Alternative perspectives: a seat on the board

ODGERS BERNDTSON

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We have the customer knowledge, discrete access to the candidate pool and credibility that are obligatory in this fast-moving area.

We work for some of the largest and most complex financial institutions in the world, as well as smaller, specialist firms, regulators, and private capital backed ventures.

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Luke heads the Financial Services Practice. He was previously Managing Partner of a management consulting firm focused on financial services clients and began his career as a Strategy Consultant at Andersen Consulting. Luke holds an MA from Oxford University.
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Rachel Stewart

Rachel leads alternatives, markets, exchange/clearing and financial services technology search within the Financial Services Practice. They are often interlinked. Rachel serves as a Director of a not-for-profit company and holds a Joint Honours MA from Edinburgh University.
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Methodology for the Research

Odgers Berndtson worked with over 100 senior alternative investment management women from 100 Women in Hedge Funds (the 10,000-strong global association for women in alternative investment) to study their potential for corporate board. The research was conducted in two stages: firstly a survey in which 104 women responded to 25 questions: secondly, interviews with one fifth of respondents (interviewees) to explore in-depth their experience, background and working style. The respondents expressed their views on the potential of women from the world of alternatives for corporate boards. We are grateful to participants for their time. This research has taken three months to complete and the findings follow.

Executive Summary

The performance benefits of women in management are well researched.[1]

Since Lord Davies' independent review of women on boards a year ago (February 2011), the impetus to seek out female talent for the boardroom has never been greater. FTSE 100 companies appointed 26 women to their boards in the first eight months of 2011, a jump by 227% from the whole of 2010. Of these 26 appointments, 31% were women with financial services backgrounds, i.e. the most in-demand demographic.[2]

This paper considers why women from the world of alternative investments could be appropriate for publicly quoted corporate boards. Working with senior members of 100 Women in Hedge Funds, we have conducted a study into the potential among women in alternatives for board. Of the 100 participants, 85% felt they were ready for a corporate board role within five years or less and 58% within two years or less.[3] In contrast, less than half of interviewees (47%) had board experience, public or private. In starker contrast, only 6% had public corporate board experience.[4]

[1]Fondas and Sassalos, 2000; McKinsey's *'Women Matter'* reports, 2007-'11; *Harvard Business Review* research; and '*The Bottom Line: Corporate Performance and Women's Representation on Boards*,' Catalyst, 2007
[2]Odgers Berndtson Business Intelligence Unit research
[3]Appendix 1, Chart 1: Opinion of their years to board
[4]Appendix 2, Chart 1: Experience on a corporate board

All quotes throughout this Report are from study participants and are non-attributal.

Diversity is an axis of corporate high performance

Gender diversity is one of several ways in which a board's composition can be balanced.

A mixture of specialist and generalist knowledge including functional backgrounds is useful in calibrating expertise with broad management perspective. Cultural diversity, by nationality and ethnicity, is critical in an ever-globalising world where large corporates are typically multinational. 55-75% of the FTSE100's revenues are generated ex-UK. Age diversity is another valuable aspect of board composition in a world where the global median age is 28.4 years and longevity is rising. A quarter of the world is 14 or younger, 8% is over 65 years old and the rest is adult.[5] If management should reflect its workforce and client base, there is value both in encouraging younger directors and mining the wealth of wisdom in experienced directors.

Non-corporate backgrounds on corporate boards are recommended by the Davies Review as a way of expanding the pool of talented women from which board candidates can be appointed. Gender aside, bringing non-corporate perspective to corporate management (and vice-versa) is a positive way of broadening views on a board.

> "The best teams are made up of diverse groups of individuals. The predominance of any one group at corporate board level has to be an impediment to decision making."

Financial services and investment professionals – relevancy to corporate boards

Financial markets are dynamic, developing a profound level of responsiveness in successful players.

> "The market has a highly changeable nature – you're constantly having to react to dynamic situations."

Financial services demands from its professionals the discipline of synthesising large amounts of quantitative data and qualitative information to make disciplined decisions. In an asset management context, the decision is an investment one for which investment managers are answerable to their investors.[6]

> "The investor culture expects responsible decision making."

This generates "a high level of care" in decision making. Almost all those interviewed cited generating a return as their primary investment purpose, with those who did not stating the interwoven goal of client satisfaction as their driver.[7] This transition from detail to big picture with a high degree of accountability mirrors the evaluation and decision making process of corporate boards.

[5]CIA FactBook, July 2011
[6]Appendix 1, Chart 2: Direct experience of investing
[7]Appendix 2, Graph 1: Investment goals

Women in financial services

Enduring in the demanding financial services industry as a minority takes good ability and survival skills. Women are succeeding as a minority in this male-dominated industry.

