Clicker test
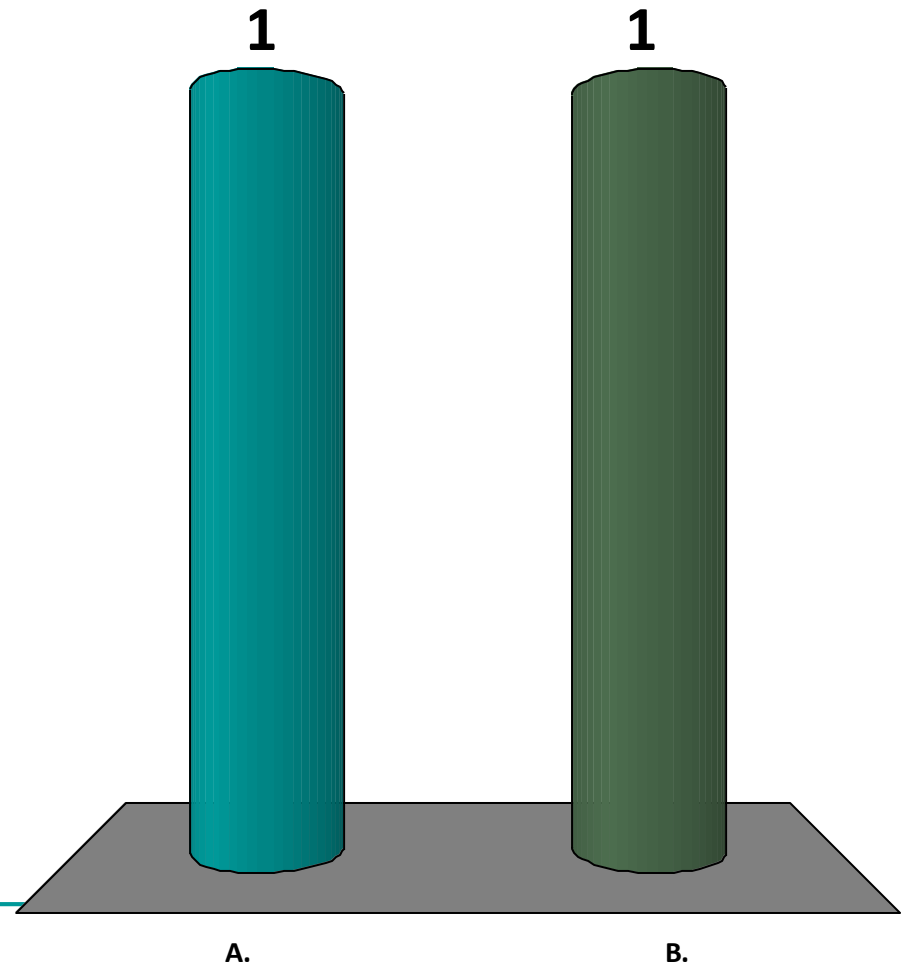
A. One

B. Two

Defining Operational Alpha

Jim Ware, CFA

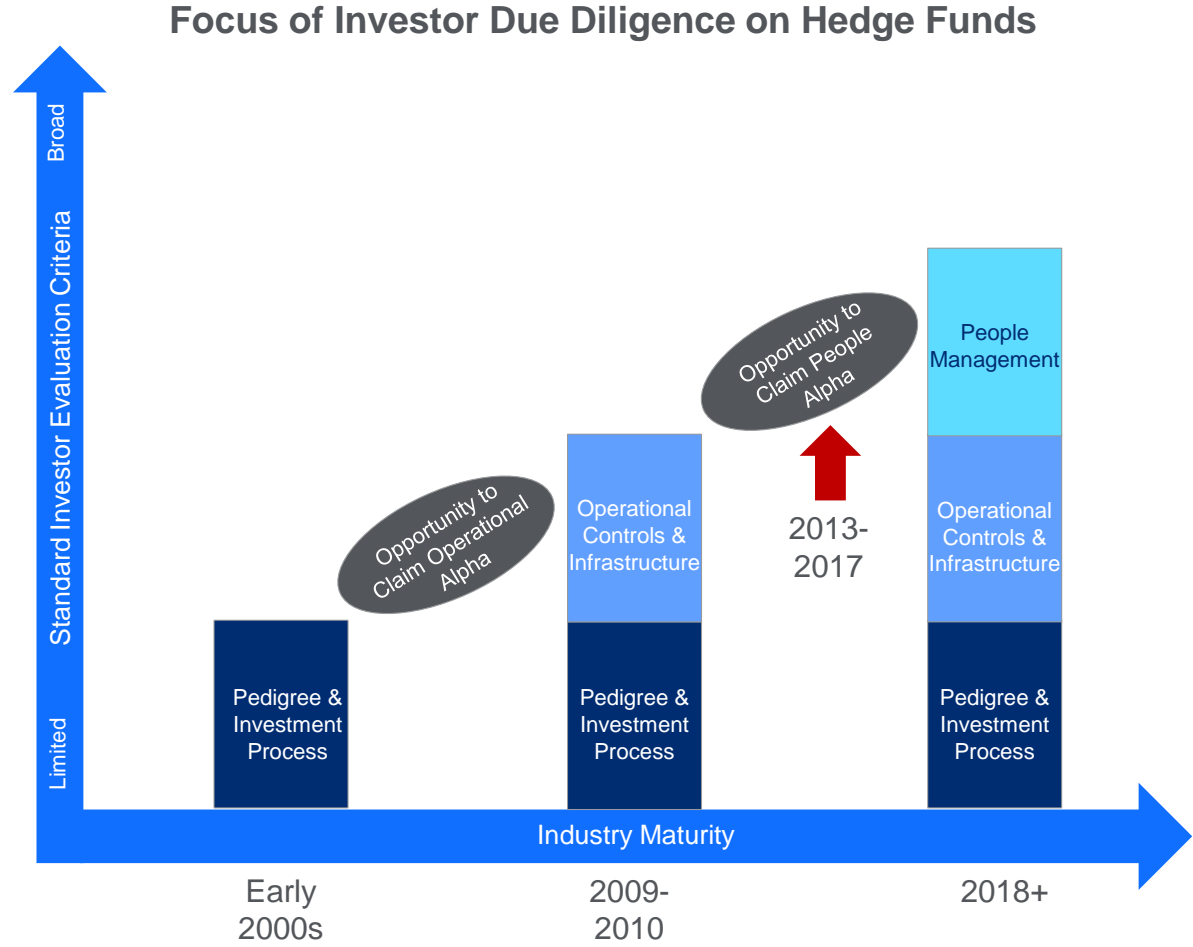### October 16, 2014

Bivium's Annual Investor Summit 2014

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Purpose: Culture as Competitive Advantage

