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HEDGE FUND LEADERSHIP

How to Inspire PEAK PERFORMANCE from TRADERS & MONEY MANAGERS

ARI KIEV

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John Wiley & Sons, Inc.

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John Wiley & Sons, Inc.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

Library of Congress Cataloging-in-Publication Data:

Kiev, Ari.
Hedge fund leadership : how to inspire peak performance from traders and money managers / Ari Kiev.
p. cm.—(Wiley trading series)
Includes bibliographical references and index.
ISBN 978-0-470-19387-7 (cloth : alk. paper)
1. Hedge funds. 2. Investment advisors. I. Title.
HG4530.K538 2008
332.64′5240684—dc22

2007051212

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

For Phyllis, with all my love

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Acknowledgments

Many people have helped me with this book. I am especially grateful to the hedge fund managers who have provided me with the opportunity to explore the interface between trading and psychology. I am indebted to the many traders who shared their personal experiences with me as well as those who read and commented on the manuscript in its earlier form. I want to thank Grace Lichtenstein for helping me organize an enormous amount of interview material and for her efforts in editing several versions of the original manuscript. Tricia Brown was especially helpful in fine tuning subsequent drafts and preparing it for publication. As in the past, much of this would not have been done without the support of my beloved wife Phyllis, who has always been there to encourage me to stay on point throughout all phases of this project.

Ari Kiev

Introduction

In 2004, while researching this book, I had the good fortune to hear Chris Mathews interview General H. Norman Schwarzkopf on MSNBC television. General Schwarzkopf, who commanded American forces during the first Gulf War, had this to say about leadership: “Ten brave men, well-armed but lacking faith in their leaders would not dare to attack the lion. Those same ten men, trusting their leaders, become the lion.”[1] This image conveys the kind of integrated dynamism that good leaders can generate, by empowering others to become all that they can be, and is the driving metaphor behind much of what I have written in this book.

This book, the fifth in a series about the psychology of trading, focuses on the issue of leadership in hedge funds and how great leaders can organize themselves and their associates to become like Schwarzkopf’s lion, that is, a functioning business entity that is greater than the sum of its parts, able to ride the roller coaster events of the financial markets.

Hedge funds have evolved in recent times from a small group of 600 funds handling $39 billion to a large industry of 8,000 funds handling more than $1 trillion. This was expected to more than double by 2008, growing to an estimated $2.35 trillion under hedge fund management.[2]

While still a cottage industry of small shops, there are increasingly large numbers of hedge funds that have begun to develop into substantial and institutionalized multistructure business entities, which are facing new leadership challenges necessary to take their organizations to the next level of success. For instance, Front Point has been spotlighted by the magazine *Institutional Investor* as the “new breed of alternative-investment entity: a multi-strategy, multi-manager hedge fund conglomerate,” which is attempting to lengthen the life of hedge funds so they are scalable way beyond their initial founders’ talents and can endure as business organizations.[3]

Unlike many hedge funds, which are governed by an individualistic *Top Gun* fighter-pilot competitive mentality, Front Point and other progressive hedge funds are attempting to incorporate teamwork and cooperation into

their business plans. One founder, CEO Philip Duff, explained, "We felt that if we could create a structure that would allow the investment talent to spend ninety percent of their time focused on what they love to do—which is run a portfolio, not manage a business—we could give them a competitive advantage."[4]

Hedge funds have become so central to the markets that they demand the attention of every player. In a *Wall Street Journal* article written by Sylvia Ascarelli, the author noted that whereas hedge funds were once considered "niche products for the super-rich," they are now "mainstream," with "pension funds, insurance companies and other professional investors" giving them "a larger chunk of their money." The *Journal* quoted one study as predicting that "the amount of money going into such investments from U.S. institutional investors could quintuple within five years."[5]

With this surge in growth, hedge fund managers are also becoming well-known in circles far beyond Wall Street. As *Alpha* declared in a July 2004, article, different kinds of financial titans seem to capture the headlines and the imagination of each era: "In the 1980s it was the corporate raiders and leveraged buyout artists who dominated the scene; in the 1990s it was the dot-coms; today it's the turn of the hedge fund managers."[6]

By definition, hedge funds are shielded from public scrutiny and lightly regulated. They are often described as unregulated investment pools using borrowed capital, able to short the market, and are available to wealthy investors. Thus, their significance has probably been under-emphasized for years.

Their leaders are among the best compensated people in all of finance: the *average* annual compensation of managers who made *Alpha's* Top 25 list for 2004 was $251 million, with the number one manager, Edward Lampert of ESL Investments, listed at an incredible $1 billion. To put that in perspective, only one CEO of a major American company, Terry Semel of Yahoo, made anywhere near what the top hedge fund managers made (Semel got about $231 million in total compensation). Only two others were reported in the $100-million-plus category.[7]

Moreover, hedge funds can move markets. "When hedge funds are enthusiastic about a stock, they have the collective buying power to drive up the price, at least for a while. When they turn on a stock, they can drive the price down," Joseph Nocera wrote in *The New York Times Magazine*. "Some hedge-fund managers have become activists," he added, "buying up stakes in companies and then demanding change from management."[8]

Because of the escalating wealth and power of hedge funds, it is imperative for anyone in the financial sector to pay close attention to how they operate and expand. The industry has become so crowded with new funds that many will fail. Smart leadership is essential for new funds to find a permanent foothold.

Without question, hedge fund leaders must empower their people to set optimum, as well as achievable, targets for markets that are particularly difficult, using risk metrics such as P and L over specific time periods, W/L ratios, volatility measures, VAR, and the like. They must also ensure that their teams are managing risk and keeping drawdowns to a minimum whenever possible to prevent massive psychological breakdowns. Then, when they have built a cushion, it is up to the leaders to make sure their teams are taking enough risk (which they often are not) commensurate with their capital and their targets and that they are using their analytical resources to develop high-conviction ideas.

But beyond these basic hedge fund objectives, hedge fund leaders must also learn to communicate better and to align the behavior of key personnel with their larger vision, gain greater commitment from key participants, and build on the strengths of the people in their organizations so as to produce winning strategies and winning results. Leadership themes also extend beyond these issues to include diversifying decision-making processes, providing transparency to investors, evolving a flat-organization approach as opposed to top-down command and control, giving people equity in a firm so they have an incentive to stay, and building and sustaining long-term value.

For those of you who are already at a hedge fund or are contemplating accepting a position at one, the quality of leadership is undoubtedly a major factor in job choice and satisfaction. And even if you are not the CEO or the top manager, leadership is still an important issue for you. If you are a trader, you are a leader when you are trying to get analysts to give you better material. If you are a portfolio manager, you face leadership challenges when you deal with your traders and analysts.

That is why I have written this book—with the purpose of sharing my perspectives on various leadership themes that I have been exploring over the last several years with hedge fund managers in a variety of organizations. The key issues in my consultations and training programs have expanded from trading psychology and risk management to other issues such as communication, conflict resolution, and personal empowerment.

The world is an ever-changing, sometimes fear-filled place in which your career, your relationships, and your long-held beliefs often face dizzying challenges, a truth that all of us learned anew on September 11, 2001. Staying focused, keeping your balance, maintaining a sense of openness and optimism each day, and showing those around how to do the same can be a struggle. Achieving goals that you set for yourself can be remarkably satisfying, but becoming a leader and empowering others can offer you even greater psychological rewards. The principles outlined in this book will help open the door for you to learn how to do just that.

Hedge Fund Leadership

CHAPTER 1

Developing Good Leadership

Long before I was a psychiatrist, I was a basketball fan, and throughout my adult years I have followed the careers of great players and great coaches. One person I have admired from afar is John Wooden, the legendary coach known as "The Wizard of Westwood," who earned his nickname by accumulating an extraordinary track record: 10 NCAA titles in 12 seasons before he retired in 1975.

While it is true that Wooden recruited and coached remarkable players, his modest demeanor and his ability to manage such outsized personalities as Kareem Abdul Jabaar and Bill Walton contributed much to his legendary status. Today, his famed Pyramid of Leadership, which includes 15 building blocks to success, is posted not just in locker rooms, but in offices and boardrooms as well.[1]

At the foundation of Wooden's pyramid are personal character traits—industriousness, friendship, loyalty, cooperation, and enthusiasm. At the top sits "competitive greatness" which Wooden defined as being "at your best when your best is needed."[2] In between, he constructed layers of personal qualities such as self-control, skill, "intentness," poise, confidence, and team spirit.

Coach Wooden's vision of success and the steps he outlined in his Pyramid to achieve it are as valid for the workplace as for the basketball court. A great coach, like any great leader, teaches those who join him how to play to their strengths, how to stay on target, and how to tune out the distractions and the emotionality of the game. In this sense, what is called *executive coaching* is similar to what a good sports coach does. Wooden's example, as well as my personal experiences with Olympians and top hedge fund masters, has demonstrated that it is possible to help people to tap their hidden leadership potential and thereby maximize their own performance and the performance of others. This interest in helping people become leaders in their own lives and achieve greater personal freedom and self-expression by overcoming their self-doubts, inhibitions, and fears, is a very intense paradigm for leadership that has led me to write this book.

A UNIQUE PERSPECTIVE

In my previous books on the psychology of trading, I emphasized the importance of going beyond self-limiting notions about yourself and public commitment to goals, risk taking, centering, and turning breakdowns into breakthroughs.

In this book, I focus more on the empowerment of others. How do you lead a team? How do you get to your objectives with the help of others? How do you get collaboration from other people? How do you get the best out of them? How do you do it in a way that engages them without dominating them? In this book, I want to focus on how you can not only empower yourself but also empower others with these principles—in essence, how you can become a successful leader.

THE VALUE OF EMPOWERMENT

Leadership in the hedge fund world is not all about numbers anymore. It's about people. But, of course, that presumption alone leads to numerous questions. How do you get people to go to bat for you? How do you get people to make that extra bit of effort? How do you empower your team to get the job done?

Successful leaders have found that empowerment results from finding a leverage point from which they can encourage others to see the necessity of trying something new. Good leaders help others to develop a willingness to change behavior and take risks. They develop the skill to reach the emotional wellsprings of belief, motivation, courage, and perseverance, which help contribute to trading success for themselves and others.

Peter represents a new breed of hedge fund managers who have begun to understand these concepts. With 10 years of experience under his belt, he recognizes the importance of leadership skills in preparing for the next phase in the evolution of hedge funds.

Peter also recognizes the importance of defining a vision or goal for the team, but then looking for the cutting edge and asking what more can be done to help reach the goal. He considers what incentives will motivate change, how he can reframe the team's objectives so as to overcome inertia, and considers longstanding patterns of complacency and caution.

Case Study on Leadership Issues in Hedge Funds

A successful leader doesn't shun resistance. In fact, he anticipates it and prepares to challenge the resistant team members in a compassionate way. He helps them to keep focusing on the goal, while creating a safe space that allows them to experience failure. He understands struggles and listens to what others are saying—directly and indirectly.