Women with fifteen years or more tenure in financial markets are survivors: despite almost 50/50 intake at graduate level, there is significant attrition at each corporate grade of promotion until by MD level, only c. 3% of financial services professionals are women. This durability is achieved by high performance on one hand and diplomacy on the other, what one study respondent described as:

> "Balanced battling. You can't fight all the fights or you'll lose the war. You have to know when to play offensive, when to play defensive."

A patient communication style was evident also among many women surveyed in an awareness that working with investors[8] meant communicating complex strategies and products in a simple language. They aimed to help investors develop understanding and to develop trust.

> "You've got to know something about finance without being either too frightened or too sophisticated about it."

Alternatives professionals and their potential for company boards

What could an alternatives background add to the mix?

Being bound to an investor client mirrors the relationship between listed boards and two of their four core stakeholder groups: shareholders and independent pension fund trustees. They seek returns in a transparent environment of good governance.

Study participants in the alternatives sphere had a keen awareness of to whom their boards were answerable. The majority of participants' boards were answerable to shareholders (public and private, including partners), investors, independent trustees and directors.

Over 87% of research participants had experience of dealing directly with investors. For 60% of interviewees, that was dealing directly with institutional investors. Almost 10% of interviewees dealt with sovereign investors.[9]

The third group of stakeholders is employees (and unions). Most second stage research contributors had experience of managing people. 35% of interviewees described their staff management style as giving talented people autonomy. Communication, working as a team and helping people to develop were the other core styles.[10] 44% of interviewees had experience of redundancies,[11] although for nearly all, this was as part of

[8]Appendix 1, Chart 3: Direct contact with investors
[9]Appendix 2, Graph 2: Direct contact with investors by type
[10]Appendix 2, Graph 3: Participants' personnel management styles
[11]Appendix 2, Chart 7: Experience of mergers including redundancies

the business rather than a leader implementing headcount reduction programmes. Few study participants had experience dealing with union representatives and for the small minority who did, it was as a client.

The fourth stakeholder group for corporates is customers and consumers. Only in private equity did respondents have exposure to considering industry consumer demand or the commercial customer experience.

Distinct to alternatives investment is the leveraged, collateral management nature of the business. Likewise, funding is a key concern to corporate Boards in today's neo-recession environment.

Broadly, there is more alignment between the key concerns of corporate boards and boards in alternative investment than may be widely understood.

The value of alternative investment strategies

If the key concerns of alternatives and the corporate world are similar, what makes the skills, perspective and style of alternatives professionals relevant to company board roles? After all, isn't alternatives the world of hedge funds, investment managers chasing 'fast bucks'?

Long/short is – as the strategy's name implies – not purely shorting[12] but also, in part, long term investment. Approximately one sixth of those surveyed are experts in long/short.[13]

This is only one of many hedge fund strategies and while we do not seek to educate on all here, several involve investing for value over years.

Aggressive growth and value strategies invest in securities seen to be selling at a discounted rate to their true value. Such hedge funds can hold securities long term, investing for expected growth. Both strategies tend to have significant holdings in the securities of small and medium enterprises (SMEs). SMEs account for over 99% of businesses and 66% of private sector jobs in Europe[14] and over 99% of non-farmland businesses in the USA.[15] In an environment where the economy has adversely impacted nearly two thirds of SMBs, investment in these engines of the economy is a driver for growth. Indeed, many alternatives businesses are small or medium sized themselves.

Distressed debt and special situations fund managers buy securities in firms facing uncertainty, e.g. bankruptcy, restructure, hostile takeover or merger. While this may involve shorting the stock of the acquiring firm, it does not always. Both can help to finance companies which might otherwise fail to retain and grow their value. 7% of study participants are practitioners in distressed strategies.

[12]The practice of selling stock in a company which the investor expects will loose value.
[13]Appendix 1, Graph 1 - 'Investment strategies participants viewed as their greatest expertise'.
[14]European Commission research, June 2011
[15]RSM International, March 2011

6% of survey respondents are *FOHF* experts. FOFs and FOHFs create blended portfolios of investment vehicles. The ideal goal is to provide more stable long term investment returns than any of the individual funds. They conduct due diligence into the funds in which they invest as businesses, not just as investment options. An impetus for capital preservation as well as returns means this segment of alternatives is often the most attractive access point to alternatives for institutional investors. Respondents in this area had significant experience dealing with institutional investors.

Like distressed debt investing, *private equity* (and venture capital) strategies invest in companies which are underperforming or might otherwise fail. Almost a fifth of our study participants are senior practitioners in private equity (PE). The goal is to retain value then drive growth in the investee firms. Like FOHF professionals, they conduct due diligence into investee firms. PE funds have a mid-term investment horizon, e.g. 3-5 years.

PE investors sit on the boards of companies in which their firms take a stake, so have board experience. This involves restructuring businesses: refocusing strategic direction, the delicate task of removing and replacing some incumbent management, merger or divestment. As activist investors, PE participants spoke of taking back lessons and best practice from those experiences to their own firms.