1. The **Context**: operational and people alpha

2. What is **Culture**? So what?

3. What is the **Core** of strong culture?

4. How do you manage the **Red X**?

5. The **Tribes**: how are they different?

6. How do **Leaders** build culture?
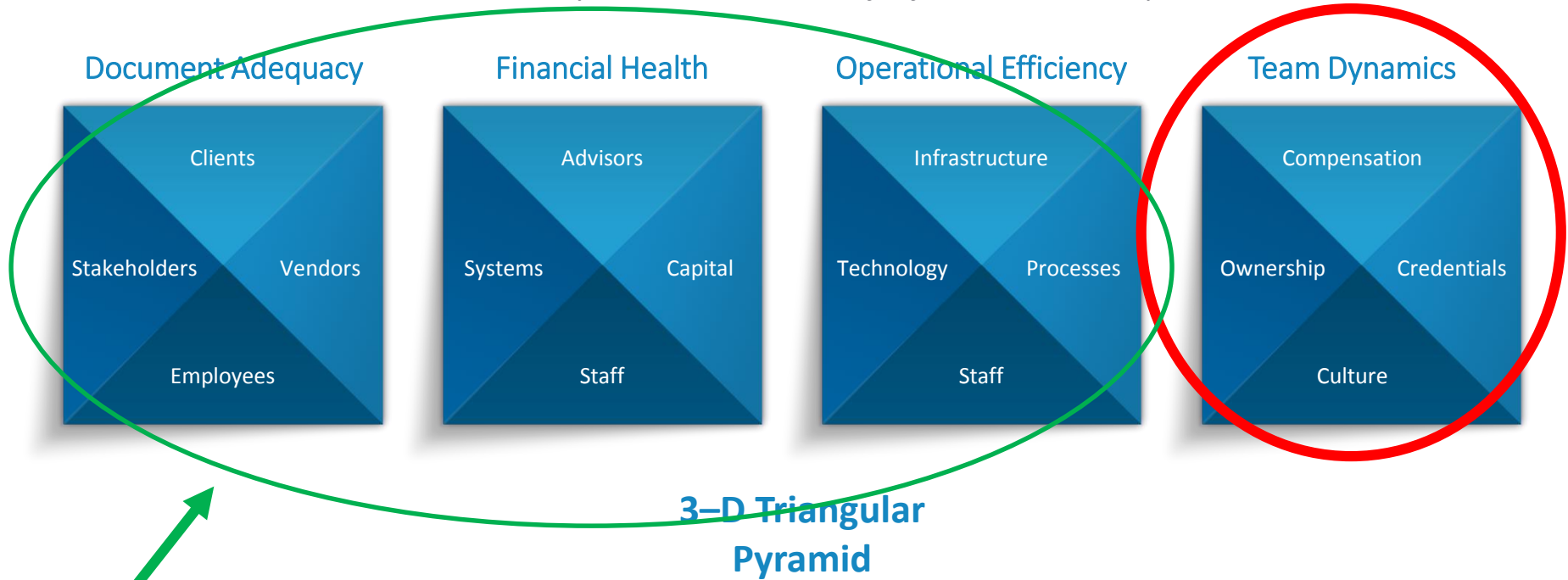
Evolution of Investor Evaluations

Only a subset of hedge funds are focusing on excellent people management as a differentiator—this creates a unique opportunity for them to cite their "People Alpha"

Focus of Investor Due Diligence on Hedge Funds

Standard Investor Evaluation Criteria (Limited → Broad)

Industry Maturity

- **Early 2000s:** Pedigree & Investment Process
- *Opportunity to Claim Operational Alpha*
- **2009-2010:** Pedigree & Investment Process; Operational Controls & Infrastructure
- *Opportunity to Claim People Alpha* (2013-2017)
- **2018+:** Pedigree & Investment Process; Operational Controls & Infrastructure; People Management

Source: Citi Prime Finance

- Pre the 2008 Global Financial Crisis investors evaluated hedge funds based on the CIO's **pedigree** and **investment process**

- During this period, only a **sub-set of hedge fund firms** had built out **robust operational platforms**. These firms were able to differentiate themselves with investors by claiming that they created **"operational alpha"**

- After the 2008 Global Financial Crisis, the industry became more institutional and the **requirement to have a high caliber operational platform became an industry norm**

- Investors are now looking at firms' **people management** and employee turnover metrics. They believe that firm's with a focus on people management have a **unique opportunity to create "people alpha"**

citi

*Equally weighted, the **FUNDAMENTALS** create institutional stability because they each sit on a base of informed leadership*

Document Adequacy

Clients

Stakeholders

Vendors

Employees

Financial Health

Advisors

Systems

Capital

Staff

Operational Efficiency

Infrastructure

Technology

Processes

Staff

Team Dynamics

Compensation

Ownership

Credentials

Culture

3–D Triangular Pyramid

Four Pillars of "People Alpha"

1. **Talent Acquisition**: Identifying the Best Talent and Fit for the Organization
   a. Sophistication of Recruiting
   b. Sourcing of Candidates

2. **Talent Retention**: The Focus on Culture
   a. Clear articulation of firm values into behaviors and mindset
   b. Quality of benefits

3. **Learning and Development**: Building a Performing Organization
   a. Training and mentorship programs
   b. Trading and executive coaches

4. **Performance Management**: Measuring a Performing Organization
   a. Performance measurement reviews annually
   b. Feedback and peer reviews

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Top benefits of a strong culture are… (2 choices)