These and a number of other insightful issues are more fully elaborated upon in the following verbatim dialogue with Peter, the principal at one of the more successful funds on Wall Street. His 10 years in the business provide him with a number of comparative experiences and insights into the nature of leadership issues in hedge funds.

Kiev: What does it take to succeed as leader of a hedge fund? What are the tasks and what are the skills you need?

Peter: It starts out as portfolio management, but at least from our perspective it's much more about people management and HR. The people who are building good hedge fund businesses are doing a better job of paying attention to people, HR recruiting, and screening people. They try to set a direction and vision for the firm so that when somebody joins such a firm, they know exactly what the next three to five years look like. If you look at the model from the late nineties, it was the sole proprietor. From the perspective of an employee joining them, they were only trying to figure out how much capital they could deploy and how much they could get paid for it, and that was really about it. The process of business building wasn't collaborative.

Kiev: How is it different now?

Peter: People who I think are being successful today are looking to not only financial risk, but also business risk. They are interested in protecting, preserving, and growing their franchise. They are choosing multiple products. They care about the brand name and they care about retaining talent. You may not make as much money as the old-time CEOs in any one year, but over five years or ten years you are going to make a lot more. I think people are reinvesting rather than just taking the money out of the business and stuffing it under a mattress. Today, people are making real reinvestments in hiring and training a bunch of junior people, opening offices in London or in Asia, and expanding the business that way. They bring in professional business managers, professional HR people, and leadership consultants. So people are making discretionary investments that you normally find in other businesses. I think the difference between a good leader in a hedge fund business and a bad one is that they are thinking about it as a business in much the same way that we expect our portfolios to think about it. We have free cash flow. Do we reinvest that in the business? What's the return that we can get from there? Do we give it out to ourselves or do we do a share repurchase?

Kiev: This sounds like a real paradigm shift.

Peter: In the past, CEOs could just keep the money, or they would pay it out to people who kept the money for themselves. The best funds today have invested phenomenal amounts of money, people, systems, marketing, and product design in advance of launching new products. If you have the right team in place today, you are doing things that are small and reasonable, and making normal returns when it comes time, so that you have excess returns and still have the capabilities in place.

Kiev: What happened that led to this paradigm shift or awareness of looking at hedge funds as businesses? Is it that they existed long enough for people to realize they had some longevity and that some of these other considerations weren't what they thought?

Peter: I think that is part of it, along with the fact that the industry has grown so large and that there are so many multibillion dollar hedge fund managers. If you are a professional CEO, COO, or HR person, you tend to look at what their growing industry is. I think the business is growing so much that it attracts professional management.

The second thing is that it's attracted interest in capital among third-party investors. So we have seen insurance companies take stakes in hedge funds. We actually have seen hedge funds sold. We have seen a lot of third-party interest in the investment at multiples of earnings. There are leaders and there are fast followers. Portfolio-wise, hedge funds are very good fast followers, and also in the business sense. They saw somebody not only maximize the short-term profit, but make seven to ten times that amount by selling a stake in their business. And putting a seven to ten multiple on it, that really changes things. Where you had businesses, which were sole proprietorships, there are some people who manage money, and they have all been into institutional business over time.

Kiev: Can you discuss other keys to success in hedge fund leadership?

Peter: To a certain extent, it's the growth and popularity of attracting a professional management. Since you have a larger population of people that are of critical mass, there are just the odds of you getting good business models out of fifty to a hundred companies. Those odds are better than the odds of getting them out of four. If you look at good hedge fund managers today, you know there is something about a thirty- or forty-year-old CEO that thinks with a twenty-year time frame investment future versus people who are at the twilight of their careers. A smart younger guy is thinking about not only that year's profit, but how can he build something for the next ten, fifteen, or twenty years? He has a lot more gas left in the tank than many of the earlier guys.

Kiev: Did you see some transitional leaders that were learning to be CEOs without necessarily bringing in outside managers? There is a learning curve, if you are aware of it.

Peter: Yes. You can either bring in a swing coach to teach you how to get the golf club or you can try it yourself or some combination therein. The fact is, that the best are built around portfolio managers who trust their own decision-making power better than they trust others. You are getting much more on-the-job-training. There is more bringing in of coaches than handing over the reins of the business to a professional manager with the idea of, "You run the register and I will just be the chef." Because of the wealth of the CEOs of hedge funds, they can afford to do it. They are used to making decisions and they trust their own analytical abilities. I am thinking of one guy who went from working at a top investment bank, to block trading, to being a portfolio manager, and then to being a business builder. He didn't bring anybody to help him do that. I think he just learned on the job. Another leader surrounded himself with bright business people, good legal advice, good operations, and counsel to provide input and alternatives to him. When he finally makes the decision as to which direction to go, he trusts his own instincts.

Kiev: How self-aware does a great leader need to be?

Peter: Some people have the ability to look in the mirror and see their own weakness and compensate for them, while other people look in the fun house mirror and see themselves differently. I think that

> is true both in the portfolio sense and business sense. The ones who will succeed—and hopefully, we will be one of those—will have a good idea of what we are lacking and hopefully go out and get help.

Peter represents the new breed of hedge fund manager who recognizes the importance of leadership skills in preparing his fund for the next phase in the evolution of hedge funds. He has formulated both a short-term and long-term vision and has the desire and willingness to impart it to his people, while recognizing that the learning curve is steeper for some than for others. He also recognizes the unique features of hedge funds when compared to other business organizations. Many of the most successful funds are run like small family businesses, even though they are managing billions of dollars and generating hundreds of millions of dollars of profits. In fact, the hedge fund manager is often a unique combination of both player and coach and in many instances the principal owner, trader, and moneymaker in the organization, which makes for certain special psychological challenges in managing such organizations.

CASE STUDY ON THE PLAYER-COACH CONCEPT

Because of the importance of this distinction, I explored the theme of the player-coach with Dean, a portfolio manager whose work experience included time as a consultant for a major management consulting firm. His remarks help clarify the critical variables differentiating hedge funds from other business organizations.

Kiev: What's unique about the leadership of hedge funds?

Dean: Hedge funds are unique in that the leader is often still a player. It's not like professional baseball where the coach is more often than not someone who played baseball twenty-five or thirty years ago. Joe Torre is not batting in the lineup. He can't get in that box to take swings. His credibility is based on his track record as a coach, not his record as a player.

Kiev: What's the significance of this?

Dean: Hedge fund managers can lose credibility as managers if their stats aren't the best. This may be why some managers have decided to stop running money so that they could concentrate on managing the firm. Others have brought in new people to manage the firm.

Kiev: How do these models differ?

Dean: Hard to say. A guy like Torre in baseball or Pat Riley in basketball has years of being a coach that he can draw upon. His playing stats are a long time ago. The issue is different if you are a player-coach, which is how it is in the vast majority of hedge funds and what creates the most difficulty. There are a lot of hedge fund managers who are trying to coach people while they are still trading alongside them.

Kiev: Can you go into more detail about those who have trouble as a coach when their stats aren't great?

Dean: Your stats have to be great for you to continue to be a player-coach. Otherwise you risk rejection. Take basketball. It's hard to be a player because if you are sitting and telling the young guys to do this and do that, they are likely to say, "Wait a minute, old man. You can't even get up and down the court anymore." Your answer is credible if you are able to say, "Yeah, but I am a coach. I am not playing anymore. I am not doing what you're doing." I read about one successful fund manager who basically said, "I am just surrounding myself with really smart guys. I am not doing this anymore." It's clear who the leader is.

Kiev: Do you think a guy whose numbers aren't that good would be wise to do what this manager is doing?

Dean: I think so. You are starting to see guys who are mediocre step back and say, "I am going to get other guys to run this and just leverage my brand name." Then they try to build the organization and try to do those other things.

Kiev: What are the leadership tasks involved in running a hedge fund?

Dean: You need to be very clear on what you are looking for. You say, "Okay, this is the amount of money we're looking for. This is the kind of volatility that we are looking for." You need to be explicit about your expectations and the minimum requirements for keeping a position so as to reduce the degrees of uncertainty, which exists in so many firms. One of the strengths of our shop is that basically everyone knows how much he or she is getting paid, based on a formula. In this way, you don't have a big conversation at the end of the year. More and more organizations are moving in this direction, although there are still many where you don't know where you stand until the end of the year. A lot of places they don't until the end of the year.

Kiev: Have you observed hedge fund leaders who understand the psychological issues, the sensitivity of others? Do they see how they might get in their own way in reaching their objectives? Does a leader need to improve his ability to listen to his people to communicate more clearly with them? To provide feedback to them on how they are doing?

Dean: Difficult to say. It's such a dollar-and-cents business. If you look at typical corporations, many of them do that kind of three-sixty evaluation, where everyone evaluates everyone else and there is an effort to improve communication around these softer issues. Most hedge funds don't do that sort of thing, but I would say that some of the more forward-looking firms are starting to pay more attention to these kinds of issues.

Kiev: Is it a good idea to think about doing such things, at least paying attention to the quality of communication, and whether or not you are tapping into the hidden potential of the people in your organization?

Dean: Absolutely, but it will take time because ultimately it's about the dollars and the cents, and if this adds value, it will be incorporated.

Kiev: Is this starting to happen?

Dean: Yes. I can see it. It involves a real difficult cultural change in this business. What you are talking about is the process of institutionalization, where it's not just about your whole net worth, or your whole experience isn't based on how much you get paid.

Kiev: Even if your net worth is based on how many dollars you make, are you going to make more dollars if you are nurtured a bit more?

Dean: What you are saying makes sense. You need a real commitment. When old-line hedge fund managers are running a book, I don't think they view themselves as mentors. They don't view themselves as a coach per se because they are worried the guy is going to leave them. But the new breed of hedge fund managers is definitely thinking this way. They recognize that if the environment is right, people aren't likely to leave, and while it may be too much of a burden for a lot of fund managers to take on, they are finding ways to institute these processes.

Kiev: It's not all about numbers; it's about people. How do you get people to go to bat for you? How do you get people to make that extra bit of effort? You need to relinquish some of the control. You can't look at all the companies. You've got to teach somebody how to do it. Maybe if a guy learns how to do it, he is going to leave you, but at least while he is with you, he will have done it in the most effective way possible. I am suggesting that there is value in bringing this soft side out in the open and trying to figure out how to empower people in the best way possible in order to get to the top of Everest.

Dean: The challenge in doing this is an issue of time and resource allocation from the leader's perspective.

Kiev: OK. So how do the best funds handle this? How do they maintain a consistent level of performance year in and year out? How do they boost the level of ordinary performance? What do they do about recruiting top talent? What do you think of such key principles for maximizing performance as focusing on a larger vision, looking for the cutting edge, challenging resistance in a compassionate way and creating a safe space in which the greatest mistake is not making an effort?