Several of the strategies above are designed to be non- or low-directional, ideally resilient against market volatility. Distressed securities, FOHF, market neutral-arbitrage & market neutral-hedged, multi-strategy and special situations all strive to deliver returns independent of the market's direction. In a bear market, this could be relevant to corporates with pension funding liabilities.

A range of investment styles and horizons are available via alternatives. Some strategies actually sponsor corporate performance. Perhaps alternatives should not be as vilified as they sometimes are.

Even working in a frequently criticised industry can have its value:

> "We've had to learn so much about communicating with our investors. We've had to restructure and turn things around."

In alternatives, this has included re-examining the thorny issue of client fees and remuneration structures: pressing topics for corporates and Remuneration Committees.

The added value of an alternative perspective

Alternatives is a core part of global financial services with $2.01 trillion assets under management (AUM).[16]

The goal is to generate 'alpha', i.e. returns in any market environment, adjusted against risk such as market downturn. At its best, this mission drives towards

[16] *Annual HFR Global Industry Report* for Year End 2011

exceptional performance in a highly risk-aware context. This demands perfection from professionals in the industry, creating a cultural emphasis on rigour and a strong sense of accountability.

> "We're operating in a robust environment where perfection is demanded."

In part deriving impetus from its risk-adjusted focus, the drive towards perfectionism in alternatives also draws impetus from regulatory pressures. This means alternatives professionals are practiced in adjusting to market infrastructure changes.

Regulation and legislation often guide governance[17] and among interviewees, there was an awareness that:

> "Good quality governance is about being good at challenging decision making – and about good, timely decision making."

In alternatives, often trading in illiquid markets where information is not always transparent, the ability to "dig for information, to challenge and question" is honed.

Financial services professionals are versed in a range of financial products. Some of the most sophisticated products and complex investment techniques are those used in alternatives.

Also, alternatives managers need to consider liquidity and collateral in a way that traditional investment managers do not, making them practised in financing:

> "It's part of the language that's required by corporates. There are many different financing techniques. You've got to choose the right mix relative to the business environment."

Women on alternatives boards

According to Odgers Berndtson research, half (48%) of the world's top 23 alternatives managers[18] have zero women at executive management level. Just a fifth of top hedge funds have 40% female representation in their executive committee. 9% have c. one third (29-33%) women in the uppermost echelon.

This is at odds with the performance of women in the industry. Research[19] has proven that alternatives funds managed by women outperformed by 72% those managed by men over a 10 year period. Similar research proved that hedge funds managed by women at the height of the financial crisis dropped performance at half the rate of those managed by men (9.6% down vs 19% down).

In an industry focused on generating risk-adjusted returns, one research respondent attributed this success to:

[17]Appendix 2, Chart 2: Involvement in corporate governance
[18]Judged by a blend of 2011 performance and AUM, according to *Institutional Investor* in May 2011 and EurekaHedge
[19]By *Hedge Fund Review*

> "Women being sensitive to analysing the basis for taking risk. Women like to be confident they're standing on a solid platform when the take risk, so they're especially good risk anlaysers."

To reflect this performance, the alternatives industry can do more to promote women from within and nuture its female talent. Just a fifth of research respondents have a mentor.[20]

One of the reasons given for the homogeneity of directors on alternatives boards is the offshore-registered nature of many funds. Candidates qualified to sit as directors on alternatives businesses who also reside offshore makes for a very small pool of appropriate directors. Demand from so many alternatives funds for non-executives in such a small pool of candidates means some 'independent' directors holding a large number of 'cross-directorships.'

> "This has led to rent-a-director culture. Some of these directors hold as many as 60 or 100 directorships! How can they treat funds as anything but identikit? How do they even have time to read the board papers?"

The fiduciary demands on independent directors are evermore testing. Such a large number of 'cross-directorships' creates systemic management risk in alternatives. This is not good news for countries with a significant number of alternatives employees in onshore workforces. The hedge fund industry employs some 240,000 people in the USA and 40,000 in the UK.[21]

Greater transparency is needed in the selection process for directors in alternatives. This could be achieved by:

- Legislators increasing the proportion of onshore directors permitted on offshore-domiciled funds. In turn, this would allow alternatives businesses to fish from a bigger pool of candidates – including women
- Affected alternatives funds employ a more transparent appointment process

Board readiness

Almost half (47%) of women surveyed had 20 years or more professional experience.[22] 41% of interviewees owned – as (co-) founders or partners – or headed companies themselves. 53% lead business units and divisions within a firm. 94% of interviewees had some form of management experience.[23] Proven in the alternatives investment sphere, these women have experience of running businesses too.

