4 business schools and get resumes that way. Then we send to analysts on the investment team to narrow the list to 15-20 resumes. We have a phone interview and bring that list down to about 12 candidates and have them do a case study and present us with the results. Then invite 3-4 people back for interviews. These are really case by case hires with no quotas that we need to reach.”

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~ $1-$5 Billion AUM Hedge Fund with Fewer than 50 Employees

“ We pride ourselves on diversity. We have 40 countries represented in firm, which we consider diverse for a 200 person firm.”

~ $1-$5 Billion AUM Hedge Fund with More than 150 People

“ We consider ourselves to be pretty diverse but it’s not a driving factor in our hiring process.”

~ $1-$5 Billion AUM Hedge Fund with Fewer than 50 Employees

“ With most job searches we receive 20 male resumes and 5 female resumes so we are looking at how we can get a more diverse candidate pool.”

~ >$10.0 Billion AUM Hedge Fund with 50 to 150 Employees

“ Diversity is very important to us. We are committed to being an equal opportunity employer. There is no discrimination of any sort and we have policies in place to prevent this.”

~ $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees
Talent Retention: The Focus on Culture

The next pillar in our people alpha model is the ability to retain top talent and build a lasting and enduring people franchise. As the hedge fund industry enters its third decade of significant growth and expansion, we are witnessing an increased focus on the value of the organization itself as some founders look to create their exit plans and maturing firms aspire to become multigenerational.

We assessed firms across two categories in order to assign their people score with regards to talent retention. The first was the focus that the firm had on developing a strong culture, and the second was a more practical list of incentives to support employees and improve their overall work-life balance. The total score possible within talent retention was therefore 20 points (10 points for each of the categories). Chart 17 shows the average scores of our various survey respondents for this measure.

As shown, there is a distinct difference in scores between those firms with fewer than 50 people and those firms with more than 150 people. As would be expected based on our earlier analysis, those firms with between 50 and 150 people that fell into the upper half of our people scores had higher averages than smaller firms, but still not as high an average as the largest firms.

However, the most interesting finding in Chart 17 relates to those firms with between 50 and 150 individuals that scored in the bottom half of our range. These firms actually had averages that were lower than the average scores achieved by firms with fewer employees. This disparity in their talent retention score drags down the overall average people score for firms with between 50 and 150 employees in the bottom half of our range to essentially the same level as firms with fewer than 50 employees—24.2 points versus 23.6 points.

This is relevant because those firms with between 50 and 150 people that fell into the bottom half of our people scores actually underperformed firms with fewer employees. As noted back in Section I, these firms registered a 4-year average return of only 8.6% versus 9.4% for firms with fewer than 50 people.

This highlights the importance of focusing on talent retention—a finding supported by all the academic studies and by our own analysis that shows an average people score for firms with 50 to 150 employees in the top half of our range of 38 points and a 4-year average return of 14.3%, nearly 600 basis points greater.

With such a significant difference apparent as a firm grows from 50 to 150 people, it is therefore important to understand the difference between the standard and the market leading practices and observe how these are implemented and managed within different organizations. The analysis also raises a broader observation about what it takes to move a firm from being a mid-sized hedge fund to a large franchise organization, placing culture at the center of the discussion.

Defining Culture and Its Importance to Hedge Fund Organizations

In the survey, culture was a consistent term that our interviewees used to describe what was unique about their firm, and they cited their culture as a reason why they felt that their firm has been successful. The relevant dictionary description describes culture as the behaviors and beliefs characteristic of a particular social, ethnic or age group. For hedge funds, culture was consistently described as a collective way in which the people in their organization operate.

The majority of our interviewees stated that culture starts at the top of an organization and is then driven throughout the firm, also noting that without strong leadership in place it is difficult to maintain a successful culture. Three key elements were consistently cited as making up a strong organizational culture: defined vision and goals, open communication, and a collaborative team.
Interviewees described having a defined vision and goals as fundamental to any effort to build culture. By espousing their vision, leaders of the firm are able to lay out the principles and objectives that they feel define their organization; by setting clear goals, leaders are able to provide their employees tangible outcomes against which they can evaluate how well their efforts are succeeding. While the visions and goals may have expectations about the hedge fund’s desired investment performance and AUM growth, they typically look beyond these measures and set a tone for the kind of organization the leaders want to create.

Most of the hedge funds that had a defined vision and goals indicated that their founders have worked with outside professional coaching and leadership firms to assist them in defining and codifying their ideas. Additionally, these firms will often help the hedge fund leaders craft a set of strategies they can pursue to ensure that they achieve their goals and realize their vision. Having this cohesive plan makes communicating the vision easier and encourages employees to feel actively included in the path forward. Funds that operate in this way believe so strongly that their vision and goals will contribute to their firm’s success that most evaluate their employees on them as part of their year-end evaluation process.