1. Attract top talent
2. Effective hiring
3. Retain top talent
4. Promote and compensate based on values
5. Mentor and coach more effectively.
6. Better weather the tough times
7. Improved decision making
8. Stronger branding
9. Lead change more effectively
10. Client satisfaction
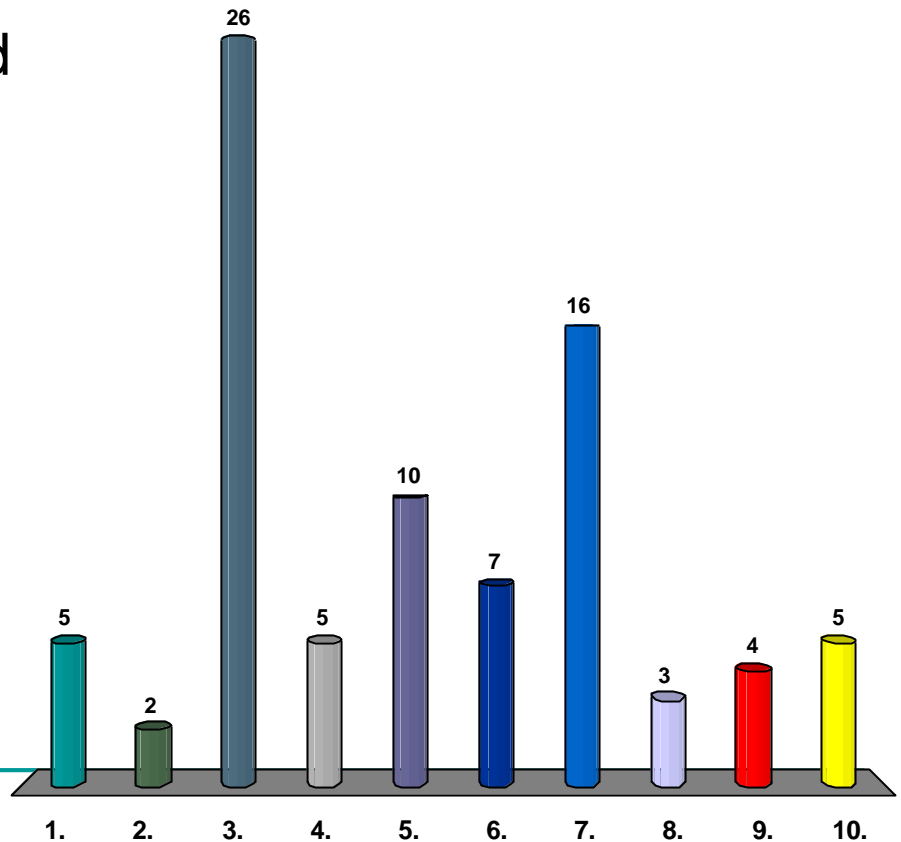
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1.	2.	3.	4.	5.	6.	7.	8.	9.	10.
5	2	26	5	10	7	16	3	4	5