Many alternatives businesses were established within the past decade or twenty years and are often small. So while professionals in this relatively young industry are

[20]Appendix 1, Chart 4: Have a mentor
[21]TheCityUK research, May 2011
[22]Appendix 1, Chart 5: Years of professional experience
[23]Appendix 2, Chart 3: Experience of running a business

entrepreneurial, life at the top in these small firms means being immersed in several aspects of the business.[24] This involves:

- Contributing to or setting corporate strategy
- Dealing with HR issues including hiring, redundancy and remuneration structures
- Regulatory matters
- Legal and compliance issues
- Systems and operations
- Service providers
- Corporate reputation and branding
- Marketing and reporting to investors
- Financial issues including raising assets, managing collateral as well as liquidity for funds and cash flow for the company

47% of interviewees had board experience. Within this group, the vast majority's track record was on a private company board.[25] 41% of the surveyed women reported to a board member and/or frequently worked directly with the board.[26] They understood the demands on the board and how they should behave to support the board, including documentation required. This had also given them opportunity to hone their influencing skills in managing up.

41% of women surveyed had sub-board committee experience.[27] 53% of interviewees sat on industry working or advisory groups.[28] In both instances, these women have practice operating with influence in these steering groups.

82% of interviewees had an interest in being on a charity or not for profit (NFP) board.[29] Many already were: 47% had board experience with a charity or NFP organisation, many reflecting societal concerns such as education, children and the developing world.

95% of all respondents were interested in corporate board roles.[30] Just 2% of those surveyed saw themselves sitting as executive directors, while 49% would like to contribute as non-executives. 32% were interested in either role.

[24]Appendix 2, Graph 4: Involvement in strategic business decisions
[25]Appendix 2, Chart 1: Experience on a corporate board
[26]Appendix 1, Graph 2: Reporting line
[27]Appendix 1, Chart 6: Sitting on any sub-board committee(s)
[28]Appendix 2, Chart 4: Contribution to industry working groups
[29]Appendix 2, Chart 5: Interest in charity and NFP boards
[30]Appendix 1, Chart 7: Envisage themselves contributing to a listed board

Conclusion

Alternatives are not always well understood by people outside the industry which can give the impression this is a niche area, not relevant to public company boards. Yet it is run in a way that frequently mirrors the corporate world and touches on the corporate world in significant ways.

Women from the world of alternatives have a high degree of financial literacy and are accustomed to expressing that to investors in a readily comprehensible and diplomatic style, suited to servicing clients. They work in a highly changeable and competitive market, rapidly responding to evolving regulations and the shifting economic landscape. Their asset gathering experience mirrors capital raising in several ways. They understand financing techniques and are accustomed to debating and deciding funding issues.

Trained to be accountable to investors, they are geared to deliver 'absolute' returns. This disciplined investment ethos of outperformance extends to their own professional conduct. These women are accustomed to critical analysis, to being challenged and to challenging on decision making. They are entrepreneurial in an industry with risk awareness at its core. They regard good corporate governance as an underpinning of performance.

What is the added value of women in alternatives?

Women in alternatives sit on the outside of their own industry – both as alternatives professionals in asset management and as women in alternatives. This offers them a naturally independent, alternative outlook, so often described as a key requirement for a good non-executive director.

At a time when the role of directors is being cast into sharper relief and assuming greater liability, the technical, fiduciary and corporate governance demands are rising. Boardroom diversity is a proven catalyst for corporate competitiveness. It needs to improve within both alternatives and the corporate world. A broader pool of qualified candidates than traditionally fished needs to be considered for boards.

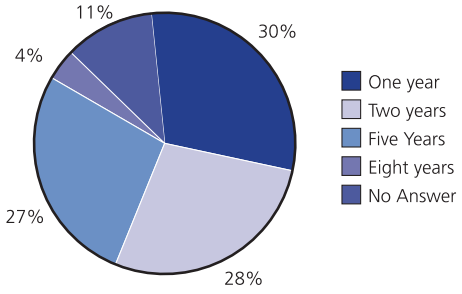
As Lord Davies observed in his speech on 1st March 2012 for International Women's Day:

> "A year on, we are at a tipping point. I would not say we have cracked it but we are making great progress."

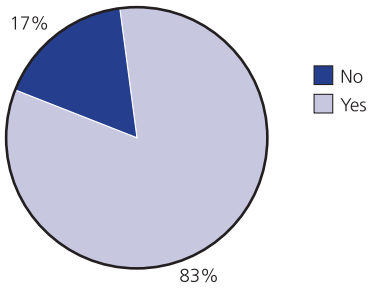
While appointment to boards must be on merit, there is a need to consider fresh pools of talent to improve gender balance – that is central to being competitive. The 100 women we studied have 2,140 years of collective experience. That experience, the skills accumulated through it and the inherently alternative perspective of women from this sphere gives them great potential for a seat on corporate boards.