The final aspect of creating an open-air environment is related to the hedge fund’s organizational structure. In most instances, survey participants noted that they tried to make their organization as flat as possible. They avoided having too many layers of managers because this would create unwanted distance between the leaders of the firm and their employees, and would thus interfere with communication. Having less formal management structures was seen as challenging individuals to contribute as fully as possible and to incentivize them to be more cooperative with their coworkers. This helps lay the foundation for the final aspect of culture.
The last element of culture commonly described in the interviews was the proactive fostering of a collaborative team environment within the hedge fund organization. The best-selling 1995 book entitled, “Tips for Teams: A Ready Reference for Solving Common Team Problems” notes 5 characteristics of teams that work well together. High-performing teams 1) have a common goal and purpose; 2) trust each other by being honest and giving their team members the benefit of the doubt; 3) have clear roles and responsibilities; 4) appreciate diversity of opinions and views; and 5) balance the team’s focus so that they recognize both individual and collective results.

The impact of being a part of an effective collaborative team is that the members develop respect for one another and will become increasingly effective and committed to one another. This theme of having respect for their colleagues and believing that they work with the best people in the industry was one that emerged in many of the interviews with firms that believed strongly in their culture. Indeed, the power of teams was such that many founders of hedge fund organizations seek opportunities to encourage teamwork in environments that extend beyond the office environment, as will be discussed in a moment.

“We have a very flat organization and everyone has a voice.”
– $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“We have a family oriented culture. We believe that there needs to be a work life balance and we try to be as flexible as possible.”
– $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

“We are sticklers about culture. We have been able to maintain our culture even as we have continued to grow. We have a manager’s offsite where we focus on culture.”
– $1-$5 Billion AUM Hedge Fund with More than 150 People
Compensation and Talent Retention

Managers also highlighted compensation deferrals when asked about retaining talent. Nearly all of the firms that participated in this survey stated that they currently use or plan to use compensation deferrals as a retention tool. These funds noted that not all employees have deferred compensation plans, and not all plans are created equal.

Employees need to achieve a minimum compensation level in order for deferred programs to kick in. A number of deferral schemes were also cited. These ranged from cliff vesting to straight time vesting. There were some outliers, funds that did not implement compensation deferrals, but even these stated that they will likely institute one in the near future. When we asked whether employees would receive any of their compensation deferrals if they left the firm, most respondents said the employees would forfeit compensation if they left prior to vesting.

Having laid out the aspects of what makes up hedge fund culture and how compensation deferrals are used to additionally foster employee retention, we will now look at what constitutes standard and market leading practices within our set of survey participants.

"Deferrals are typically in place for people who make over $300k. 2 years and cliff investing but this can change."
— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

"We have comp deferrals in place throughout the firm. Level at which it kicks in would typically be higher that what you would pay a non-investment professional. It’s an 18 month deferral."
— >$10 Billion AUM Hedge Fund with More than 150 Employees

"We are not interested in creating golden handcuffs and forcing those that want to leave the company to stay. Currently bonuses are all cash and are paid out as soon as the announcement is made. On the flip side, we don’t want to be picked off by their competition. Will probably do short term deferrals or claw backs."
— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

Scoring Framework for Talent Retention

Within our talent retention category we scored two categories, as we felt that culture needed to be distinguished from more concrete benefits and incentives offered to employees. Given the importance of building a high-performing team and retaining top talent, this category was assigned a total of 20 points—one-third of our total people score.

Chart 18 below shows the main activities and practices that we used to score the category; by using the 1-to-10 scale explained in the methodology, we were able to differentiate firms that had varying levels of sophistication in this area.

Chart 18: Scoring Framework for Talent Retention

<table>
<thead>
<tr>
<th>TALENT RETENTION (20 Points Total)</th>
<th>FOCUS ON CULTURE (10 Points)</th>
<th>QUALITY OF BENEFITS (10 Points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>STANDARD PRACTICES</td>
<td>• Clear articulation of firm values into behaviors</td>
<td>• Platinum Healthcare Benefits</td>
</tr>
<tr>
<td></td>
<td>• Team building events (eg softball leagues, drinks event)</td>
<td>• Retirement savings plan (eg 401(k) plan)</td>
</tr>
<tr>
<td></td>
<td>• Off-site team building program</td>
<td>• Discretionary healthcare flexible spending accounts</td>
</tr>
<tr>
<td>LEADING PRACTICES</td>
<td>• Formal firm strategy and vision process update</td>
<td>• Extended benefits packages</td>
</tr>
<tr>
<td></td>
<td>• Embed firm strategy and vision into annual performance management process</td>
<td>• Flexible work arrangements</td>
</tr>
<tr>
<td></td>
<td>• Workplace perks including gym memberships and parking depending on location</td>
<td></td>
</tr>
</tbody>
</table>
Focus on Culture: Standard Practices

The majority of firms interviewed, across all of our size bands by number of employees, stated that they had a clear articulation of their firm’s values and understood how those values were exemplified by their employee’s behavior. The values were discussed in the hiring and on-boarding processes and then included in the employee handbook. The founders of the firm took opportunities to discuss and highlight the values of the firm on a regular basis.

The other common factor across the majority of our survey participants was that they planned team-building events outside the office to increase the ties between their employees in more relaxed settings. These could be sports events such as participating in softball leagues, or more social events such as scheduling team drinks. In either instance, the intent was to foster team spirit. This was seen as an enhancing factor in retaining talent and building loyalty to the company. This was broadly consistent across our interviews, so we defined these characteristics and behaviors as standard.