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Core of winning culture

Purpose, Trust, Values

Actions

Results
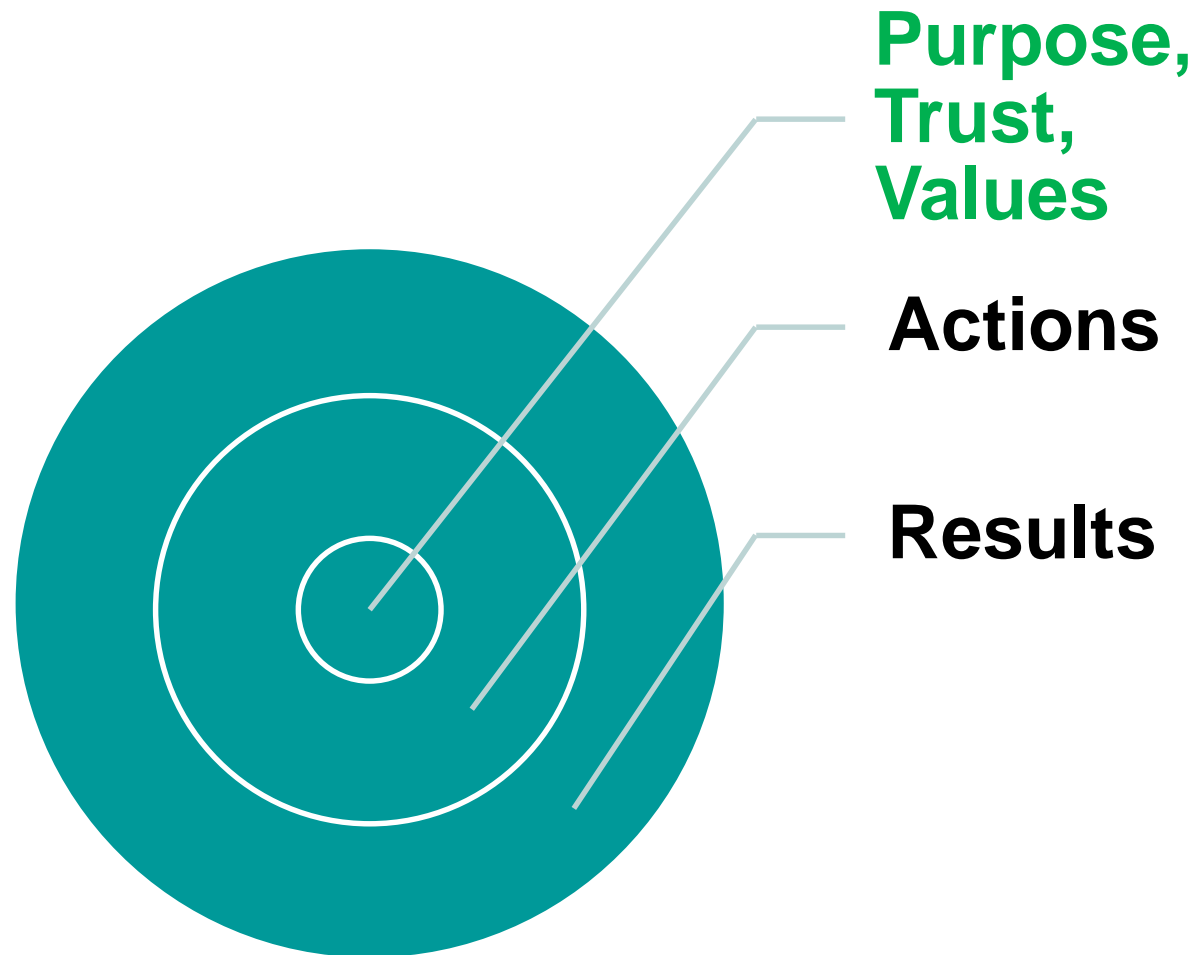
LRN, The HOW Report

Which are most meaningful to me? (pick 2) My work…

A. allows me to use my talents and abilities and to challenge myself.

B. allows me to spend time with bright and engaging colleagues. I like these team interactions.

C. contributes to a sound and sustainable financial future for our firm.

D. benefits our clients, and I enjoy happy clients most of all.

E. serves a larger purpose, doing something positive in the world (such as allocating capital properly in the markets.)

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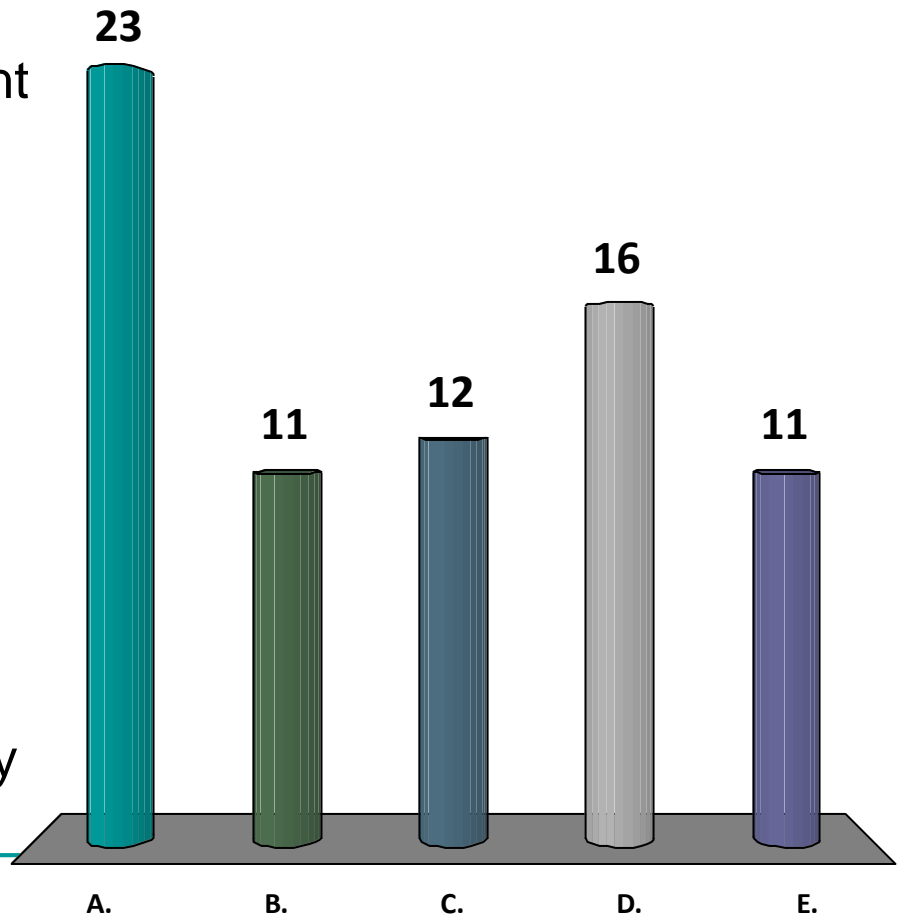
Trust Builders vs. Trust Busters

| **Trust Builders**	**Trust Busters**
1. Eliminate Gossip	Gossip A Lot
2. Make and Keep Clear Agreements	Make Sloppy Agreements
3. Adopt Win/Win Attitude	Serve Only Yourself
4. Take Responsibility	Blame Others
5. Practice Candor	Withhold, Withhold, Withhold
6. Discuss and Agree on Decision Rights	Second Guess Decisions
7. Be Consistent	Be Inconsistent
8. Assume good intent	Assume the worst
9. Align Incentives	Create Poor Alignment of Incentives
10. Create a True Meritocracy	Play Favorites

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Game Theory: Building Trust

1. Lead with Trust (Win/Win)
2. Respond in kind (Trust begets Trust)
3. Inquire about Dis-trustful behavior (24 hour rule)
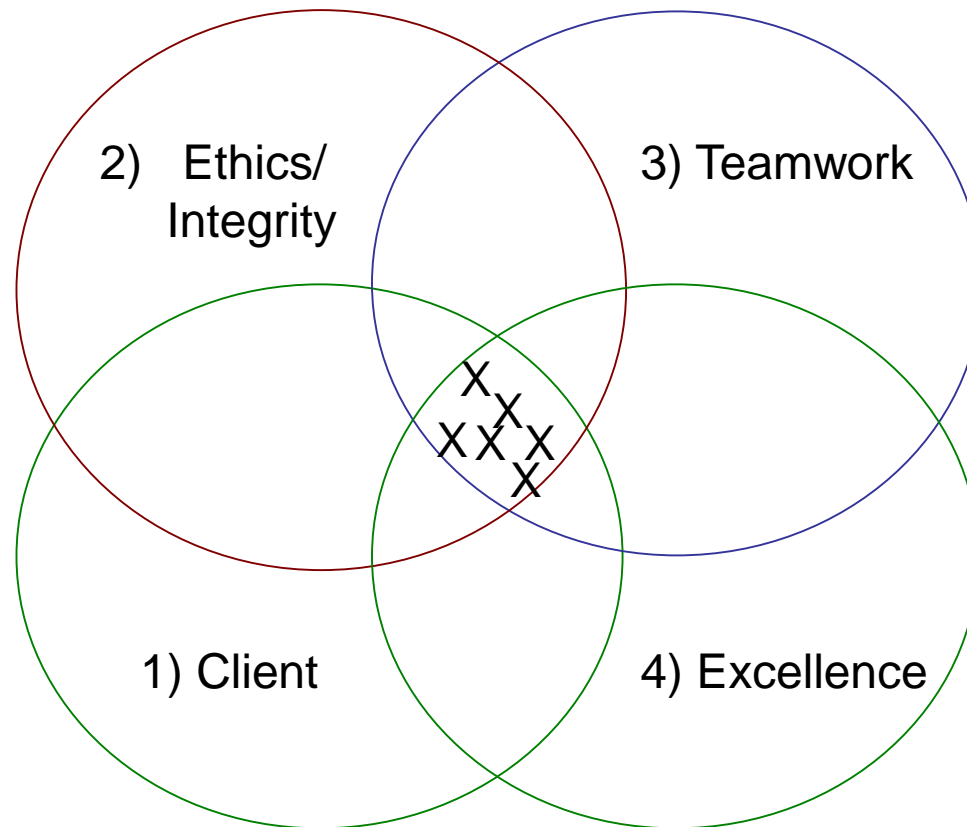4. Forgive & forget, allow for fresh starts

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My intention at our firm is to help create a culture of trust.