Appendix 1 Charts: All study respondents

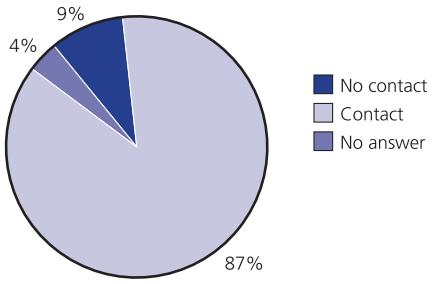
1. Opinion of their years to board



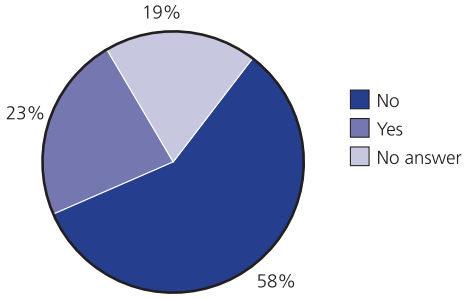
2. Direct experience of investing



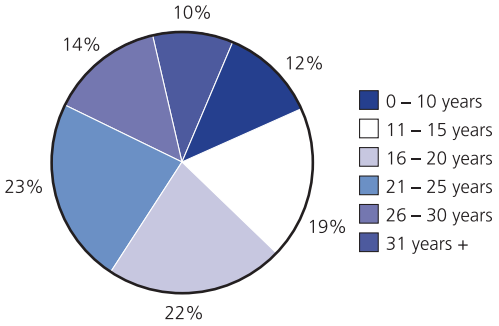
3. Direct contact with investors



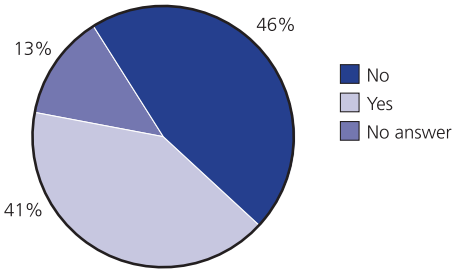
4. Have a mentor



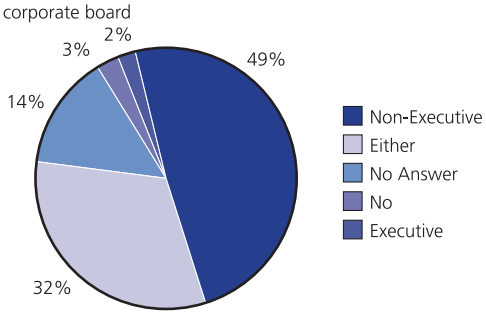
5. Years of professional experience



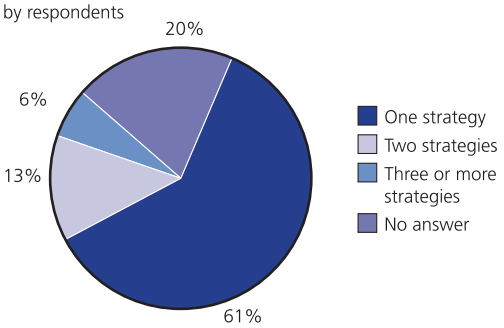
6. Sitting on any sub-board committee(s)