Focus on Culture: Leading Practices

A subset of the survey participants interviewed went beyond casual outside-the-office events and instead put much more of an investment into this effort—relocating their entire team or their main leaders to an off-site facility for more intensive team building away from the distractions of the office.

Different types of off-site activities were cited in the interviews. For some firms, these off-sites were an opportunity to examine their culture and performance and invite a deeper level of discussion and scrutiny about how the firm was doing. For other firms, these off-sites could take the form of competitive sports or games. There were even instances where not only the employees, but their entire families were included in these outings.

Another type of off-site that was cited by firms exhibiting a leading practice around building their culture was taking a time out and gathering the top members of the firm together to refresh the vision, goals and strategy of the firm. Interviewees that hosted these types of sessions noted the importance of getting the key decision-makers outside the work environment. There were typically professionals brought in to facilitate and guide these sessions, and many firms noted long-standing relationships with these leadership consultants that had spanned multiple iterations of their plan.

The final leading practice we identified was the embedding of the firm’s values and goals into the employees’ performance management process. The details of how performance management is handled across firms will be explored in more depth in a coming section, but the willingness to elevate consideration of cultural factors to be on par with an examination of the employee’s actual job performance is a differentiator that only a subset of firms had pursued.

Those firms that described how they had integrated their values within their evaluation processes demonstrated a much stronger focus on culture than those that had not gone to this extra level of attention. This was, therefore, a way in which we could distinguish the scoring and separate a common practice from one that appeared to be differentiated.

“We do sporting events to build camaraderie with our team. This is a good opportunity for our CIO to interface with the team.”
— $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

“We recently started a softball team. We want our employees to feel like they have a home.”
— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“We established a set of core values that employees have to follow. People are evaluated on the six core values.”
— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“Family is a big part of our culture. Our founder takes all employees and their respective families on a trip every year.”
— $5-$10 Billion AUM Hedge Fund with Fewer than 50 Employees

“We do an annual outing with management. We do a variety of competitive exercises which helps us with team building.”
— $1-$5 Billion AUM Hedge Fund with More than 150 Employees
Quality of Benefits: Standard Practices

The quality and nature of a firm’s employee benefits are much easier to measure in a survey of this nature. Hedge funds are known for providing good benefits packages as part of the employment contract; therefore, the range of benefits considered standard is well understood within the industry.

Our survey participants were nearly unanimous in their willingness to offer platinum healthcare plans for their employees. This is often a legacy of the founder’s origin, as many emerged from much larger organizations that were able to offer superior healthcare packages. Maintaining this level of care was seen as critical to attracting and retaining talent even though hedge funds are much smaller organizations that do not have the same options for spreading the cost of healthcare across a large number of employees.

Most interviewees picked up the cost of premiums for coverage not only for the individual but also for their families. Core medical coverage was usually supplemented with both dental and vision coverage. The benefits package also included standard insurance coverages such as short-term disability and worker’s compensation, and the majority of firms also pay for an employee’s long-term disability premiums.

A retirement savings plan, such as a 401(k) plan in the United States, was also considered a standard part of any employment contract. While the majority of hedge funds did not match their employee’s contributions, some did choose to go this route to encourage savings. To make administering these plans easier, many hedge funds choose to invest in a safe harbor 401(k) plan or a SIMPLE 401(k) plan, neither of which is subject to the same nondiscrimination testing that traditional 401(k) plans require. Testing in traditional 401(k) plans is required to ensure that higher compensated employees are not receiving a higher contribution rate than those making less pay. The main difference in 401(k) types is that employee contributions are fully vested when made in the safe harbor or SIMPLE plans.

The 401(k) plans offered by many survey participants also included the option for employees to invest their capital into the hedge fund’s own investment pools. In such instances, special arrangements are typically made with the plan sponsor to facilitate the mechanics of such investments, including how to handle subscriptions, redemptions and reinvestments of proceeds from the fund. There will often be different firm-sponsored funds available in the 401(k) plan, with some open to all employees and others available only to partners.

Another common offering across our pool of interviewees was the ability to set up discretionary flexible spending accounts. These accounts allow employees to use pre-tax dollars to help manage certain categories of medical and family-related services that may not be recognized in traditional coverage plans. For more detailed information on benefit packages, please refer to our United States benefits primer, which can be found at the following web address: http://www.citibank.com/transactionservices/home/demo/tutorials29/HedgeFundUSBenefits_Jan2012/.