Dean: These principles sound fine in theory, but in actual practice at the best hedge funds, the focus is generally on performance and not so much on creating a safe space. It is results oriented and most big funds are only recently beginning to embrace the supportive approach you are talking about.

Kiev: So you agree with my viewpoint, but only insofar as the focus is on goals and helping people to reach them.

Dean: I like to compare the best funds to the New York Yankees.

Kiev: How so?

Dean: The New York Yankees have done very well with home-grown guys that came through the Yankee organization—Pettitte, Rivera, Posada, for example. They won a lot of championships with those guys. Not that they were the best players. Jeter is not the best player at shortstop. But it's ingrained in them what the environment is like. You then get a guy who is a very talented guy outside the organization to come into the Yankees, let's say. They just don't do as well. I think it's the makeup. They don't understand the culture. They don't understand the expectations coming in. You can make the argument about some of our guys who came through our hedge fund organization and know what it's like.

Kiev: Do you think the organization articulates what the culture is?

Dean: The culture doesn't know and sometimes it's a negative. When Steinbrenner is bringing a new guy in, he is not going to tell him what to expect. When you're losing, he may go in the public arena and say you stink. If you read the paper, you kind of figure out that's the way the guy is. Now I came in to this fund and I had known some of the guys for a fairly long time. I clearly knew what it was like to come in to the situation. It's basically been what I expected. So that's why I think I have survived. I think you do better when you know what to expect.

Kiev: You weren't disappointed?

Dean: My expectation was based on what this organization's leaders told me.

Kiev: Would newcomers do better if they understood the environment? If everyone owned up to what it's really like, if you could really see it? You know this place isn't for everyone. This is for guys who have thick skins. These are the guys who want to go for the gold and [are] willing to go through hardship and starvation and loss of limbs. You are signing up for the Marines.

Dean: I think most people know that it's a tough environment. I think most people know the reality.

Kiev: I think that's good. You want the expectations to match the reality.

Dean: If you want to play for George, what's the big deal? I have come in with that mindset since Day One. This is the Yankees. I might be a superstar to someone else but when I come in here, I have got to play a superstar game if I am to be considered one. If I go to other places, guys might think I might walk on water. Here I have to face the reality of my performance if I am not up every day.

Kiev: Is that maturity?

Dean: I think it's somewhat maturity.

Kiev: Are you saying that with a Yankee-type hedge fund, you don't need approval and are willing to be judged by your performance?

Dean: I know what the deal is. I know the expectations.

Kiev: Jack Welch talks about the value of candor and being willing to speak the truth and being willing to follow things straight.

Dean: My thing is, we should embrace the Yankee image if this is the way it works.

Kiev: Does that mean this firm is not made for everybody?

Dean: I think we say that, but we are always trying to grow the firm and recruit people who eventually won't make it or who will have trouble doing so. I came here because I wanted to be like the portfolio manager who started at zero and now he is worth a hundred million bucks. It would take me twenty years on the Street. If I can do that in two or three years, that's why I'm here. That's the difference. I still can go somewhere else. It's always in your mind. You always want to make sure you are not cheating yourself, making excuses for the people around you, just to justify being here. That's not the case. This is like the Yankees. The Boss gets impatient every now and then, but that's fine.

Kiev: Because you want to play for the best teacher, the best leader, right?

Dean: In baseball, there is one standard and it's the Yankees. Right now our fund manager and this firm are the standards. You almost have to embrace it unless they want to change it.

Dean: Look at the Yankee turnover. The Yankees turn over and we had like four or five guys that are the same. The idea here is you become one of my core guys. Jeter is a core guy. Posada is a core guy. Four guys on this team won the championship game, like seven years ago. Just like at this firm.

Kiev: What happens when a core guy leaves? Can his performance standard remain so high?

Dean: Most guys would do as you would expect. It's pretty good and it's not taking a ton of risk.

Kiev: Do you think they have learned enough?

Dean: I think they have learned enough.

Kiev: Do you think they have learned what this firm is doing or they have discovered the confidence in themselves?

Kiev: So, they do well, knowing that they know it's doable.

Dean: I think it's the confidence.

Kiev: I always thought the place was entrepreneurial.

Dean: In fact, it could help get rid of people. Say look, they couldn't cut it with the Yankees. There is no shame in not being able to play with the Yankees. There are lots of other teams you can play for. The more we run away from that, the less genuine we are, I think. We pay top dollar for talent. That should be the standard. If you run a hundred and you are down in a few months we're not going to be happy. I think we should embrace that.

The discussion with Dean underscores the need for the leader to balance his own objectives with his need to manage the team. The more he learns how to manage other people and to leverage his knowledge through them, the bigger the organization can be. If he thinks he is the only one who can do it, then he is never going to build a team. So the challenge of leadership is to build a team and then leverage it by setting larger targets and motivating people to get past their own fears. To do this, the leader has to get past his own fears and anxieties about helping other people, which is not always as easy as it may seem. Those are the kinds of things that are inherent in leadership.

IT BEGINS WITH YOU

To activate authentic leadership, you must put yourself on the line to resolve personal issues and take the first steps toward personal mastery. When you are more present-centered and psychologically at risk, you will be an ideal medium for growth.

The key to developing mastery *and* leadership is a willingness to be open and to share your experiences, both good and bad. Of course, this requires that you first overcome a variety of limiting beliefs and stopping points that serve as obstacles to becoming an autonomous, emotionally connected decision-maker. This begins with a considerable amount of self-examination. Ultimately, self-examination becomes the paradigm for transformative leadership in which you can become even more powerful and effective in your own trading life and in your impact on supporting others in the process as well.

As you learn how to act independently of your own blocks and fears, you can begin to see how you can lead your teams toward greater performance. To the extent that you can reveal your own vulnerability and sense of uncertainty, you will develop greater mastery and become an invaluable leader to your team.

In effect, the willingness to talk openly about your personal trading issues will enable you and your team members to get past the need to appear stronger and more confident than you really feel inside. As you expose your weaknesses and frailties, ambitions and dreams, and get past the need to maintain a facade of competence, you will become amazingly alive and empowered by the process and discover a tremendous amount of support that exists for you and others in this shared experience.

This type of communication doesn't happen by accident, especially in the harried world of trading. A good leader will have to make communication a priority and work to establish opportunities for the team to develop communicative skills. Whether it be a regular weekly consultation or an intensive several-hour consultative seminar, I encourage you to set aside a specific time to examine a variety of issues with your trading team. As you and your team openly discuss them, you will rapidly get at the heart of some of the issues that keep people from being as effective as they can be as traders and leaders. Begin by addressing the following items:

- The most common psychological problems: lack of specific goals, an inability to cut losses, panic, fear of success, fear of losing, euphoria, gambling impulses, perfectionism, and so on
- Problematic trading patterns: not trading big enough, not holding long enough, holding too long, excessive caution, inflexibility, paralysis by analysis, excessive risk-taking
- Examples of trading strategy in regard to sizing, conviction level, price targets, and P and L goals
- Examples of investment ideas vis-à-vis specific companies in regard to bullish and bearish case, catalysts, risk and reward parameters, and

variant perception (what was known at the time of the investment that no one else knew, which gave them a trading edge)

- Examples of best and worst trades
- Summary sheets of trading statistics, if available, in regard to P and L, amount of capital being used, percentage of winning days, ratio of average amounts of money made on winning days to average amounts of money lost on losing days, and any other statistics that might be illustrative of trading patterns
- Thoughts about trading objectives
- Examples of experiences in dealing with analysts, risk management, and management—including communication issues, command and control issues in the organization and the like so as to empower the team by initiating openness and the sharing of vulnerabilities
- Receptivity to coaching—how much the team can admit to vulnerability and the need for support
- Spreadsheets illustrating the sizing of positions, hedging strategies, and level of conviction of ideas

The more you bring to the table, the bigger the impact the meeting will have on you and your team and the more you will accomplish during the session. If you really put yourself out there, by exposing some of your own performances as well as the performances of the people on your team, and if you are willing to explore the good and the bad, what works, and what doesn't work, for yourself as well as your team members, then you will walk away with a huge win by your understanding of behavioral and attitudinal changes in yourself and others.

This open dialogue will translate into profit potential in your own trading and that of your team. Perhaps most important, such a dialogue invites the opportunity to break through and develop team connections. There is suddenly an opportunity for everyone to see that leadership is not about demanding something from people, but about providing a setting in which everyone can voice concerns, fears, self-doubts, differences, and even disagreements without fear of retribution.

Group discussions encourage people to see the nature of sharing, help overcome the natural reluctance of others to speak out, and challenge the status quo. As team members learn to share their dreams and identify everyday obstacles in the life of the organization, what often emerges is an amazing interaction that was not previously present because of fear, or lack of time, or opportunity. Such discussions will help foster a sense of teamwork, loyalty, and motivation as well as motivate better performances and a more competitive edge.

ENJOYING THE PROCESS, SOLVING THE PROBLEMS

Of course, the point of good leadership is not just to get the team engaged in a dialogue, it is to move the team toward the resolution of problematic issues—especially those issues that prevent the production of out-sized results. By talking about such specifics as trading targets, goals, sizing positions commensurate with the targets, and so on, you can translate the lessons of the dialogue immediately and directly into trading profits and thus quickly see how to accomplish breakthroughs that reinforce goal-oriented achievements.

As you work with your diverse group of team members and recognize their diverse responses, often to the very same or very similar experiences, you will begin to understand that each person will get something very powerful and unique from the communicative exchange with others and from the opportunity to reveal certain truths and recollections about his own experiences. This kind of experiential learning is not formulaic but rather stimulatory, creating a context in which people can take as much or as little as they are willing to absorb at a particular time. Still, the results can be very powerful.

For example, after one group dialogue in which a variety of concerns were addressed, one trader zoned in on the discussion about sizing his high-conviction ideas bigger. After hearing that only 3 percent of his trades accounted for much of his profitability, he spent several weeks reviewing his 250 positions and seeing where his sizing needed to be bumped up consistent with his level of conviction and profit targets. This trader also saw the benefit of reviewing his data from a statistical perspective to unearth various trading patterns that pointed to strengths and weaknesses—including the time frame in which he made the most money and where he needed to get out of positions when the trade had matured to its maximum point (rather than holding on and seeing his profits dwindle).

Another trader found that the same dialogue had confirmed some of his perspectives. He recognized that he was not trading to win as much as he was trading not to lose so as not to disappoint his demanding investors. He began to understand that he had been adjusting his position sizes to reflect his level of conviction. While he had been thinking about some of these things before, the discussion offered confirmation that led to a boost of confidence about his methodology.

Another group of traders found an appropriate and forgiving atmosphere in which to launch a variety of concerns about risk management—such as when to cut losses, the importance of having real and unemotional reasons for putting trades on, how to develop an algorithm for getting bigger as they developed higher conviction, and how to leverage ideas from the analysts so as to build their investment thesis, understand catalysts, and create a variant perception. So, the interaction helped everyone feel freer to reveal their problems without embarrassment and to discuss issues that are often ignored in “polite” company.