7. How participants envisage themselves contributing to a corporate board

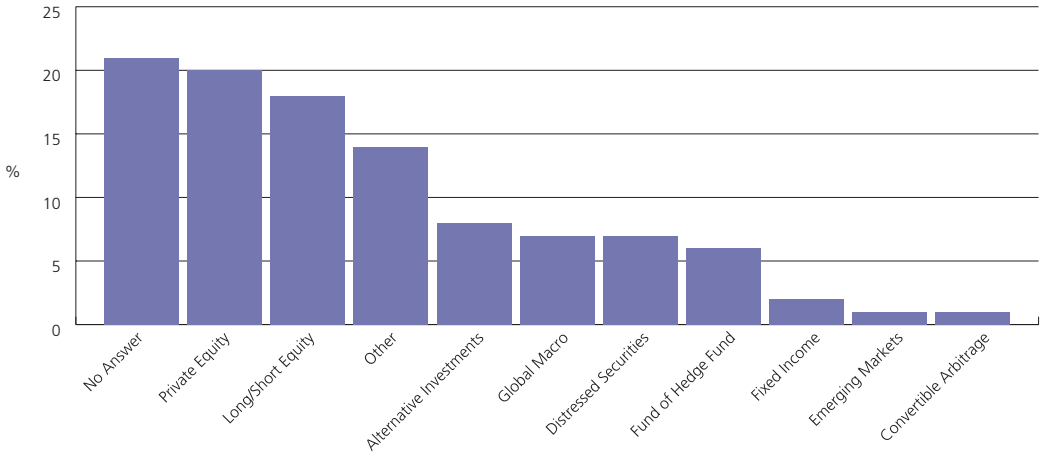


8. Number of investment strategies regularly used by respondents

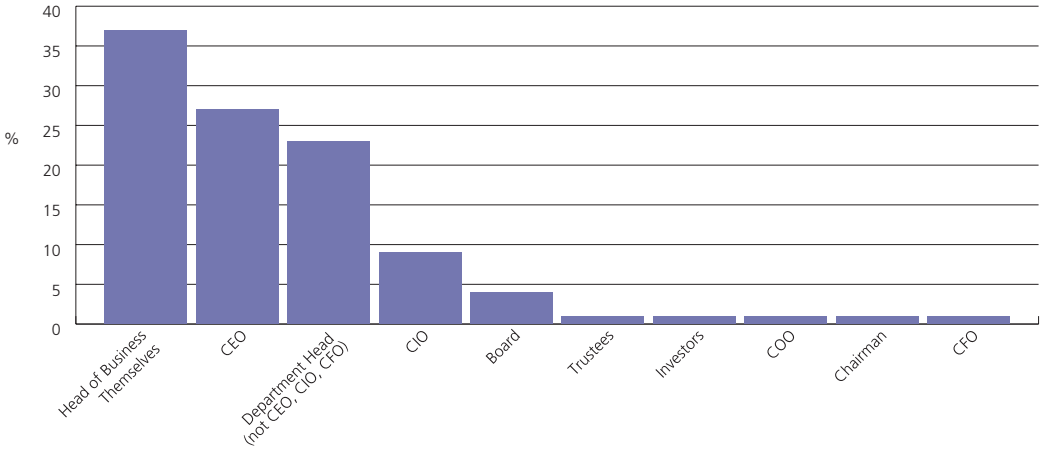


Appendix 1 Graphs: All study respondents

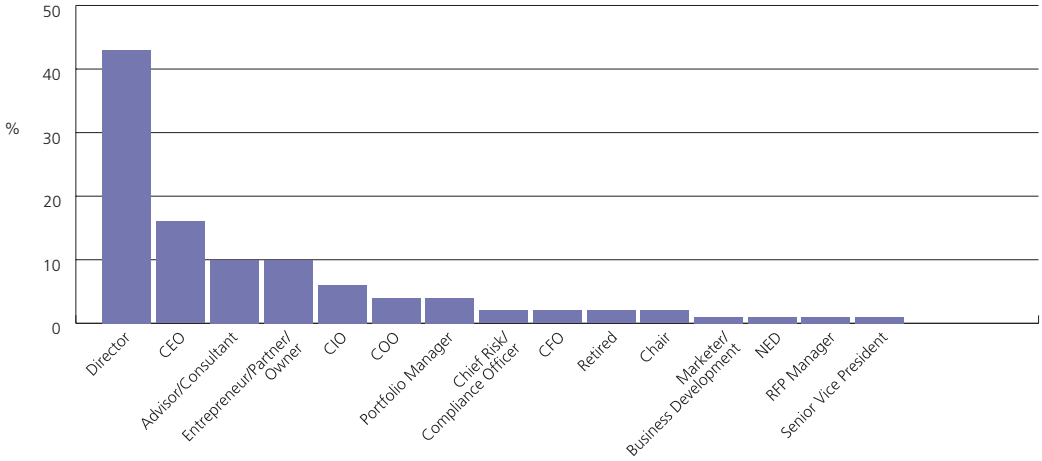
1. Investment strategies participants' stated as thier greatest expertise



2. Participants' reporting line

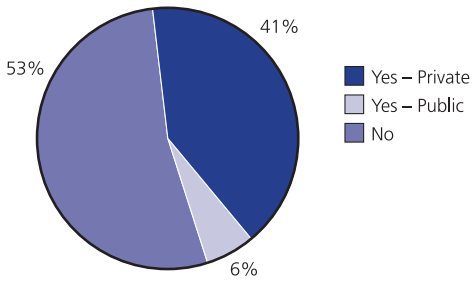


3. Functional title

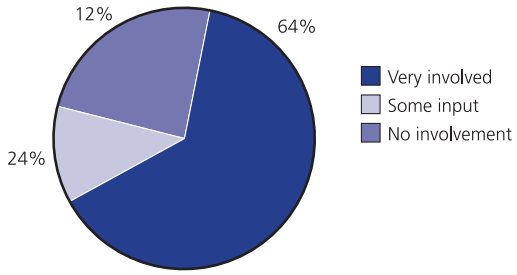


Appendix 2 Charts: Interviewees (20% of all study respondents)