"Benefits are another way to retain talent and the fund tries to provide good benefits for employees as well as also utilizing cost deferrals for both investment and non-investment staff.”
- $1.0-$5.0 Billion AUM Hedge Fund with 50 to 150 Employees

"We recently switched benefits and we think that this will be helpful from a recruiting and retention perspective.”
- $1.0-$5.0 Billion AUM Hedge Fund with 50 to 150 Employees

"Our employees don’t pay any health care premiums. We provide medical, dental, vision plans from top providers.”
- $1.0-$5.0 Billion AUM Hedge Fund with Fewer than 50 Employees

"We pay 100% benefits for employees and family. Provide lunch to all employees every day, provide relocation packages and 401K matching.”
- $1.0-$5.0 Billion AUM Hedge Fund with More than 150 People
Quality of Benefits: Leading Practices

In addition to the standard benefits, a number of firms discussed additional measures that they had implemented to provide a more flexible and supportive work environment for employees. Several different examples were mentioned that we felt were not commonplace across the industry. While these examples are currently considered out of the norm, they may rapidly become a standard part of the employment package over time as firms look to strengthen their talent retention.

Some firms offered extended benefits packages that included additional services beyond the standard offerings discussed above. Given the wealth creation that often occurs in hedge fund organizations, some interviewees offered estate and tax planning services to their employees. Others chose to cover their employees’ gym memberships and other health-related pursuits.

Offering employees a flexible work arrangement was another benefit that some firms were pursuing to help employees achieve a better work-life balance. There are several types of flexible work arrangements that hedge funds offer. The most common is having a flexible or alternative work schedule. This permits variation in an employee’s core hours in terms of starting and departure times, but does not alter the total number of hours worked in a week. The next most common option is to offer work location flexibility. This allows employees to work from home or at another off-site location for a specified number of hours/week or limited duration. For firms with global operations, the ability to interact with other time zones by working from home was a clear policy.

Another option is a compressed work week schedule that allows for an employee to complete his or her work within fewer days. Job sharing is a less-explored option in which two people share a regular part-time position.

The final leading practice observed across the participants was related to workplace perks. These offerings all made the work environment easier for employees to access and enjoy. Items mentioned could be as small as paying for employee parking in nearby garages, covering commuter expenses or picking up the cost of dinners when employees stay late. Leading firms also had more substantial offerings like having an in-house chef or cafeteria that offered employees fresh food either free of charge or at highly discounted prices. One hedge fund even had an internal juice bar where employees could order fresh mixes daily.

“We feel that making work experience enjoyable is the best way to retain talent. A work-life balance needs to exist and even though we trade Asian hours we try to be flexible to accommodate personal needs.”

— $1-$5 Billion AUM Hedge Fund with Fewer than 50 Employees

“ We offer our employees gym memberships and we pay for lunch and dinner.”

— $1-$5 Billion AUM Hedge Fund with Fewer than 50 Employees

“ We pay for parking depending on the location that our employees work.”

— $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

Learning & Development: Building a Performing Organization

The third category that we explored during our interviews was the way in which a hedge fund trained and developed their employees and how they focused on fostering leadership across a broader set of managers beyond the original founders.

We assessed firms across a single set of criteria covering both job-specific training and professional development, allowing for a maximum score of 10 points if all of the practices and techniques were present within the firm. Chart 19 at right, shows the average scores across our size buckets, again splitting out the middle group by fund performance.

This is the category that has the biggest percentage gap between the score awarded to small firms with fewer than 50 people and franchise-sized firms with more than 150 people. Indeed, the average for our franchise-sized firms in this measure was 2.75x larger than for small firms.

Developing a broad training and development program is an exercise that requires significant effort and investment to achieve. The cost of doing this is much more prohibitive for small firms that are still looking to cover their management and fund company expenses from a lower asset base than for large firms. Moreover, as firms grow to over 150 employees, the differences in the skill levels of employees will become more noticeable, particularly as these firms are typically of older vintages than many small firms; as such, there is likely to be a bigger age and experience gap between the founders and junior staff. This increases the need to formalize development programs.
We also see a noticeable difference in scores between firms in the top and the bottom half of the middle size band—indeed, the size of this gap is significantly larger for learning and development than for our earlier talent acquisition and talent retention categories. Those firms with 50 to 150 employees, that fall into the top half of our people score had a people score that is much more in line with larger, franchise-sized firms where the average AUM is $13.8 billion. In contrast, those firms in the bottom half of our analysis have scores much more in line with smaller firms with fewer than 50 people that have average AUM of $2.6 billion. Given this wide disparity, it is important to understand the differences and identify the standard and market leading practices in this category.

The scope of training and development can be split between a focus on improving employee skills specific to the function they perform and then more broadly developing the professional skills of the individual.

The skill-specific training clearly differs between the investment team and the investment support team, so there were a range of courses and programs (such as cross-training) described to enhance job-specific skills.

The professional development techniques described compared closely to those of professional service partnerships such as law firms or management consulting firms. These included mentorship and coaching programs of differing sophistication, and management training for team and department leaders as a firm expanded and grew.

External professional development courses, such as those provided by organizations like Harvard Business School, were less commonplace but did get discussed in some interviews. More commonplace, particularly for multimanager hedge fund platforms, was the use of external trading coaches to focus on an individual’s approach to the market and formulation of their portfolio strategies.

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**Chart 19: Learning and Development Scores for Various Sized Hedge Fund Firms**

<table>
<thead>
<tr>
<th>Score</th>
<th>Less than 50 people</th>
<th>Bottom half</th>
<th>Top half</th>
<th>More than 50 people</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.8</td>
<td>3.8</td>
<td>6.8</td>
<td>7.7</td>
<td></td>
</tr>
</tbody>
</table>

Source: Citi Prime Finance.