The more you learn about your team, the more you, as a leader, will be able to help your team to improve their processes, to maximize their creative input and to give them a greater sense of ownership. When an open dialogue is created, there will be an increased awareness of millisecond responses associated with hesitation about pursuing objectives. Leaders and team members will become more adept at discerning quick, subtle, nonverbal emotional communication and other clues that can help traders push themselves even further than they imagined. Along the way, you will gain a glimpse of a new future—a future in which team members can make more decisions on their own and have a greater role in their own destiny.

Understand that communication in and of itself is not necessarily the answer to all of your leadership dilemmas. It is the process of communication, inviting traders to join an interactive dialogue, that helps everyone face the often unpleasant task of owning and overcoming anxiety. One particular meeting won’t necessarily solve all the problems that you are facing. But such meetings will help construct a methodology of inquiry about what is needed to develop leadership and to empower the people on your team.

Of course, the type of communication I am describing involves participation as opposed to top-down edicts from the leader. The best leaders are able to help others call on their strengths and move the organization along, not by fiat, but by engaging everyone’s interest and enthusiasm.

BREEDING GOOD LEADERSHIP

Warren Bennis, one of the most respected writers on business leadership wrote, “Around the globe, we currently face three extraordinary threats: the threat of annihilation as a result of nuclear accident or war, the threat of a worldwide plague or ecological catastrophe, and a deepening leadership crisis in organizations.”[3]

Does it surprise you to hear such a respected author lump a “leadership crisis” right among the threat of nuclear war or some sort of endemic plague? Most of us would not consider the three to be equally intimidating. Yet, on a broader scope they probably should be. Our world seems to be groveling for good leaders. Men and women in leadership seem unsure of themselves at best and totally incompetent at worst. The hedge fund world is no exception.

But it doesn't have to be this way. There is no shortage of talent, and leadership is a skill that can be learned. In fact, leadership will thrive if the environment is suitable, and thankfully, many hedge funds are beginning to understand what conditions are necessary to breed successful leaders.

Bennis and his co-author, Burt Nanus, note in their book *Leaders* that the best leaders "are able to concentrate on what matters most to the organization and to use the organization as a learning environment."[4]

They develop skills, says Bennis, that allow them to acknowledge and share uncertainty with colleagues in task force settings. They use their mistakes as "learning experiences . . . they engage in goal-setting exercises to force reexamination of current assumptions and priorities; they use their interpersonal skills to encourage others to join in the search for new ideas . . . they constantly enhance their understanding of their own limits and biases by testing their views against those of knowledgeable colleagues and outside experts."

Hedge funds that embrace this type of management become more adaptable and exemplify the best features of what MIT professor and author Senge has called the learning organization. This type of open meritocracy is far superior to the traditional command-and-control hierarchical style of leadership that has always been prevalent in the financial field and breeds better leadership as well as greater stability and the opportunity for more sustained success.

Case Study: The Distinctive Organization of Hedge Funds

To better understand some of these distinctions I talked with the head of the quant division at one of the premier hedge funds on Wall Street about his views of leadership and how they differed from his prior experience at one of the larger investment banks. I think Todd's views are useful in defining some of the ideal characteristics of the best hedge fund leaders and in emphasizing the importance of trust and autonomy and the creation of a safe space where creative people can innovate without fear of retaliation for making mistakes.

Kiev: Based on your experience working in a number of different kinds of financial organizations, what would you say is the key to your leadership success in a hedge fund?

Todd: I put a special emphasis on hiring extremely talented and motivated individuals. The key element is one of trust. A good leader has to hire people that he trusts and then give them a tremendous amount of freedom within the constraints of the requirements about the way they are going to perform. You say, "Here is your sandbox. I am going to trust you to do what you know how to do, and I am basically going to leave you alone. I am only going to look over what you do to make sure you are staying in the sandbox and playing fair."

Kiev: What else can they expect from you?

Todd: I need to be sure that I can live up to my commitment to those who trust in me. During the good times, it's easy. They are making money every month, and there is no problem. But in bad times, I need to stick by them and stick by that commitment to give them freedom to function within the constraints of the requirements.

Secondly, I have to have a great deal of discipline in executing the strategy. I need to look ahead when I hire someone and say, "What are all the things that could go wrong?" If they have drawn down quite a bit, but they say their strategy is not fundamentally broken, that it hasn't violated the sandbox parameters, then I stick with them, even though I say, "This is killing me." I am staying by it because we agreed ahead of time this is correct.

Kiev: What are other elements of this mutual arrangement?

Todd: As a good leader, I need to understand what they are doing so that I can support them in bad times. In order to make these promises, I have to know what I am talking about because otherwise I am going to find myself changing my mind a lot. At the same time, I need to be disciplined so that when people violate the sandbox, I can say, "You are outside the parameters. You haven't lived up to your end of the bargain, and we have to reestablish or end this relationship."

Kiev: How would you characterize this type of relationship?

Todd: I think giving people the intellectual freedom to do what they want is incredibly empowering.

Kiev: It seems that these principles would apply to a lot of different organizations where leaders are dependent on the knowledge base of the people on their teams.

Todd: I would think so.

Kiev: Have you seen situations where these principles haven't been applied?

Todd: Yes, when I was at one of the largest investment banks, a general partnership, my bosses were incredibly micromanaging. They would come by twelve hours before we launched a new strategy and say, "Well, we would like you to run these tasks before you launch." Their only explanation was: "We are in charge." I was living and breathing this for a long time: "I know better than you do right now about this strategy. You may have broader knowledge. You may be wiser than me in general. In this little corner of the world, I am the pro. You should listen to me." So whether it was ego, fear, or both, they were forcing me to make changes that complied with their current wishes. Oftentimes there would be a blow-up—something would go wrong. I could point to the exact moment where they needed to make a change. But then they thought I was making excuses, and the relationship would unravel.

Kiev: Where do you think management goes bad? Can you give me an analogy of how it happens?

Todd: Imagine Bobby Fischer or some world champion is playing chess, and I am managing it. He is about to do a move, and I say, "Before you do the move, explain it to me. Go down that road; let's see how it goes five moves in." This kind of bad micromanaging happens far too often. The manager is pulling his hair out. "This is a disaster. You are fired. Leave—I am going to take over." Of course, he takes over and loses because he doesn't understand it fully. Not only does he lose, but also he completely blames the fired person (who now hates the manager because he feels he is being blamed for the result, even though the manager didn't know what he was doing). In this kind of damaged relationship, both sides think they are right, but fundamentally, it was the boss's lack of understanding.

Kiev: Do you think that pattern happens more often in traditional organizations than in the more empowering model that you follow?

Todd: Absolutely! I think that pattern is *de rigueur* in America.

Kiev: Command and control?

Todd: Command and control by egocentric individuals who are ruled by their own narcissism. I don't think that's right. I think the really strong person understands what their role is. For example, my role here is to hire people who are smarter than I am at what they do, then trust them. I know this guy is great. I don't fully understand what he does, but I believe he understands it. I know enough to know that this scenario is very possible.

Kiev: To create good work you have to allow your team creative space within the parameters you have set. To make money in finance requires a certain amount of ability to deal with the unknown, to deal with a lot of changing variables. What if the leader doesn't do that? What is the effect of bad leadership?

Todd: Depending on the degree, it can be everything from frustration, to lack of trust, to a lack of willingness to do work, to a lack of loyalty. If my boss is constantly telling me that I am not so good, that he is better than me, he is saying, "You are just an extension of my brilliant mind." That frustrates me. When I am frustrated, I shut down. I start to second-guess myself. I start to worry more about what my boss is thinking than what I think is right. People leave because they are frustrated, or they shut down, or they simply under-perform.

It takes a certain amount of strength to empower others, to tolerate their risk when you recognize that you are responsible for it. But the only way for a leader to truly empower his team is to allow them the freedom to take the risk and sometimes to even fail.

This kind of psychological awareness on the part of leaders is necessary for team members to function as creatively as possible within the parameters of the firm's objectives and is a good jumping point for consideration of what is known as the flat organization.

INTRODUCING THE FLAT ORGANIZATION

A flat organization is different from the way in which many of us have experienced the business world, but it can offer opportunities that we may have never considered possible before. The flat organization is a structure designed to tap into the creative talents of the people in the organization in the best possible way by encouraging autonomy and self-directedness within the framework of a firm's larger objectives and vision.

A leader in a flat organization may find some initial discomfort in the new surroundings. After all, leadership in this type of atmosphere requires sharing (not hoarding) research and information. It requires leaders to be emotionally sensitive, open, and yes, even vulnerable. If leaders can master these strange waters, they will soon learn that these characteristics are consistent with the psychological openness and tolerance of uncertainty, ambiguity, and change, which enable the best traders to navigate the marketplace. By surrendering their ego and maximizing their trading performance, the best hedge fund leaders will be able to empower their colleagues and teammates and discover that managing a flat organization enables the leader to tap the hidden potential of every team member.

Most creative hedge funds are basically flat organizations with a lot of contact between the leader and his teams of analysts, traders, and portfolio managers. The hierarchical structure is limited, allowing the leader to recognize the emotional needs of people to express themselves and to be acknowledged by him.

As Paul, an industrial analyst, put it: "The value of a flat organization is that you have more autonomy and flexibility and can more readily adapt to changing markets. You have more chances to take the initiative and more accountability for your results, which can be a good or bad thing, depending on how you are doing. Furthermore, you can talk more directly to various analysts or traders who are working in other sectors, exchange information, and share your best ideas in order to produce these results. There is more autonomy and greater accountability for results. You have to put your ass on the line every time. You can't hide behind the structure of the organization."

By contrast, in a more traditionally structured kind of organization, such as an investment bank or large long-only funds, there is less opportunity to monitor the work of the analysts who may be reporting to another department because of the complex way in which the organization may have been structured. In such organizations there are too many layers of people to go through, and communication is not as precise or timely.

For example, I recently had a discussion with a hedge fund manager named Micah. Micah and I discussed ways in which he could involve his team in his larger vision for the firm. I urged him to challenge the team members to find new ways for developing the investment thesis, even if that made them (and him) slightly uncomfortable. I encouraged him to use a more forceful view to help get the team members to voice their ideas instead of just standing on a soapbox and pontificating. This was going to require a movement out of his and their current comfort zones.

To be a good leader in a flat organization, I explained, a manager has to push his people as far as he can, not so much for challenging their analytic points of view but in getting them to think beyond what they would ordinarily think about as they try to size the positions. Listen to Micah's initial response:

> *It is like sitting around a table and saying, "Let's talk about the art of painting with water colors." Is everyone going to have the same look in painting when they leave the table and go back and paint something? No, they are going to have a different impression and different view, a different product of their experiences and what they are feeling. That to me is what portfolio construction is like. It is not totally formulaic. A lot of it is an art form. I have thought about it a lot, of how my painting would look. What I want to ask is, "How do I make my painting better? How do I adjust it through input*

by other people?" The reality of it is, no one else in that room has ever managed money before. I don't think that they have ever really thought about it. I think they are still learning how to paint.