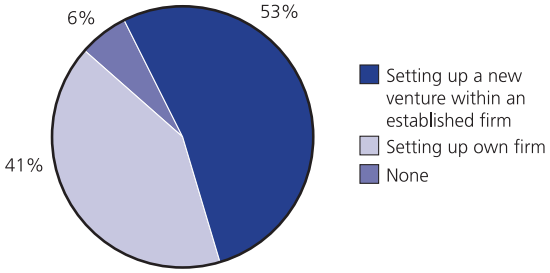
1. Experience on a corporate board



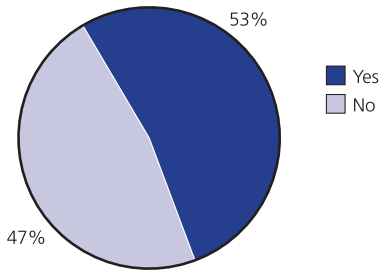
2. Involvement in corporate governance



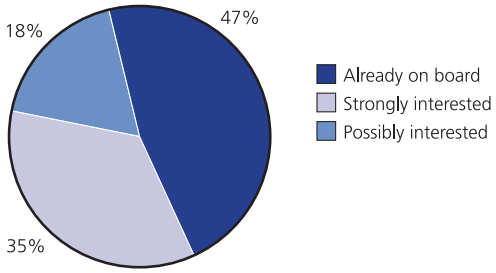
3. Experience of running a business



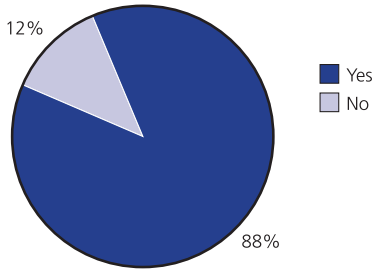
4. Contribution to industry working groups



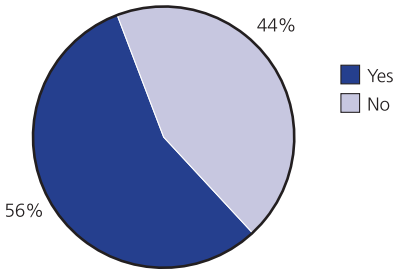
5. Interest in charity and NFP boards



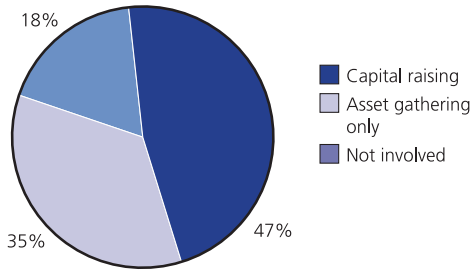
6. Management experience



7. Experience of mergers including redundancies

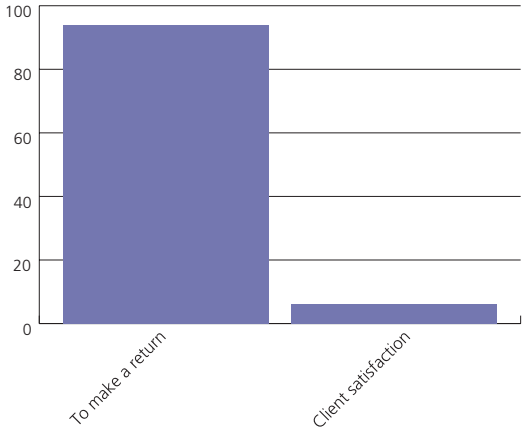


8. Experience of capital raising

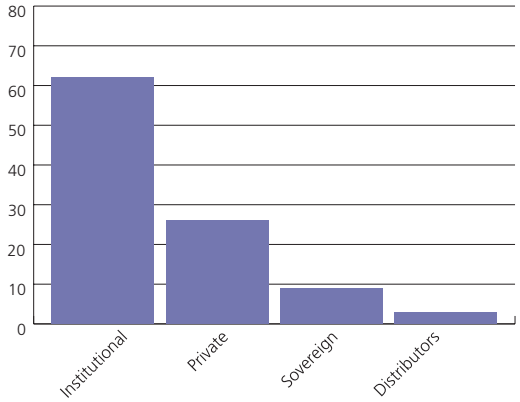


Appendix 2 Graphs: interviewees (20% of all study respondents)