**Chart 20: Scoring Framework for Learning & Development**

<table>
<thead>
<tr>
<th>LEARNING AND DEVELOPMENT (20 Points Total)</th>
<th>SOPHISTICATION OF RECRUITING (10 Points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>STANDARD PRACTICES</td>
<td>• On the job training</td>
</tr>
<tr>
<td></td>
<td>• Ad-hoc training</td>
</tr>
<tr>
<td></td>
<td>• Cross departmental training</td>
</tr>
<tr>
<td></td>
<td>• Informal coaching and career advice from senior members of the firm</td>
</tr>
<tr>
<td></td>
<td>• Offer support for external professional certifications</td>
</tr>
<tr>
<td></td>
<td>• Encouraging staff to attend industry conferences and seminars</td>
</tr>
<tr>
<td>LEADING PRACTICES</td>
<td>• Offer on-line training courses</td>
</tr>
<tr>
<td></td>
<td>• Formal program of mentor/mentee interactions</td>
</tr>
<tr>
<td></td>
<td>• Establish formal leadership/management courses (partnering with external consultant)</td>
</tr>
<tr>
<td></td>
<td>• Offer assistance of trading/executive coaches</td>
</tr>
</tbody>
</table>
Scoring Framework for Learning and Development

Chart 20 on previous page shows our single category for learning and development across what we believe to be the standard and leading practices in the industry today. The differences were harder to separate between the firms but the real distinction comes from formalized mentor/mentee programs and the establishment of formal leadership/management courses.

The most surprising observations from our interviews were the extent to which some of the leading firms had integrated their training and development programs into the overall growth strategy of the firm. The leading firms had all engaged with outside groups to develop a training and development curriculum, and all viewed these programs as key to achieving future growth. The behaviors of these leading firms closely mimicked those of Fortune 500 companies and public companies with significantly more employees than the relatively small hedge fund organizations.

Training and Mentorship Programs: Standard Practices

The most commonly cited approach to training employees was described as on-the-job training, and this was a default answer given in the majority of the interviews. The assumption that new employees had the raw skills required to learn quickly and adapt to new techniques and procedures is understandable given the caliber of people being filtered through the recruiting process, and given the high bar that all hedge funds set on talent and skills. For the investment team, training is typically led by the portfolio managers or more senior members of the research team. For the investment support teams, training is led by the respective managers of the functions being supervised.

Survey participants also frequently mentioned situations where a decision might be made to train a specific employee to close a skills gap or where there might be a new system, process or regulatory requirement that necessitates a one-off period of training. We categorize all these types of initiatives as ad hoc training.

Cross-training between departments was also a fairly common pursuit across the majority of our interviewees, primarily in the investment support functions. This was seen as an important factor in encouraging employees to move laterally within the organization—a pursuit that helps organizations in both developing and retaining talent. In line with that goal, some firms proactively reviewed internal candidates before seeking an external hire for a required position, enforcing a career mobility ethic that was cited as being beneficial to the overall culture.

Firms that valued their open-air environment, as discussed in the talent retention section, also noted many situations where the senior members of the firm would provide informal coaching and career advice to more junior employees. This could take the form of one-on-one discussions or be fostered through small group sessions, where one or more seniors shared their experiences and offered general guidance to several more junior employees.

There were also many instances where the firm supported more formal training, sponsoring employees to pursue external professional certifications. These certifications were typically within the employee’s job sphere, such as a controller getting his or her certified public accountant (CPA) degree, a human resources lead getting accredited from one of the industry institutes, or an investment analyst earning professional certifications. These certifications were typically within the employee’s job sphere, such as a controller getting his or her certified public accountant (CPA) degree, a human resources lead getting accredited from one of the industry institutes, or an investment analyst earning professional certifications.

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“ The non-investment staff is typically trained on the job.”
$1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

“ If we have someone in a seat that we think is good and they want to try something else we try to offer them the opportunity to learn a new skill.”
$5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“ As an organization we support obtaining professional certifications. We want to try and implement a full program that addresses different roles and different career levels and are moving towards a systematic program, but it’s not formalized at the moment.”
$5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“ The support staff is encouraged to attend conferences as well as attend various networking opportunities. We want our people to be out in the marketplace.”
$1.0-$5.0 Billion AUM Hedge Fund with 50 to 150 Employees

“ We as an organization spend a lot of time developing and mentoring but it’s through an active on-going dialogue and not through a structured/formal program. There is a lot of dialogue and regular scheduled meetings. Our founder and CIO meets with PMs in small groups every week.”
$1.0-$5.0 Billion AUM Hedge Fund with 50 to 150 Employees
his or her chartered alternatives investment analyst (CAIA) certification.

Encouraging their employees to attend industry conferences and events to expand their understanding of emerging trends and topics was another form of training supported by the majority of survey participants. These events spanned sessions being presented by industry bodies (e.g., the MFA or AIMA) to regional hedge fund industry associations at the industry conferences and events hosted by prime brokers. Some firms also noted their appreciation for broader events put on by their counterparties such as hedge fund university days. All of these forums were seen as a useful part of the ongoing education of junior employees, as well as good networking opportunities.