A. Yes
B. No

36

1

A.   B.
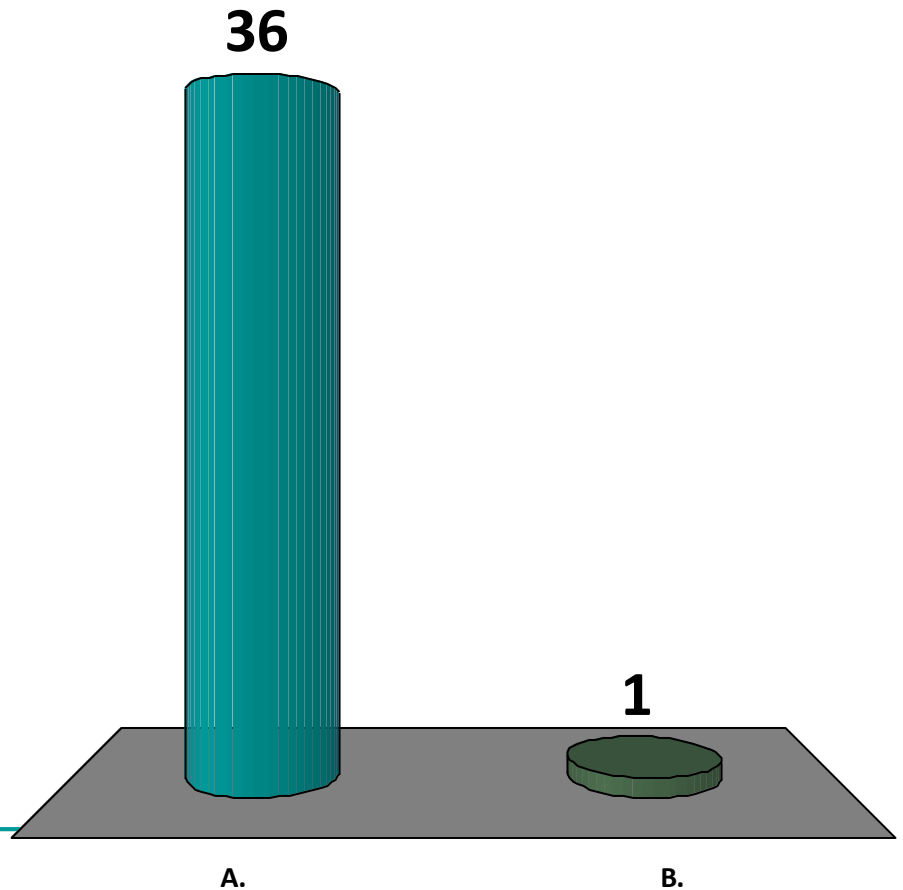
# Culture: Values, Beliefs and Behaviors that differentiate one firm from another.

Maslow on Culture

Client, Integrity →

Excellence →

Teamwork →

Purpose: "Service, Ethics, Clients"

Mastery: "Excellence, Improvement, Discipline"

Connection: "Trust, respect, belonging"

Security: "Money, safety, insurance"
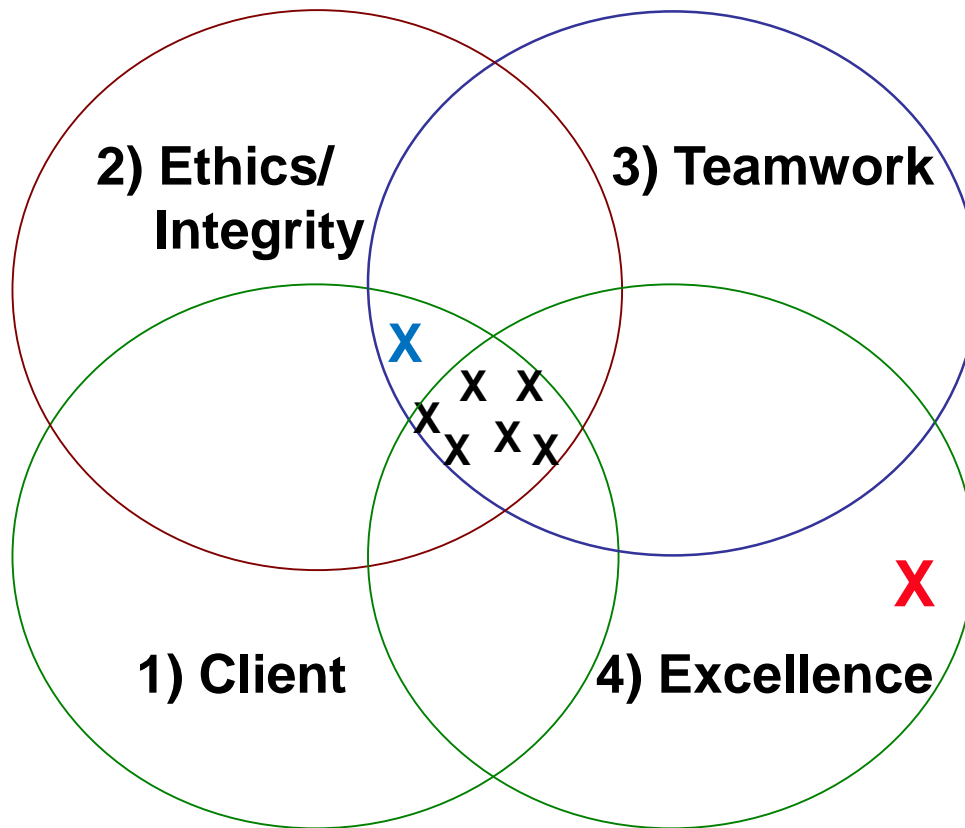
FOCUS Consulting Group
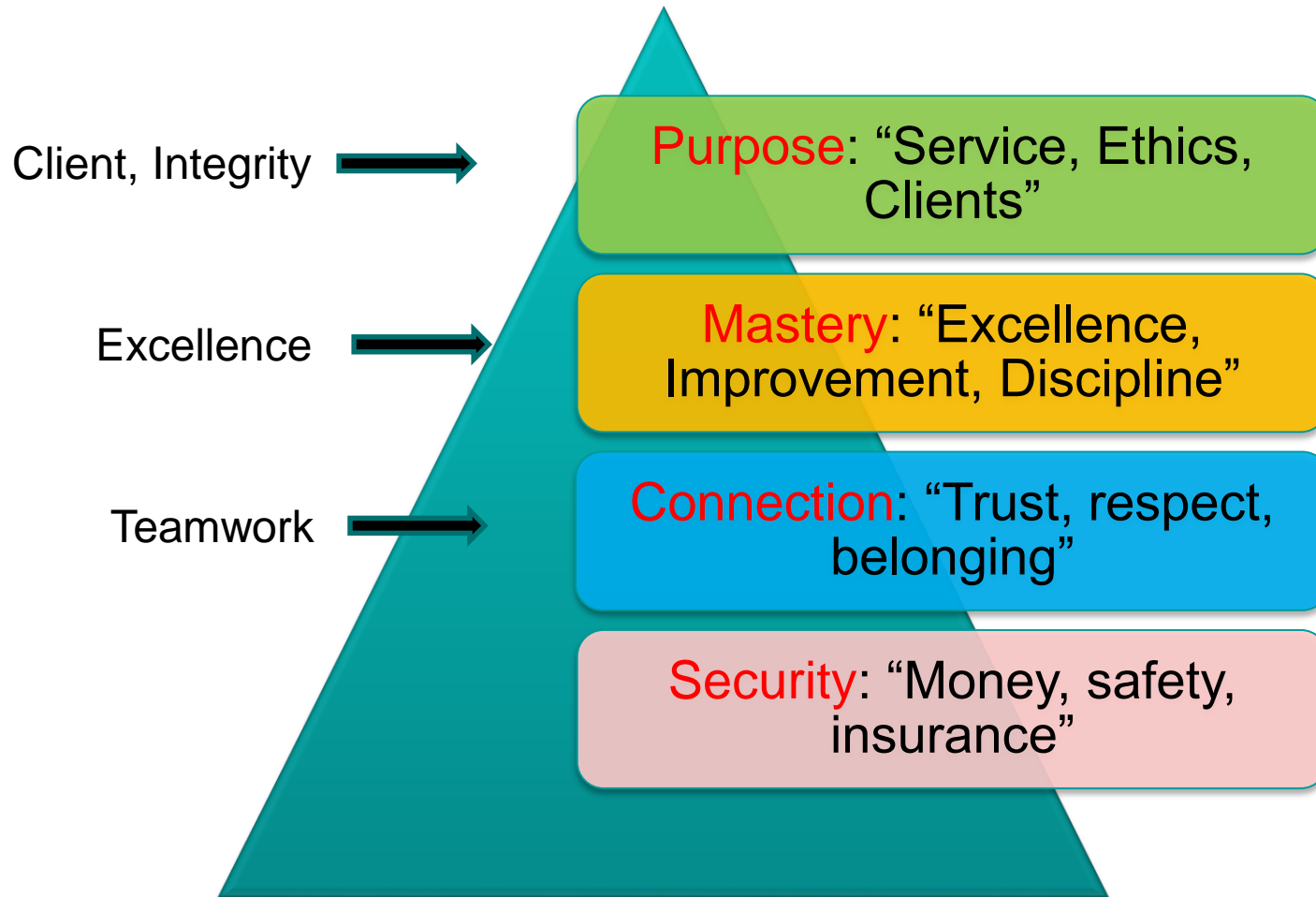
Which 3 would be top rated at your firm?