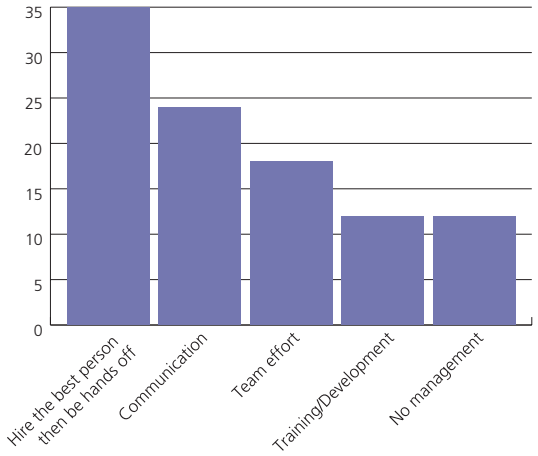
1. Investment goals



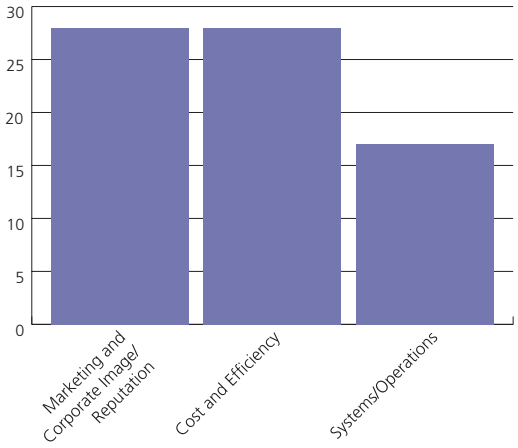
2. Direct contact with investors



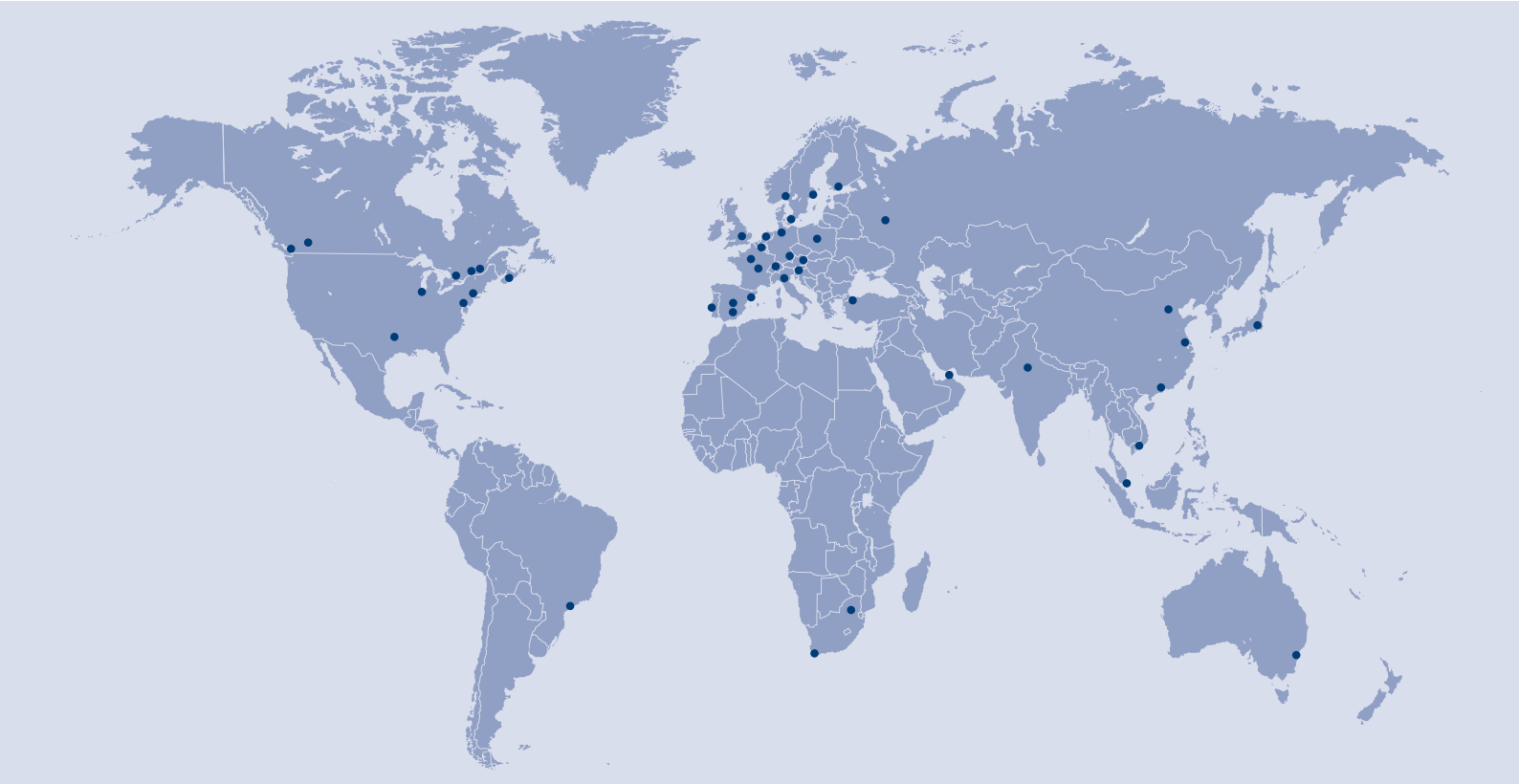
3. Stated personnel management style



4. Involvement in strategic business issues



International Offices



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