Training and Mentorship Programs: Leading Practices

A less frequently cited type of training that only a subset of firms mentioned during our interviews was the use of on-line training tools to help educate employees in finance or operations. Many times, junior resources arrive in the hedge fund firms with only rudimentary knowledge about the products used in the investment portfolio or the processes required to manage a portfolio of trades and positions. Giving employees access to on-line learning allows these individuals to work at their own pace and explore their own areas of interest in topics that will be beneficial to their overall job performance. Zoologic, which is part of SS&C Technologies, is an example of an on-line training tool that some interviewees are utilizing for their employees. This site offers access to a variety of courses in finance and/or accounting to employees of firms who subscribe to their service.

It is likely that on-line training will quickly become a standard practice given the proliferation of on-line training in other industries; larger organizations rely on on-line training as a common component of their training curriculum. For this survey, we scored this as part of leading practices. We only had a few references to this type of training, but we expect this will become standard over the next 12 to 24 months.

The establishment of a formal mentorship program marked a much clearer differentiator between standard and leading practices as we compared the feedback of all of the funds in our dataset. These programs are commonplace in professional service firms (e.g., law firms, accounting firms and management consulting businesses) primarily because the value within these companies is contained within the people it employs. In these people businesses, it is critical to optimize the capabilities of each individual. Establishing formal mentoring relationships between senior partners and junior ranks allows for an effective transfer of knowledge and an expanded understanding of interpersonal dynamics. It also allows these organizations to identify and focus on their top performers to build the next generation of leaders for their firm. The adoption of this same practice within leading hedge fund firms is another sign of the maturation of the hedge fund industry and recognition that the value in these firms is also very much linked to the people they employ.

Formal mentorship programs require planning and organizational buy-in. The United States Office of Personnel Management, which runs recruiting and training for all federal employees, has a handbook that highlights best practices in mentoring drawn from current mentoring programs sponsored by federal agencies and the private sector, as well as from secondary research. They note the following steps for developing a mentoring program: 1) conduct a needs assessment that addresses why this program is being designed and what the organization hopes to gain; 2) develop a roadmap that includes a project and implementation plan; 3) gain top management support and commitment and identify a champion of the program, if possible a senior leader; 4) appoint a program manager to focus on managing and administering the mentoring program as their primary responsibility; and 5) create a steering committee or working group that is tied to the organization’s leadership.

Approaching mentoring in this way is much different than fostering informal relationships between employees and requires a much broader organizational commitment.

In addition to establishing formal mentorship programs, some employees are also identified as future leaders of the firm and offered internal—and in some cases external—leadership training. This can range from internal courses that can be run during the business day to developing an external curriculum and sending key individuals to an off-site facility for a more intensive deep dive experience. In both cases, the hedge fund is working with an external organization to develop the curricula and support their implementation, offering the courses to employees identified as having the potential for future leadership roles.

Several leading firms also discussed having coaching programs, where one or more key individuals were paired with a professional coach to help them work

on their individual goals. These coaches could be focused on leadership issues and be assigned to the senior management team; or, in some organizations, the coaches had investment backgrounds and were paired with portfolio managers, analysts and traders to focus on more trading-related issues and concerns. Some firms had full-time internal coaches for their trading areas, and others leveraged a set of external coaches for both their senior management and trading teams.

For platform firms (those with multiple portfolio management teams trading different strategies) having a trading coach is described as a core function within the investment team, but the role was also cited by more traditional, single-strategy hedge funds. The benefits were described as providing a check and balance to trading style and helping investment teams understand the forces influencing their conviction regarding specific ideas. The trading coach is a mentor to all members of the investment team and in some examples was described as the head of research, although this individual was not making any portfolio decisions.

Performance Management: Measuring a Performing Organization

The final category in our people alpha scoring framework is performance management, and the practices and techniques being used by different hedge funds to measure improvements in their teams and employees. This category has one main set of evaluation criteria and a total potential score of 10 points in our people scoring framework.

This topic covers goal setting, feedback and appraisals, measuring alignment with firm values and the relationship between performance and compensation. The topic is more familiar to individuals who have worked in larger organizations, where measuring the achievements of an individual has become an integral part of corporate resource management practice; to some degree, it represents the aspects of a larger corporate culture that entrepreneurial hedge funds have traditionally tried to avoid.

The scores for this final category are shown in Chart 21 and represent another dramatic conclusion when we compare the average performance of firms between 50 and 150 employees. The gap between the top and bottom half of these firms in this measure is the widest across all of the 4 pillars. Moreover, the scores for firms in the bottom half of this data set actually show a drop-off from the score registered by much smaller firms. By contrast, the scores for the top half essentially match those of the larger funds with more than 150 people. This extreme divergence leads us to believe that the investment in robust performance management is one that can flag mid-sized firms that are likely to grow, both in terms of their team size and their assets, and can thus be seen as a type of leading indicator.
The fairly high average score for firms with fewer than 50 people also indicates that all hedge funds are engaged in some way with a program for providing feedback and measuring performance. As we examined our standard and market leading practices, we observed that all of our interviewees had at least basic procedures in place to review more qualitative aspects of an individual’s contribution to investment returns and contribution to developing the firm.