A. Meritocracy
B. Candor/transparency
C. Balance (home/work)
D. Respect
E. Professional/ accountable/ trust
F. Long term vision
G. Creativity
H. Development/ mentoring
I. Passion/energy
J. Curiosity/open minded
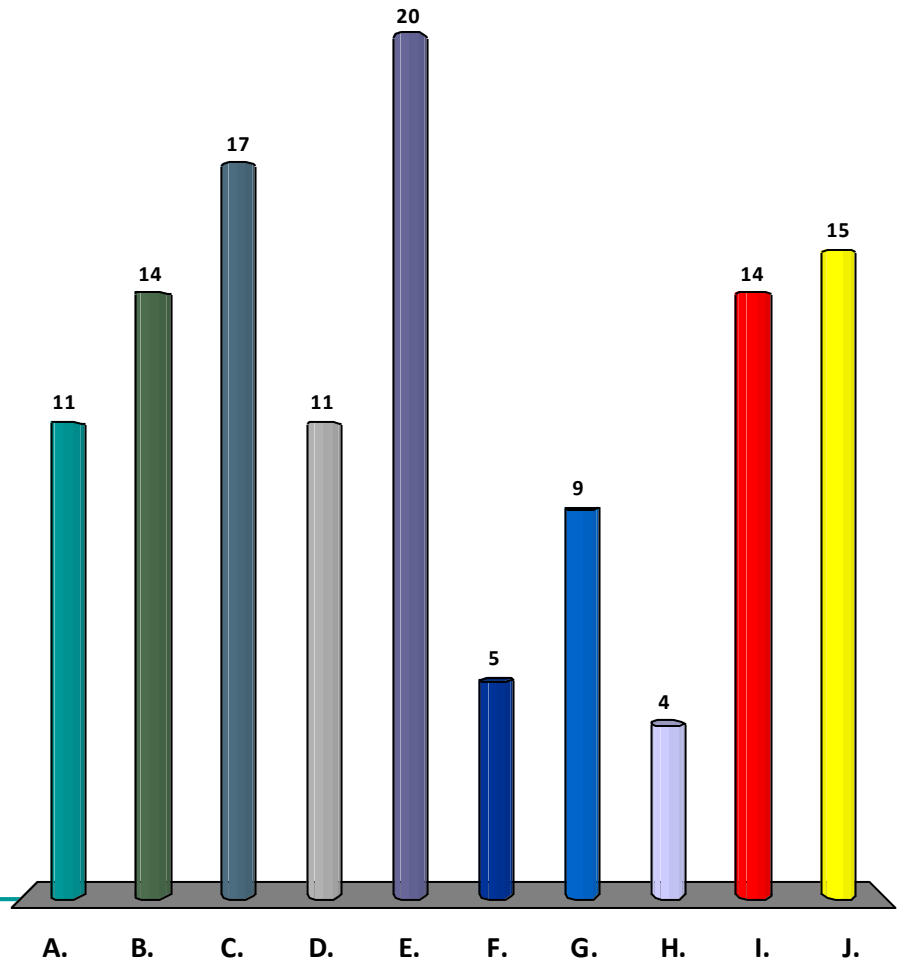
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Values: Defined & Aligned

2) Ethics/ Integrity

3) Teamwork

1) Client

4) Excellence

"Let's face it: you and this organization have never been a good fit."

Consequences of a Red X

78% — Less engaged, less committed
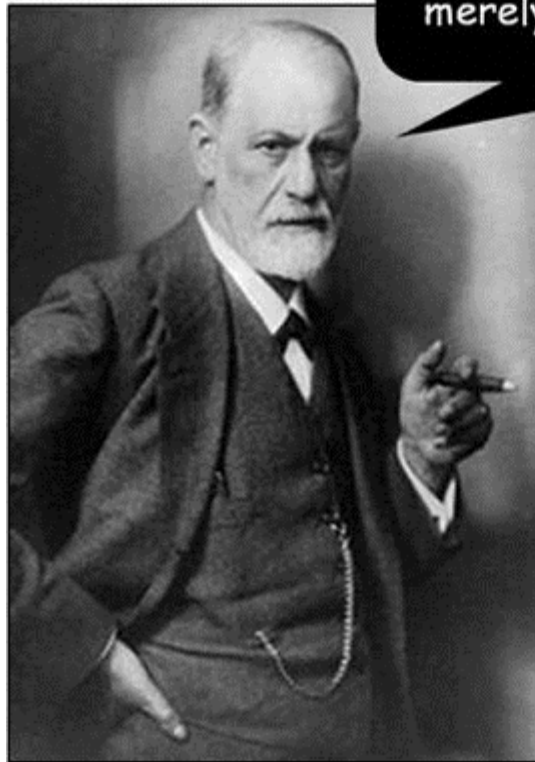
Performance declined — **66%**