Using Micah's own analogy, I argued that the issue is not to teach the team "how to paint" but to brainstorm their best thoughts in the sense of helping him (the leader) to create the picture he wants created. For example, if there is an objective in mind of how to produce a portfolio of a certain size with a certain profitability, then ask the team to consider their formulations as *that* objective rather than some vague theoretical one. If indeed you have to make $10 million in technology as part of the $100 million result for the month, how big do you have to get? By using the reverse engineering principle, leaders can challenge team members to come up with a size that is consistent with the outcome that is needed.

Of course, there is going to be tension, but the best leaders want to push people to fit into a larger frame. It is very probable that you are going to hear a little bit of "I don't know what I need to do." Then you say, "Fred, what do you think Jack can do?" You encourage them to contribute to each other's quandary. You are trying to introduce a little more vitality into the place through dialogue among the members of the team and then by holding them accountable for the goals. When a team works together in this way, their efforts will still reflect individual points of view, but they will be stretched to have met the requirements of the portfolio.

As we walked through this discussion, Micah began to get a glimpse of what I was describing.

" 'They should be giving me a more realistic set of guidelines,' he said, 'not just relying on my intuitive grasp of the market. Then they will feel more connected to what I am doing because they have thought it through . . . and will be more committed and watch it more closely or think about it a little more. So you are saying, get people to express what they think the upside is versus the downside. Then they have to see what the quality of it is and relate it to how much money they want to make.' "

As he began to look at his organization in this way, Micah began to see that he is the pilot, but his team members are the navigators. The leader sets the destination. The team plots the course. Obviously, there will be times that the leader's experience dictates that his opinion takes precedence, but when team members are given the opportunity to think through the plans with the leader, they will still feel more powerful and engaged. Don't worry, at the end of the day their natural, artistic intuition won't disappear. They will still throw the ball the same way they throw it. The leader's goal is to get them to throw it harder and faster.

Case Study on Becoming Comfortable with a Flat Organization

Not everyone welcomes the autonomy and responsibility that comes with the seemingly laissez-fare approach of the small hedge fund. Newcomers, therefore, to such a flat organization often feel as if they are not getting the support they need.

While the flat organizational structure of hedge funds fosters autonomy and greater personal responsibility, it also provides fewer guidelines and structure for those originally trained in more highly organized and hierarchical organizations such as investment banks and mutual funds. This was true for a portfolio manager named Sean who felt that this new firm was "a little bit disorganized."

Sean: I come in with a little bit of a different perspective. I didn't have a lot of the portfolio management experience. I think it would have been helpful to have a layer of structure. You've got a lot of autonomy, but it would almost have been nice if I had received more guidance and mentoring for the first three to six months. The firm is so loosely structured as a flat organization. I don't know what is expected of me, and no one seems to want to tell me.

Kiev: Have you ever considered that the firm was intentionally designed this way, to bring out the best in people and that it might be useful to learn how to take advantage of this freedom?

Sean: Not really.

Kiev: I think there is a set of expectations of how to do things but that each PM is given a lot of discretion in figuring out how to contribute to the main account. Have you figured that out yet?

Sean: I think so. You helped me realize that I have to get past my own expectations and interpretations of things.

Kiev: Do you have some notion about yourself that has changed?

Sean: The change that I have made is just being less passive. You do have a lot of autonomy here, and you do your own thing. The bad thing about it is you don't force yourself to change as much. You want to be out of your comfort zone and put yourself on the line and make a bet and then get rewarded. I have had to move from being more passive to being more aggressive.

Kiev: Were you brought up to be aggressive?

Sean: I was aggressive in certain ways. From the standpoint of getting my ideas into the portfolio, I was under the assumption that I should just work really hard and do my work. I thought that as I made money the portfolio manager would see it, and he would want to come to me and get my ideas. But if I want to have an effect on the firm's main account, I have to be in his face, you know, getting him to notice me.

Kiev: Being proactive. Were you inclined to be too passive before?

Sean: At first yes, because I didn't really know the structure of what's going on here. One of the things you helped me understand is this is the *modus operandi* here. This is how things function. Passive isn't going to work. I need to be aggressive. If I have good ideas and am making money, the way to get more capital is to go up and say, "I have great ideas; give me more capital." I can't be like "OK, whenever you are ready, I would like more capital."

Individuals who have developed a *need* to have a handle on the contextual clues of the organization often require quite a bit of coaching to learn to become more self-assertive in contributing in a flat organization, getting recognition, and leveraging it to increase their capital allocation. Of course, this is not always comfortable and may take time, but as we work through the rest of this book I hope you will begin to discover that sometimes discomfort is the first step toward mastery.

STARTING FROM THE EMOTIONAL CENTER

As you will see throughout this book, the best leaders have the skill to reach the emotional wellsprings of belief, motivation, courage, and perseverance, which help contribute to trading success. However they do it, they generally are able to do some or all of the following key steps, all of which you will no doubt learn as you read and study the leadership principles explored in this book.

1. Find a leverage point from which you can encourage someone to see the necessity for trying something new, and so be willing to change a behavior and take a risk. The ability to foster such changes works best when your colleagues can admit to problems or issues or identify something they want to change or improve.
2. Look for the cutting edge. Ask what more someone can do; what incentives will help them to change, how can they reframe their objectives so as to overcome inertia and longstanding patterns of complacency and caution.
3. Define a vision or purpose to help you and those you lead to become more engaged in the present moment before you.

4. Anticipate resistance from others and prepare to challenge them in a compassionate way.
5. Help others to keep focusing on the goal, while creating a safe space, which allows people to fail. Be open to understanding their struggle, and create a safe space for them.
6. Above all, keep listening to what others are saying directly and indirectly and pay attention to your own inner voice.
7. Most of all, listen to what others are saying, to what your associates might imply in indirect ways, to your own most trusted inner voice.

Keep these themes in mind as you read this book so you can improve your ability to lead others and get a better understanding of the psychological underpinnings of good leadership. Read it to see how to address the deeper layers of your feelings, the unspoken conflicts, the sources of tension that exist in your organization. The key, of course, is to know yourself, and to have an understanding of some of the psychological forces pulling you and others in opposite directions. You do have to recognize the need to be transparent, to tell the truth, to be as good a listener as you are a speaker, and to encourage others to buy into your strategy. You do have to learn to choose the right people for the right jobs on your staff, to uncover and unleash their strengths, and to be tough about moving out those who don't accept your ideas. You need to crank up the energy level in your organization, to build momentum, and then take what steps you must take to sustain momentum. You need to learn strategies that avoid both burnout and euphoria, which are the twin enemies of breakthrough results. You need to discover how to make sure that when you are no longer in charge, you have left a legacy that will keep your organization advancing forward. Employ these strategies, and you will begin to think like a leader.

My hope is that this book will jolt you with what I call the *ah-ha* phenomenon. I want you to think, "This makes sense! That's a good idea! I can do that. I can think about the unthinkable, I can talk about the fact that I'm not communicating, that I think some of my people are resisting me." When you reach the last page, I hope you'll say to yourself: "Communication is a two-way street. It's important to talk about the things that people don't ordinarily talk about in running a company."

I'm not going to tell you how to do your job. I'll talk about how you can do what you're doing more effectively by looking at it from a larger frame of reference, by discussing an often-buried underlying layer of understanding. With this knowledge, you can uncover some of these issues, sit your associates around in a circle, and find out who they really are. Perhaps then you and your team members can at least acknowledge unspoken issues in your organization. Maybe, having brought them out into open, you can minimize the frustrations and tensions that occur when such issues are allowed to fester under the surface. This will help you win more ballgames over the long haul.

I look forward to introducing you to these concepts. To begin, however, I would like to talk about what we mean when we use the word *leadership* as it relates to the concept of vision. Every great leader starts with a vision of the future. But leading from your vision requires a change in perspective from the old (and, I believe, outmoded) ways of taking charge.[5]

CHAPTER 2

The Value of a Vision

Possibly the most famous and successful vision statement in recent business history was propagated by Bill Gates in 1995. Microsoft had fallen behind nimble startups such as Netscape in recognizing the growing importance of the Internet, which was still in its toddler stages. Gates declared that he was throwing the huge company's weight behind efforts to dominate the new medium, saying it would be the "primary driver of the new work we're doing across our entire product line." Within a few years, Microsoft erased Netscape's large early lead in browser technology and indeed became much more closely aligned with the then-infant World Wide Web.

Like Gates, your primary purpose in leadership should be to establish your vision and promote it with clarity. This will help not only empower you but also develop security and confidence within your team. Teammates will trust leadership and perform best when they are secure about their positions in a firm and confident in the firm's place in the financial world. Of course, this is often easier to talk about than to actually accomplish because every office has its own particular culture.

Gates might never have been able to reposition such a huge company if Microsoft had not already had a culture of creativity and innovation. To be a successful leader, you have to learn not only how to create a vision but how to integrate it with the corporate culture in which you work.

CREATING THE VISION

You already know that you don't control the market. Well, you don't control the ocean either, but you can still steer a course in a sailboat across the Atlantic. You would need to have the maps, the equipment, and the training, but you could do it. So, in constructing a vision, you have to ask yourself a few questions.

- What do I do best?
- What will I need to succeed, given my current circumstances?
- What do I want to accomplish in my lifetime?
- What do I want to leave behind as a legacy?
- Where do I want to be in the next three to five years in relation to these desires?

Answer these questions, and then ask yourself how the current culture of your firm is helping move you toward your desired end or away from it. As you begin to look at your organization through fresh eyes, you will be able to gain a greater understanding of what steps you need to take to move you toward the realization of your dreams. By reverse engineering the process, starting with what you have instead of a blank slate, you will be able to determine the steps you can take in the present to assure that you and your team reach the desired future.

In their book on leadership, Warren Bennis and Burt Nanus write:

> *To choose a direction, a leader must first have developed a mental image of a possible and desirable future state of the organization. . . . The critical point is that a vision articulates a view of the realistic, credible, attractive future for the organization. . . . A vision is a target that beckons. With a vision, the leader provides the all-important bridge from the present to the future of the organization. . . . By focusing attention on a vision, the leader operates on the* emotional and spiritual *resources of the organization, on its values, commitment and aspirations. The manager, by contrast, operates on the* physical *resources . . . capital, human skills, raw materials and technology. . . . Great leaders often inspire their followers by showing them how their work contributes to worthwhile ends. It is an emotional appeal to some of the most fundamental of human needs—the need to be important, to make a difference, to feel useful, to be a part of a successful and worthwhile enterprise. . . .*[1]

When you declare a vision for you and your associates, you are saying, "This is what our firm can be. Now we have to take the steps necessary to achieve that vision." To be effective, a vision has to be more substantial than your day-to-day goals, grand yet realistic. Because it is a goal that asks your people for a major commitment, a vision must be clearly stated. It is not something you can delegate to others to create—a vision is an idea that must arise from within yourself. At the same time, the vision obviously must be an inspirational one that will jump-start your organization and fire up your associates. Part of your purpose in stating it is to get your people to buy in to your ideas and to make them their own.