This entrance of qualitative measurement into our discussions was surprising given the history of formulaic compensation that the hedge industry is known for. It was even more surprising that some of the leading firms consider qualitative measurement to be applicable to all employees, including portfolio managers and research analysts.

We believe that this affirms the shift in the industry towards a more mature and institutional phase of its development. The formula-driven compensation model has driven exceptional investor returns at certain points in the hedge fund industries’ growth, but encourages highly speculative and potentially volatile investment behavior. The shift to a more institutional industry that is looking for a less volatile and steadier return stream requires a different type of investment behavior. The introduction of qualitative measures into investment team assessments is an important step in rewarding that approach.

Chart 21: Performance Management Scores for Various Sized Hedge Fund Firms

The scoring framework for performance management and feedback across what we believe to be the standard and leading practices in the industry today. The differences were harder to separate between the firms, but the real distinction comes from an integration of the hedge funds’ values into the assessment framework, and the introduction of qualitative metrics to assess investment teams.

Chart 22: Scoring Framework for Learning & Development

The table shows the scoring framework for performance management and feedback.
Performance Measurement and Feedback: Standard Practices

The majority of interviewees stated they have annual or semiannual goal-setting discussions that focus on both qualitative and quantitative measures. These discussions are generally scheduled in January and July, when managers meet with their individual team members. They oftentimes use these opportunities to establish personal goals as well as professional targets, and nearly all funds indicated that goals can be modified throughout the year.

In most cases, the firms that were interviewed stated they would have each employee complete a self-assessment prior to their annual review. Clients view this as a way for each employee to voice his or her opinion about how he or she performed in that given year. Self-evaluations are typically submitted to both the employee’s manager and Human Resources.

Nearly all of the funds that participated in the survey indicated that their firm has a formal annual and semiannual review process. Semiannual reviews typically occur in July, while annual reviews take place in December. Direct managers evaluate how their employees performed based on the goals set earlier in the year. A standard industry practice is to have the managers write a full performance review and then hold a meeting with the employee to discuss it. At this point, any discrepancies between the self-assessment and the actual review will be addressed. The majority of interviewees cited that in order to conclude the discussion, both parties sign off on the review.

The final step in the annual performance management process is the communication of compensation to each employee. The majority of interviewees stated that an employee’s annual bonus is communicated during the annual review process. Many funds that communicate compensation during the annual review conversation stated that this is the last point discussed during the review so the message that the manager is conveying in the review will not be interfered with.

"We have a formal mid-year review process in place. It includes a self-assessment and a manager review. The manager must sit down and evaluate the employee and have a discussion about the review. Both parties need to sign off that they agree. We follow a similar process for the year-end review."

— >$10 Billion AUM Hedge Fund with 50 to 150 Employees

"We launched a mid-cycle review (April-July) which cover goals, strengths, weaknesses, development needs etc. and is qualitative in nature. The year-end review is quantitative and covers bonuses."

— $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

"We have semi-annual qualitative and quantitative reviews in place. We make sure that all reviews are documented in the event there is ever an issue."

— $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees

"We have a traditional performance review that includes a self-evaluation, manager evaluation and goal setting exercise."

— <$1 Billion AUM Hedge Fund with Fewer than 50 Employees

"We communicate bonuses during the annual review but we wait till the end so that the review is not focused on compensation."

— <$1 Billion AUM Hedge Fund with Fewer than 50 Employees
Performance Measurement and Feedback: Leading Practices

Beyond the standard performance measurements described above, some firms that participated in this survey described additional procedures that they have incorporated into their evaluation process. These additional measures helped the organization better evaluate their employees and were therefore identified as leading practices.

A select number of interviewees stated that they have incorporated peer reviews into their annual review process. The collection of peer reviews occurs once a year prior to the year-end performance evaluations, and is another tool used to measure their employees’ performance. Most firms stated that peer feedback solicited by managers remains anonymous.

Having separate review and compensation conversations was thought to be another leading practice. Many firms implementing this felt that by combining the compensation and review discussion, they were diluting the effectiveness of the review. Therefore, by keeping them separate, they are better able to maintain a focus on the actual assessment.

As described earlier, the emergence of qualitative measurements for portfolio managers and research analysts was surprising given an industry where payouts were historically driven by formulaic methods. A select number of firms that were interviewed highlighted how they incorporate qualitative factors into the compensation calculation for the investment staff. Some examples given were the adherence to firm goals, the participation in mentoring programs, and the overall team contribution. Firms that implemented both qualitative and quantitative measurements believed this fosters a more collaborative environment.

In addition to qualitative and quantitative measures, a few leading firms also assess employee adherence to firm values and founding principles. These firms stated that this is a way to better maintain firm culture.

Leading firms stood out from others in one final respect. They offer a defined path to partnership for both investment and noninvestment staff. The interviewees described how their firms are generally flat organizations, and this partnership path enables them to differentiate themselves by offering yet another compensation tool in a highly competitive industry.