48% — Decreased work effort

Christine Porath and Christine Pearson, "The Cost of Incivility"
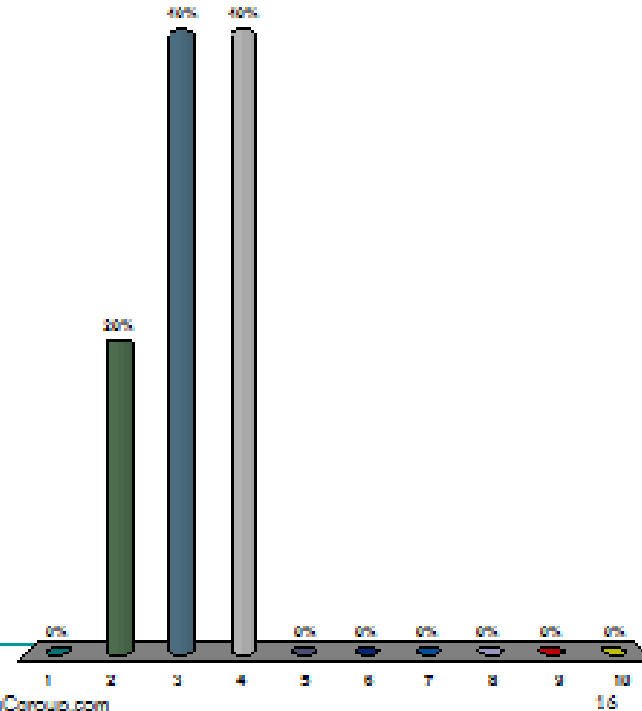
Freud on working with Red X's…

A Red X in London

How many Red X's are in this senior team? (London Team)

1. Choice One
2. Choice Two
3. Choice Three
4. Choice Four
5. Choice Five
6. Choice Six
7. Choice Seven
8. Choice Eight
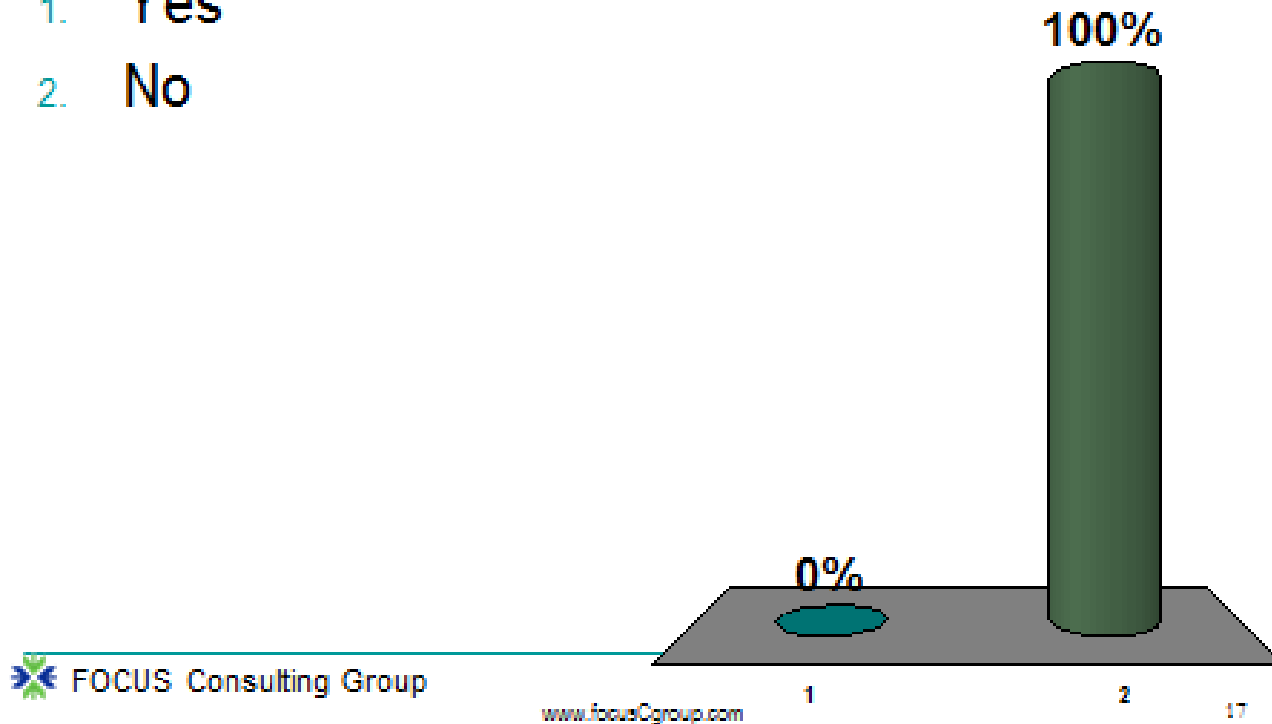9. Choice Nine
10. Choice Ten
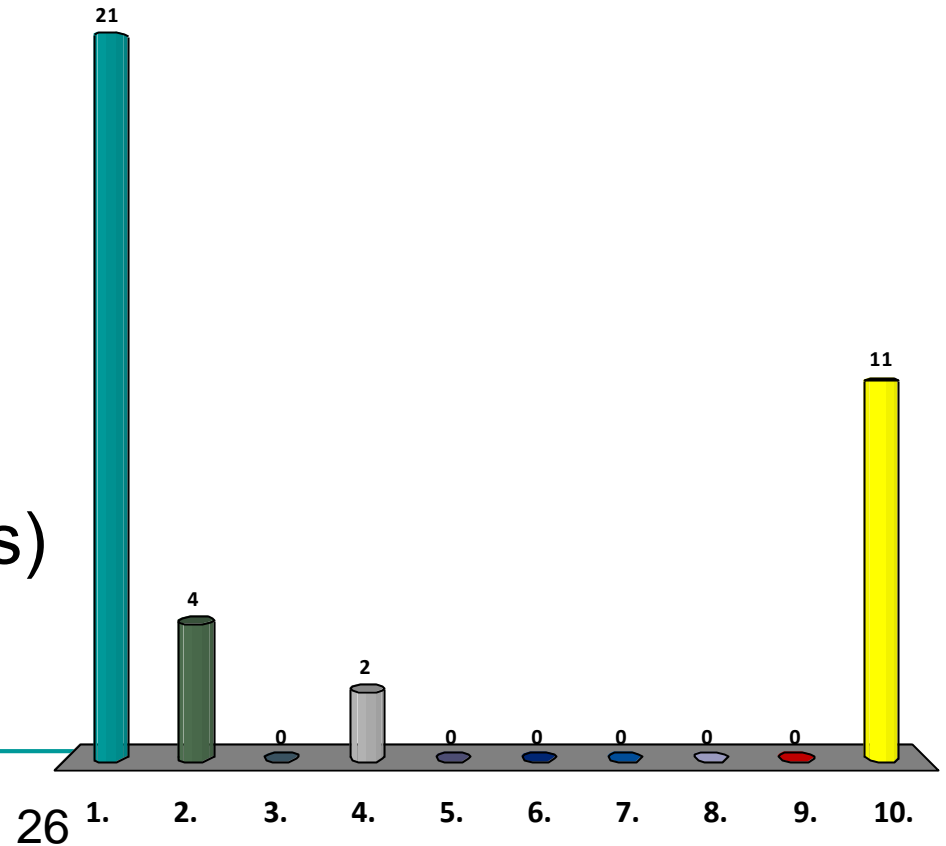
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www.focusCgroup.com

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A Red X in London…but not ME!