How do you find a vision or create it? You visualize the future by answering the questions, "What do I want to accomplish, what do I want to leave behind, and where do I want to be in the next three to five years?" This gives you enough distance to be able to expand upon what the current state of the culture is in your firm. Then you reverse engineer the steps, allowing the vision to help you define what you must and can do in the present to assure you reach the future as you imagine it. In addition, you use the vision to help define what is involved in getting into the now. Think about your most important larger goals, decide on what you want to do in line with that vision, and then start acting in line with it.

Before you begin to share the vision with others, it may be useful to get feedback about it from a select few who are skilled at helping you get more in touch with your own innermost dreams and wishes. This can be a trusted mentor, friend, confidant, or a brain trust. Such feedback can be very useful in helping you formulate your vision. But this must be done with a dose of caution and circumspection, especially in discussing your vision before it is fully formulated. In effect, while others can help you to do this, only certain selected people are skilled enough and experienced enough in working with you to help you in this way without interfering with your own creativity.

The opinions of some of your friends and colleagues may distract you. Too often, you lose power when you do this, and you begin to rely on others to justify and support you, when in fact you are better off relying on your own instincts and building confidence in your ability to define your own vision of the future. The key is to build the mental image and then begin to listen for opportunities consistent with the vision.

HOW TO THINK ABOUT A VISION

In his classic book *As a Man Thinketh*, the British spiritual philosopher James Allen drives home the point that your thoughts create the future. Therefore, the first step, once you know what your vision is going to be, is simply to focus on the vision, mastering your emotions so that you don't permit negative thoughts to seep into your mind. Slowly, the vision will become a reality.

Why is this so? It is so because the great leader is a visionary who singlemindedly ensures that the focus of all his efforts, and those of the people who work for him, is on the realization of the vision. In the process, the leader finds people to help implement the procedures and processes necessary. This requires you to believe totally in the outcome, to have faith that the small steps that are being taken have within them the seeds of the overall accomplishment.

Once you believe in the thoughts that make up your vision, you must ride out or reduce uncertainty by acting with such focus and concentration on the desired objective in such a way that your vision becomes a reality. As a leader, you are like an artist who sees a final sculpture in a plain block of wood or marble and then begins to pare away the detritus until you have revealed the artistic creation within it. In effect, outward circumstances ultimately reflect your thought processes turned inward.

This is consistent with the notion that, as Allen might put it, "He that seeketh, findeth, and to him that knocketh, it shall be opened."[2] When you seek something that does not yet exist, you will find that the door toward it is open. You are the leader by dint of your belief and your perseverance, along with your ability to instill this belief in others.

As a practical matter, leadership is about getting clear about your vision and then finding a way to implement it. You need to be unswerving and banish the demons of self-doubt from your mind.

Because belief lies in the realm of emotions, not intellect, leadership is an exercise in encouraging self-belief. This means minimizing fears so that they don't become so much a part of your consciousness that they act as hidden drivers that lead to the very outcomes that are feared, rather than to the realization of your chosen vision.

It goes without saying that you must take responsibility for what you produce. It is your vision that will ultimately generate changes in reality and bring vision to fruition. Circumstances are merely the mirror of your vision, not the explanation for the result. In the financial markets, the best leaders know that their results depend on what they do with whatever the markets provide; you cannot place responsibility on the markets for your results. Of course, the markets provide some constraint, but the effective leader accepts responsibility nonetheless.

In creating your vision, you will ultimately attract not what you want, but what you are. Your thought process starts things in motion. Eventually, that process will produce the result you are aiming for. Even the subtlest thoughts can influence the actions of others. That's why you must be interested in the smallest signs, the faintest communications you deliver to others, knowing that a real message is often embedded in a lot of what is unspoken. Just as a leader becomes a master of reading *tells* or clues as to what other people are thinking, he understands when people are also ready to listen. His nonverbal communication makes every effort to be clear about what he is communicating and how others are reading his signals.

Another way of saying this is that as a leader who recognizes that he produces the results, you take great care in what you tell people and what you set in motion. With the knowledge that others attribute great insight and ability to you, you look for ways to take advantage of the perceived power without buying into any exaggerated claims about your abilities.

By accepting the role of leader, you have accepted the trust of your associates. "Trust is the emotional glue that binds followers and leaders together," write Bennis and Nanus. "The accumulation of trust is a measure of the legitimacy of leadership. It cannot be mandated or purchased; it must be earned. Trust is the basic ingredient of all organizations, the lubrication that maintains the organization. . . . It is as mysterious and elusive a concept as leadership—and as important."[3] You have to earn that trust. In order to gain it, your vision must be clearly seen by all. People trust you when they are secure about their position in a firm and also confident in the firm's place in the financial world.

Case Study: The Creation and Growth of Visionary Leadership

The rapid success of many billion-dollar hedge funds in the twenty-first century has created a new breed of leader who has been extraordinarily successful before assuming the mantle of leadership. Hedge fund leaders often start off as successful stock pickers, analysts, or portfolio managers. Their leadership skills are often neglected or nonexistent before their assumption of a management position. This is very different from the progression in other organizations where the leader has ample time and training over many years to hone the skills of leadership. Some hedge fund managers are adjusting to this challenge with ease, but many are struggling.

For a number of years, Dennis has been one of the more successful hedge fund managers on Wall Street. In a discussion about leadership challenges, Dennis and I talked about some of the experiences that an individual must face as he moves from portfolio manager, stock picker, or analyst, to hedge fund manager or business leader.

Dennis compared being a leader of a hedge fund to being the quarterback of a football team. Just as the quarterback needs to know what everyone else on the team is doing in order to have credibility in the huddle, Dennis believes that a hedge fund manager has to know about each position on his team in order to gain respect.

As a successful leader, Dennis recognizes and admits that ultimately it is his responsibility to produce the results. While the markets provide some constraint, he must accept responsibility nonetheless. He realizes and admits that circumstances are merely the mirror of his vision, not the explanation for the result.

"You need to be introspective and understand exactly what your strengths are," he says. "Of course, in your efforts to maximize leadership potential, you also need to look for ways to take advantage of your perceived power without buying into any exaggerated claims about your abilities.

"You do have to accept the fact that there may be people that can do what you thought you were so uniquely talented to do," says Dennis. "You need to give that up from an ego perspective. . . . For somebody who is used to being fiercely independent, that's a very difficult thing. You can coach, but you can't go out there and score fifty points. You have a lot of trust in your players, one person at a time. Just give them the ball. Then turn the other way and know that they are not going to do it perfectly, maybe not even as well as if you were spending all your time on it, but well enough that you know you are doing a good job on behalf of your clients and that you are not risking everything that you have gotten to at this point."

"My own happiness is more defined by whether we reach our goals or not and less defined as to whether I am on the revenue production line or the managerial leadership production line," continued Dennis. "We cannot be afraid to fail . . . we are not perfect. We understand that."

While Dennis admits that this type of know-how comes through "some combination of art and science," he also maintains that a vital component in the realm of hedge fund leadership falls back on the leader's vision. "A good leader in the hedge fund business needs to step back and say, 'Where do we want this business to go?' "

Kiev: What would you say are the top three or four skills that you need to be the leader, differentiating that from being a portfolio manager? What would you need to get good at? Would you say it was vision? Management? People?

Dennis: They say that the quarterback of a football team needs to know how to play every position. Even though he is not going to be a lineman or a wide receiver, he needs to know exactly what everybody else is doing in order to have credibility in the huddle. Then everybody knows that he works just as hard. He is just as motivated and he knows exactly what others' jobs are.

In a hedge fund business where you are not only managing a lot of people, but you are managing people with some terrific abilities, high IQs, and not-so-small egos, the first thing that a leader needs is credibility—that they have been there, done that, and understand it. I don't think you can bring in an outsider and say, "All right, this guy was very successful in mortgage lending, so he is now going to run our hedge fund business." Whether through the force of their resume, or the force of their experience, or own internal knowledge, they need to bring a deep knowledge of exactly what it is that a hedge fund does. In order to qualify as being a leader, other people look to him.

Kiev: What are those components? Is that understanding risk taking, risk management, idea selection, or the process of change in terms of investment opportunities?

Dennis: In terms of managing the research stuff, it is some combination of art and science. You can't mechanistically go in and say you want people to follow these ten steps, or "We want information put in charts like this," or "We want to go through things in order of the cheapest evaluation level." It's not a mechanical exercise. We don't work with perfect information. In terms of the research perspective, it's understanding the numbers. Somebody has to have a strong finance background. It's also understanding how to read between the lines, to hear what's said and not said, to be able to collect and judge expectations, to see if there really is that variant perception. It's business analysis—what's a good business or a bad business? Then, you need to understand products—convertibles or cross-country relative value. It's a lot of statistical know-how. So you have to have each one of those tools in the tool belt. You don't have to be great at every aspect of the analysis. But you've got to understand it.

Kiev: You wouldn't get that knowledge if you hadn't been in a hedge fund environment.

Dennis: I think it's tough. I don't think you can take a finance professor or a salesperson and put him into the role of hedge fund leader. From a buy side versus sell side versus mutual fund, rarely do you see a mutual fund person who is able to rotate through all those different functions. So I think somebody has to come up through a generalist culture—probably multiple industries and multiple products. Somebody has to have what I would consider the hard core, the principal experience on the bigger buy side. The second thing is vision. A good leader in the hedge fund business needs to step back and say, "Where do we want this business to go?" You need to be introspective and understand exactly what your strengths are.

Kiev: How long a perspective do you need? One, three, or five years?

Dennis: Yes, I don't think you see ten years forward. I think you need to know a one-year vision and a three-to-five-year vision. I don't think you can look at a stock and say, "I am going to look out three to five years and just buy it." Nor do I think you can look at one to three months and have no concept of what's going to happen in three to five years. Both of those will have some contributing factor. We joke about slope and arc. If the stock today is here, where is it going in three to five years? Is it going to get there quickly or slowly?

Kiev: Do you formalize this?

Dennis: In our case, we set out a three-year plan formally. We set up a bunch of six-month goals in order to get it started. I think you need both. Obviously you need a shorter and longer range of planning. The vision comes multiple ways. How many people are we going to have? What's our work track going to look like? What's our reporting structure going to look like?

Kiev: Do you, as the head of the firm, generate this vision?