“Once a year we do peer reviews of two people selected by the employee’s manager. It’s based on a rating scale: 1-10 and incorporates qualitative comments.”
– $5-$10 Billion AUM Hedge Fund with 50 to 150 Employees

“Our PMs are paid on quantitative and qualitative factors. We look at how the book performed but we also look at other factors to determine compensation.”
– $1-$5 Billion AUM Hedge Fund with More than 150 People

“Our employees are evaluated on our six core principles and the skill set needed for their role.”
– $1-$5 Billion AUM Hedge Fund with More than 150 People

“We offer partnerships across the board. It is one of the only things we can offer our employees aside from compensation since we are such a flat organization.”
– $5-$10 Billion AUM Hedge Fund with Fewer than 50 Employees

“We have an open partnership book at our firm. One of the critical components for partnership is that you have to be somebody who gets along well and contributes and doesn’t have a zero sum game attitude.”
– $1-$5 Billion AUM Hedge Fund with 50 to 150 Employees
Our four pillars of people management offer a framework for investors and hedge funds alike to understand the breadth of activities that go into a standard and leading set of practices. Given their entrepreneurial roots and, in many instances, their desire to exit larger organizations that typically invest in robust people management, it is a clear sign of the industry’s growing maturity that leading hedge fund firms are adopting many of the same approaches as their legacy organizations, and that these practices are now being re-envisioned for the hedge fund community.

There are several key take-aways from this paper beyond the four pillars model:

Leading studies show that having a highly aligned workforce is the key to ensuring talent retention and reaping the benefits of superior performance relative to one’s peers—a concept that we refer to as people alpha in the context of the hedge fund industry. The culture of the organization is the most fundamental aspect of ensuring such alignment. Having a clear vision and goals, ensuring open-air communication, and fostering a collaborative team environment are the hallmarks of a strong culture and pursuits that hedge funds must revisit and evolve as they grow and mature.

Our survey findings confirmed this need to adjust one’s culture and improve benefits to ensure talent retention and workforce alignment as the size of an organization increases. Hedge funds with between 50 and 150 people that did not focus as much on talent retention registered people scores in the bottom of our range and underperformed peer organizations by nearly 600 basis points in our examination period. The gap between the top and bottom average scores for funds with this size team was larger for this talent retention measure than for any other category of our scoring framework.

Enhancing a firm’s talent acquisition process flows from being dedicated to building a thriving culture. Ensuring the right skills, diversity and fit for those entering the hedge fund becomes a firm-wide preoccupation warranting oversight at the highest levels of the organization. As these teams grow, their focus on sourcing talent earlier and more broadly increases as they look to attract the best possible people at each stage of their development and instill in them the same dedication that earlier employees achieved.

One way to understand which firms are likely to have the best odds of talent retention is to monitor their willingness to invest in learning and development. Indeed, this measure may be a good leading indicator for the likelihood of the hedge fund achieving significantly larger AUM over time. The larger the hedge fund, the more it focuses on developing its people. Firms with between 50 and 150 people that made learning and development a priority fell into the top half of our people score, registering totals that looked much more akin to the largest organizations with greater than 150 people and higher AUM. In line with this finding, the average learning and development score for firms with between 50 and 150 people in the bottom half of our people score were in line with much smaller firms with significantly lower AUM.

Having a robust performance management process brings these considerations together. It allows the senior team to identify those future leaders who warrant increased training and highlights individuals who may be disruptive to the goals of the organization and require an additional management focus. It also allows the organization to monitor and reward adherence to the firm’s qualitative goals beyond just the quantitative measures that typically make up the formulaic payouts for the investment and support teams.

While this paper lays out many of the principles and practices involved in superior people management, the Business Advisory team at Citi Prime Finance stands ready to help our clients and prospects delve more deeply into these findings and determine ways to benefit their own organization. Our view is that firms that lead in achieving superior people management can make the argument to investors that they are maximizing their potential to add people alpha to their portfolio. For the window of time that this remains a leading practice and not an industry norm, this could provide a real differentiator in marketing and investor retention efforts.

For more information on this topic or for access to our entire library of industry thought leadership, please contact us at Prime.Advisory@Citi.com or the Private Bank Operational Due Diligence group at opsdd@citi.com.
The mission of Focus Consulting Group (FCG) is to help investment leaders leverage their talent. One way that FCG does this is by designing and implementing strong cultures. Our diagnostic surveys and interviews allow us to identify the values, beliefs and behaviors that describe the mindset of an organization. We then can advise leadership teams on whether or not culture is supporting their mission and goals. Evidence from successful asset management firms suggests that strong culture links to strong performance and success.

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Proteus is a coaching, consulting, and training firm focused uniquely on supporting leaders to get ready and stay ready to meet whatever the future might bring. Proteus supports leader readiness in a variety of programs to include: working with firms to clarify their vision and strategy, coaching services to strengthen management team and customized learning and development programs to improve employees skillsets and knowledge.

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Exploring the Concept and Characteristics of “People Alpha”