Do you consider yourself a Red X? (London Team)

1. Yes
2. No

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www.focusCgroup.com

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How many Red X's in your work environment?

1.

2.

3.

4.

5.

6.

7.

8.

9.

10. (push 0 for no Red X's)

21

11

4

2

0   0   0   0   0   0

1.   2.   3.   4.   5.   6.   7.   8.   9.   10.

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How do you typically manage Red X's: Choices (2)

A. Fret about 'em

B. Forget about 'em

C. Fix 'em

D. Firewall 'em

E. Fire 'em

F. Fall in love with 'em
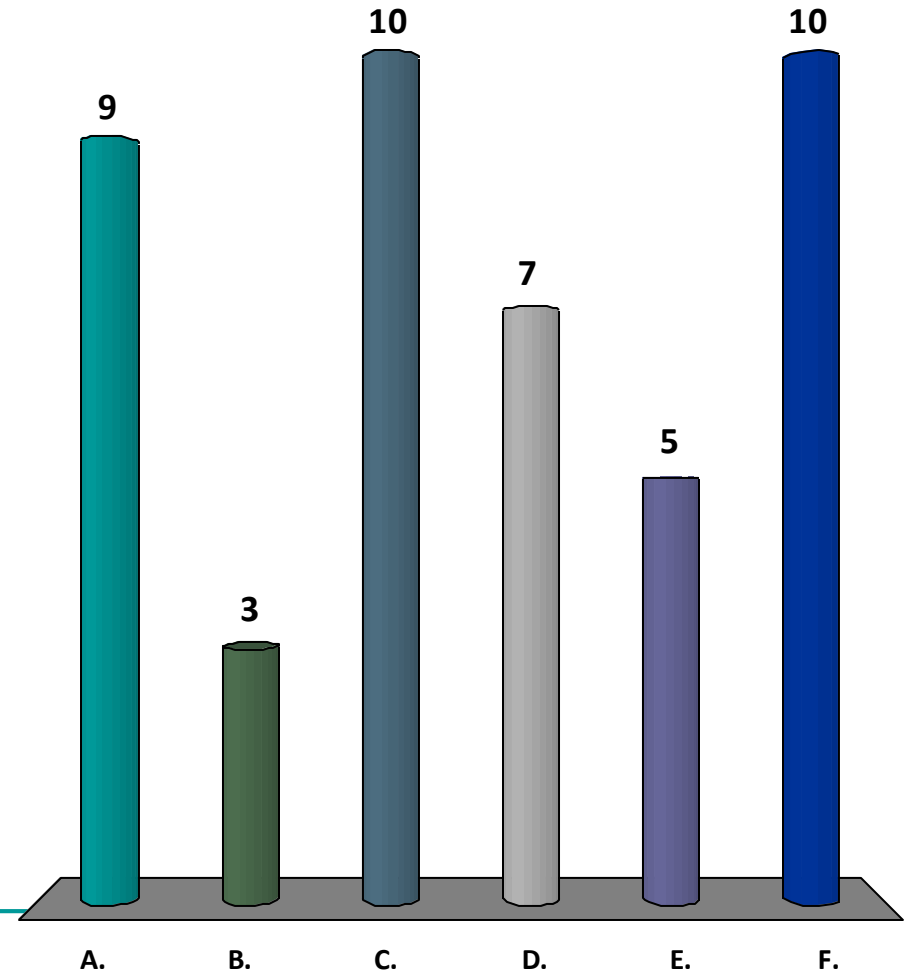
Bar chart:
- A. — 9
- B. — 3
- C. — 10
- D. — 7
- E. — 5
- F. — 10

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Investment:

Analytic/Research
Disciplined
Creativity/Innovation
Meritocracy
LT Perspective/Vision
Passion/Energy

Friction:
Respect
Appreciation
Empowerment

Operations:

Accountability
Efficiency
Quality/Precision
Respect
Appreciation
Empowerment

Core Values:
Client Satisfaction
Ethical/Integrity
Professional
Collaboration/Team
Excellence/Cont. Impr
Leadership/Mentor

Friction
Respect
Appreciation
Empowerment

Friction:
Efficiency
Vs.
Competitive

Competitive/Win
Passion/Energy/Positive
Humor/Fun
Respect, Appreciation, Empowerment

Distribution:

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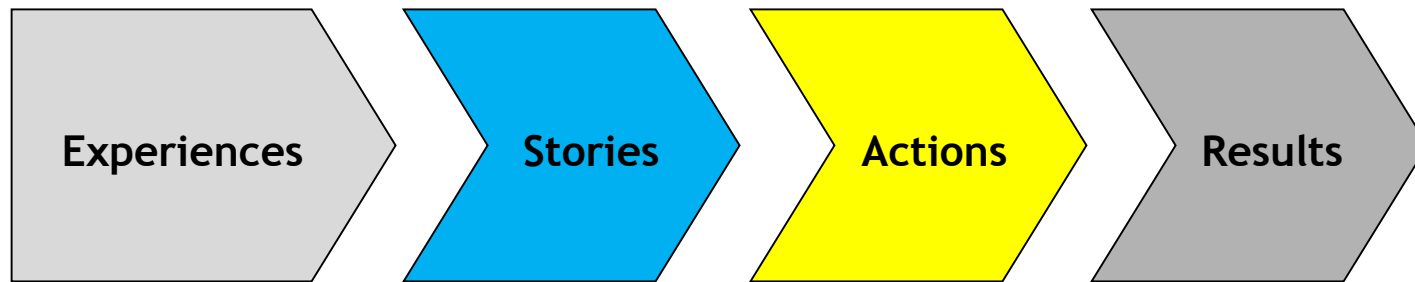
Black = Current
Green = Aspirational

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How do leaders build culture?

How Leaders Affect Culture: E-S-A-R

Experiences — **What are people experiencing in the culture?**

Stories — **What stories drive the actions?**

Actions — **What actions lead to the results?**

Results — **What is our vision of success?**

"Start with the end in mind"
Stephen Covey

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