Dennis: In our case, a year ago it was entirely driven by the guy at the top. As we move toward being a partnership, we are now having an off-site meeting in a week and a half. We are all going to discuss this with four partners and a couple of other people here. It's still going to be driven by the guy at the top. But we are going to have the debate. An overseas office—are we ready for that? What should our third product be? How should we be thinking about a work chart where people were succeeding? How quickly should they move up the chain? How quickly should we move people to where they have few analysts? Our perspective is still going to be one person with veto power and at the end of the day a go–no go decision, but it will still be a collaborative and benevolent dictatorship.

Kiev: What about the implementations of the vision? Is that the leader's task or is that somebody else's task?

Dennis: Yes, it's my task.

Kiev: Is that management or is that leadership or part of the same thing?

Dennis: I think I am a better leader than I am a manager. I think I am better organizing the multiple things that are going on and picking out the few things that matter and saying, "This is what we have got to pay attention to. Here is where we need to go and set an agenda." I think it also needs to get implemented, managed, and we need to do triage when we move off course. For me, personally, that is a more difficult task and that is something in which you can bring in professional management from the outside. But I don't think a collection of board members can set vision. A collection of board members can review if it's being implemented if we are on track and off track. There are people talented at carrying the ball from point A to point B. Leadership is about saying, "Here is point B, here is when we are getting there, and here is what happens if we don't get there." A CEO can't be all things.

Kiev: What about the guy who is running money who has set up his own hedge fund, who is entrepreneurial, who knows he wants to take it from ten million to a hundred to five hundred, knows how to take risk, and how to read charts. Is he equipped to become the leader of a hedge fund? Or do you sometimes get a mismatch where the guy doesn't really have a vision and doesn't want to think about the vision? It sounds like it's a natural evolution from portfolio manager to a fund manager to a leader. Can it work if the guy is not a visionary?

Dennis: The higher you go, the fewer the people who are qualified to do both. It's a hard thing to find somebody who is talented enough to be a good manager of an individual portfolio who also can put together an organization with good returns on capital, and then can successfully market that, and attract people to come work with him. That's what it takes to get from the ten-million dollar business to the hundred-million dollar business or the hundred to the five hundred.

Kiev: How does personality enter into this?

Dennis: Among those who perform but can't grow businesses, they may have an acerbic personality. They may not be able to look at themselves objectively. They may drive talent away because they can't say "It's my fault" or they undercompensate everybody because they think they are a hundred and ten percent of the reason the business is good and everybody else is hanging on. So there is definitely another down select there. Beyond that, how many people are there that can also set vision and set an agenda? Every day I look at my calendar and ask, "How much of the time should I spend being CEO and how much time should I spend to be CIO?" We know that without the investment performance, all this other stuff doesn't happen. I mean investment banks deal with this all the time. They take their best production people off the production staff and they make them management.

Kiev: They don't necessarily function better as management.

Dennis: They don't. They function worse, and the person you place with them on the production side may be a poor substitute for the ones who just left. I think we need to look at it on a case-specific basis. Some people have the talent to be better at the next job than they were at the last job or are more uniquely valuable. Others don't.

Kiev: What do you have to give up personally to become a leader? What's the trade-off?

Dennis: Most of us have full-time jobs to start out. So what do you give up by becoming a leader? Two things: some of the time you were devoted to that job over time or some of the time compensation rewards, psychic income, whatever.

Kiev: So how do you ride through that?

Dennis: You have a lot of trust in your players, one person at a time. How many players I can trust? Just give them the ball. Then turn the other way and know that they are going to not be doing it perfectly. Maybe not even doing it as well as if I were spending all my time on it. But well enough that I know we are doing a good job on behalf of our clients and that we are not risking everything that we have gotten to at this point.

Kiev: How long does it take to get comfortable with any given individual? Obviously it's going to vary, but how long has it taken you to get comfortable in passing the wand?

Dennis: I don't know that I am comfortable yet. I would say it's one person at a time and to a certain extent one subject at a time. I am willing to trust Ron with different things and . . . willing to trust John with other things. I respect them both. There are certain things that I would gladly turn over to Ron blindly. I wouldn't trust either one of them doing each other's required function. Is that trust permanent or do you then end up reevaluating? I don't know. Sometimes it's a time element. How much time or confidence do you have? Sometimes, maybe that confidence erodes and circumstances change. I don't know that you ever feel that comfortable. I think just like everything else, we look at the risk of giving up that control. We look up at the rewards of giving up that control and we make our decisions as to which is more valuable.

Kiev: Have you developed skill in empowering them, influencing them, and guiding them? Have you run into the question of how do I get this guy to do what I think would be best? Where do I let go and trust him? How do I coach him? Have you run into a lot of distinctions there?

Dennis: I think I have done a very good job of accelerating good performers to be starters.

Kiev: Any keys to that? Are you trying to say not what Dennis would do but what does this guy do, given his particular array of abilities, or how can I get him to play his game better as opposed to playing my game, now that he is doing what I used to do? You get the distinction.

Dennis: Going back to sports, Mike Kennen had one system and always looked for the same kind of guys. If you weren't a Mike Kennen guy, he would trade you and look for his type of guy. Whereas Phil Jackson could coach a variety of different personalities a variety of different ways because he believed that you need to treat everybody individually. Those are kind of the two spectrums. I am probably somewhere in the middle. There is a right way to do things here, and it's proven.

Kiev: How do you describe your way?

Dennis: We look for somebody to embrace our system. We are not a coach to all people. We do coach specific skills in a specific way to do things. I think that makes sense because relative to the businesses that we are in, it works. It is proven. Our minds are open to the concept that there are more effective ways to do things, and we have adapted as we found them, but we don't find them that often. In terms of my ability to help people go from good to great, I think I help people take more risk sooner, to know what they have when they have it, to recognize the value of the insight of information or perspective or analysis that they have and to push them.

Kiev: Do you find that risk tolerance depends on how experienced a person is?

Dennis: When somebody comes in, they are so scared to make a mistake that they don't want to take on risk early in their career. As people move through their career, they are that much more willing to take on risk. We should take risk universally. So I provide a safety net and encourage the newer people to our team to take risk consistent with the portfolio and not with their own career, with the business objectives rather than with their own mental blocks. It's helping people get over the natural fear of failure, helping people to focus their time.

Kiev: What advice do you give to help someone get over the fear of failure and to take bigger risks?

Dennis: A lot of times I find that hesitation, particularly with a new analyst, but maybe we can cut right through it. In order for somebody to feel truly comfortable, they feel like they need to dot every I and cross every T and know everything. They think: "Gee, I just came here. I work for Dennis. I don't want to be embarrassed walking into his office not knowing everything." It's an acquired skill to figure out the five things that are really going to drive the situation. Yet, we realize there are a thousand things we can research until we are blue in the face. There are five things that dominate ninety-five percent of the outcomes here. So I help in identifying those.

Kiev: Tell me other ways you advise your people.

Dennis: I think I help develop the ability for somebody to take four weeks of research and make it into four days of research, so that the next time they see the situation they don't need to come to me. They can say, "Let's just take a step back and think about it." It is helpful to be able to look at things and say, "I am going to decide that's not important and I am not even going to worry about it," which is an unnatural thing. People come in here and think we have got to know everything. We don't. We have got to pick out what's important and research the heck out of that. We have got to be experts in the big value drivers and dismiss everything else. Therefore, we cannot be afraid to fail. One out of ten times, one of those things will be defined as "not important" and it's going to bite us in the butt. We have got to agree up front that's what happens, but we are going to use our research time to focus on the ninety percent outcomes. Therefore, we are not perfect. We understand that.

Kiev: How do you coach people on risk?

Dennis: Part of helping people get over the natural fear of failure is helping them to move up the risk curve and to treat risk across a portfolio rather than relative to their own career. I try to focus their time so they can put themselves in that situation. The people who are stars here learn that really early. They get it and apply it.

Kiev: You don't need to manage this?

Dennis: No, the time and tension comes in the first six to twelve months, and they are on autopilot.

Kiev: Are you making all the portfolio decisions?

Dennis: We have five people, but I am still making all the investment decisions. That will change potentially over time. That's my own path whether I am CIO or CEO. I need to make that decision as to whether we are going to move to a portfolio manager route or a multimanager route. That's the difference between my business and some other hedge fund managers' business. I believe one of them has over thirty individual portfolio managers; we have one. So, it's a limiting factor. The amount of time that I spend on the portfolio limits the amount of the time that I can build, grow, and lead the business. We are trying to rock back and forth responsibly.

Kiev: Which processes do you enjoy the most? How do you like to spend your time?

Dennis: You are the fourth person in the last four weeks to ask me that question. It's funny. This probably says something sad about me, but I never even asked myself that question until somebody asked me that first. The answer is, I enjoy winning and I will enjoy a good business as successful.

Kiev: Do you have days where at the end of the day you say, "Today really worked"? Do you go back and review what happened that day to get a handle on what makes a [good] day?

Dennis: My best days are the days where I spend a lot of time with our good performers on investment situations and help them take something that they were unclear on and collectively we end up with a clear view. That's a better day than whether our P and L is up or down. It's a better day than whether I have dealt and certainly a better day than when I have dealt with the problem in play.

Kiev: How would you describe your worst days?

Dennis: My worst days are when I spend a lot of time with people who I think should have gotten it on the first or second try. Or where I spend time with investors. Not that I don't love my investors. It doesn't help me achieve my vision. It only helps me protect against my downside. I like to do one thing at a time until it's completed and then I want to go to the next thing. There are occasions where I will have three investor meetings, and two company conference calls, and I have to deal with some internal operations issues. Then my day is literally in forty-five minute day-parts in a variety of scattered subjects, where I feel at the end of the day I didn't give even one of them my full preparation efforts.

Kiev: Do you need to have results each day, on some level? Some sense of completion?

Dennis: I could work on something for fourteen days. I definitely need to have a result at the end of every task to feel good about it. The result can be P and L generated; it can be asset management; it can be people. I enjoy interviewing. I really get a rush out of when we hire because I know that we have found a good person. Those are enjoyable times.

Kiev: What do you have to improve within your own leadership style?

Dennis: I still need to narrow the amount of things that I am responsible for, so I don't have to have the smorgasbord during the day. I am going to narrow it down to one. I still think I am going to straddle the fence between leader and portfolio manager. I do think that I can significantly reduce the amount of things that I am responsible for. By doing that, I am going to be both happy and more effective.

Kiev: Is it an either-or situation?

Dennis: Rather than looking at it from two sides of the fence, I want to try to stack up the responsibilities and cut off the bottom. The bottom line is: Am I uniquely qualified to do it? Is there a really big payoff to having me do that? Do I get any kind of enjoyment, thrill, or satisfaction out of that?

This dialogue represents one of the most honest expositions I have heard about the leadership challenge in hedge funds in particular, the learning curve that the individual must climb as he moves from portfolio manager to hedge fund manager to business leader. These are not easy tasks and they require a constant review and examination of what is necessary to produce the results Dennis seeks. This dialogue demonstrates how many elements must be considered to evolve into a leader, including what he has to give up to become a successful leader. In this, he taps into the emotional issues that every great leader must master. To me, Dennis is extremely insightful and represents the new breed of hedge fund leader who is learning how to elevate his game to a new level.

By expanding on these issues, I hope to help you address the deeper layers of your feelings, the unspoken conflicts, and the sources of tension that exist in your organization.

To become a successful leader, you need to learn how to:

- Be transparent and to tell the truth
- Listen well and speak clearly
- Encourage others to buy in to your strategy

- Choose the right people for the right jobs on your staff
- Uncover and unleash your team members' strengths
- Be tough with those who don't accept your ideas
- Crank up the energy level in your organization
- Build and sustain momentum
- Learn and implement strategies that avoid both burnout and euphoria.

The primary key, of course, is to know yourself, and to have an understanding of some of the psychological forces pulling you and others in opposite directions. By doing this, you will discover how to make sure that when you are no longer in charge you have left a legacy that will keep your organization advancing forward.

FOCUSING ON YOUR VISION

As a great leader, you should be a visionary who single-mindedly ensures that the focus of all your efforts, as well as the efforts of the people who work for you, is on the realization of the vision. This requires you to believe totally in the outcome, that you have faith that the small steps that are being taken have within them the seeds of the overall accomplishment. This requires intense focus.

Focus on your vision to such extent that you begin to gain mastery over your emotions, curbing and eliminating any negative thoughts that seep into your mind. Once you believe in the thoughts that make up your vision, you must ride out or reduce uncertainty by acting with such concentration on the desired objective that your vision becomes a reality. You should be like an artist who sees a final sculpture in a plain block of wood or marble and then begins to pare away the detritus until you have revealed the artistic creation within it.

When you begin to function in the world in terms of your vision, creating the pathway all along the way, you will become more comfortable in your belief system and clearer about the possibilities that surround you. One of the best ways to create and stay focused on your vision is to practice some form of meditation and visualization. It doesn't matter what technique you use as long as you spend some time visualizing the future in your mind's eye in a relaxed and centered state. This can help you to generate the motivation and focus you will need to realize your objectives.

For example, one portfolio manager has incorporated his ski-racing visual imagery techniques into his daily preparation for the markets. As a ski racer, he reviews the perfect run in his mind over and over again before each race until he has eliminated any residue of fear or self-doubt. Similarly, he recreates the mindset of winning by reviewing some of his most successful past trades every business morning. In this positive and confident state of mind, he begins outlining his plans for the day ahead and preparing solutions for a variety of hypothetical contingencies so that he is better equipped to make smart trades and flexible choices as events unfold. The more he practices, the more confident he becomes before and during the trading day when unexpected events occur.

I am a proponent of the same sort of relaxation techniques for anyone about to embark on a difficult, competitive situation—and managing a portfolio or a hedge fund certainly comes under that heading. You can easily practice one good technique—deep muscle relaxation. It is useful for putting yourself into the best frame of mind for defining and sharing your vision.

At your desk or at home before leaving for work in the morning, simply follow these steps:

- Close your eyes and take a deep breath.
- Beginning at your toes, tense each set of muscles.
- After tensing each set of muscles, relax them, until your whole body is relaxed.
- Visualize yourself in a comfortable place, by a mountain stream, on the beach, and so forth.
- Now begin to visualize one of your best leadership moments. It could be from a meeting you had yesterday or from a time way back in high school when you were in a leadership position.
- In this restful, calm state, imagine how you will share your vision with your team. What is the best you can expect from them?
- Now, visualize what you can do if you don't see the commitment you are hoping for. Review various scenarios and how you are going to handle them.

This technique might be new to you. But I'm suggesting that it is relevant to your work and is one of the most powerful uses of visual imagery. When you visualize a future event, what you believe begins to start happening. You will find that once you've prepared yourself in your mind, you can follow your own script with confidence. It's incredible how your mind can prepare you to do things that once seemed out of reach.

Through focus and visualization you can minimize your fears so they don't become a part of your consciousness and act as hidden drivers toward the very events or outcomes that *are* feared.

MAXIMIZING YOUR STRENGTHS

Producing results requires a fair amount of self-sacrifice, and since there are no shortcuts to the creation and implementation of a vision, it makes sense to go with your strengths and to focus on what it is that you are naturally inclined to do. Work toward expressing talents and hidden potential that you know are already inside you. In doing this, you will increase the odds of meeting uncommon success sometime in the future.

Daniel Vasella, the chairman and CEO of Novartis, is an example of a leader who is maximizing his strengths and following his thoughts along a natural path. Interestingly enough, while he prefers to be known as a businessman, not a doctor, he is also a psychoanalyst. He acknowledges that "what is in one's history affects how one acts and thinks." Thus, he says, "It's very important to me to be aware of all of my feelings" when making decisions. He also uses his background in psychiatry to help him make judgments on events as important as acquiring other companies.

Vasella employs the listening skills he learned as a psychoanalyst when he interviews prospective new hires. "I ask myself, 'Am I interested, relaxed, tense, or bored, and what is this candidate doing to make me feel one way or the other? Do I feel nervous, for instance, because he is jumping from one detail to the next, or bored because he isn't saying the true story?' "[4]

Psychoanalysis, he told a *Wall Street Journal* reporter, "gave me freedom to behave as I am, rather than how I [or others] think I ought to."

If you are not sure what your greatest strengths are, spend some time writing down what you think *might* be your strengths. Then ask a friend, confidant, or an executive coach to help you review the list, and expand on it, if possible. You may not be totally comfortable with the result, but the task increases your self-awareness. It tells you what aspects of your personality stand out and how you can get the most mileage out of yourself.

DEMONSTRATING AUTHENTICITY THROUGH WEAKNESS

Of course, it is not only important to recognize your strengths. As a leader, it is also important to understand your weaknesses.

David Pottruck, the former chief executive of Charles Schwab, was in charge of the financial services company during the difficult bear market of 2001. *Business Week* reported that with the help of an executive coach, he "crafted a leadership style that centers on what he calls authenticity; that means he constantly communicated with employees about the company's wrenching restructuring and layoffs. He also tried to get across what he was like as a person, what he valued (spotless ethics, emotional maturity), and his vision for Schwab as the anti–Wall Street brokerage. And rather than avoid the animosities, communication breakdowns, and jealous flare-ups on his team—as well as his own defects—he confronted them."[5]

You undoubtedly don't like to reveal weaknesses; no one does. But in doing so, you, like David Pottruck, can gain the power of the weakness and become more authentic in the eyes of those you lead. By being authentic and transparent, you tap into your emotional center. Once you dispense with cover-ups (such as pretending to be strong or unemotional or hard-nosed when you are not), you approach people and interact with them from your center. That openness will resonate with others, who will then become encouraged to do away with their own cover-ups and relate to you in a more authentic way.

Another way of saying this is that you permit others to see through you, to witness the fact that you are vulnerable and willing to share. Your transparency helps them identify with your struggles as well as your vision.

SHARING YOUR VISION

Think about this: What if John F. Kennedy, instead of declaring that the United States *would* put a man on the moon by the end of the 1960s, had said instead, "We will put a spaceship in orbit and get halfway to the moon"? Or what if Winston Churchill had said, "We will fight them on *most* of the land, *some* of the seas and *only* on Tuesdays in the air, and for *the next fifty years* people will say this was our finest hour"? Or what if Martin Luther King had promised "to do our best to try to overcome" instead of "We shall overcome"?

The results wouldn't have been the same, because words do make a difference. Without the persuasiveness and determination inherent in their powerful dialogues, the visions of these men would have remained unleashed, and the outcomes could have been very different.

Just like these great orators, how you communicate your vision is vital to its success. Your vision is a powerful, emotionally driven image that provides the essence of what you want to accomplish in the future and around which you can harness all of your energy and activity. It is your unique view, something you wish to create, a worthy purpose on which you can focus your heart and soul and energies. But whether or not your vision becomes a success depends in large part not only what you believe about it, but how well you communicate that belief to others.

While few of us are blessed with the emotive power of JFK, Churchill, or Martin Luther King Jr., and not every leader is charismatic or flamboyant, every leader can develop the same kind of fervor that characterized their successes. Your natural style might be low key, less emotion-laden, and more prosaic than those masterful public figures, but creative, effective leaders come in a variety of flavors. While we tend to hear a lot more in the business and popular press about visionaries and charismatic stars in the mold of Steve Jobs, excellent and daring leaders exist whose pictures never adorn the covers of business magazines. What matters is how you choose to share your vision and with whom.

Fred, a divisional manager at a major hedge fund in Chicago, underscored the impact of a powerful vision when he discussed George Lucas's dream of the Star Wars movies. During the making of the original Star Wars, a trying production required actors to participate in scenes that would later be computer enhanced (a very new concept at the time). The film was over budget, and at one point Fox wanted to shut the whole thing down, but Lucas remained undeterred. He maintained the excitement of his vision and motivated his team to the finish. In the end, it was his determination and enthusiasm that kept the seemingly impossible project on course and allowed the staff and crew to eventually say, "Oh, that's what he was talking about!"

While good leaders come in a variety of shapes and sizes, they all have one thing in common. They know how to develop a vision, share their vision, and do whatever is necessary to implement their vision. Whether you are an extrovert or an introvert, limelight-seeking or publicity-shy, an entrepreneur or an organizer, you can share your vision and motivate your team toward success.

"I think it's essential that people feel that they are part of something big, that they understand how what they do fits into [the big picture]," said Fred. "By letting everybody understand that they are not in competition with everyone else, they are more excited and more supportive of it. I want them to feel that they are contributing to something great. The number one thing that I try to do (and this is the hardest thing because it's the most time-consuming) is to be really aware of the individuals that you are dealing with. I try to really get a sense of who each person is—what their goals are, what they're trying to achieve, where they have been in their career, how ambitious are they—and be in touch with that."

Fred understands vision as a motivating force, and he uses it to align everyone with goals that are flowing in the same direction. In particular, he emphasizes how important it is to encourage autonomy in the context of a framework or lens with which people can overcome stress and adversity and bring more of their resources into play in the present moment without being distracted by emotional reactions and misinterpretations of events.

Once you envision what you want your firm or your team to accomplish, you need to define your vision in the most powerful way possible. This means communicating it to the most appropriate people, and doing so in an emotional rather than cerebral manner. Did you hear that? I said "emotional rather than cerebral." The inevitable pockets of resistance won't respond viscerally to half-hearted or poorly communicated statements of vision. But when you generate emotions, then your people will get involved on a gut level.

Although the easiest way to begin sharing your vision is to prepare a one-page summary of the results you expect and the strategy you have formulated, don't assume that vision-building is a reasoned, linear process, and that all it takes is an outline of the steps. Your vision should be moving and emotionally engaging, something original, something that taps into deep wellsprings of feelings, something that makes people feel as if they are creating a historical moment. There should be passion here. Strategies should be bold and commensurate with the power of the vision.

Rationale and logic do not fire people up. You must draw them in. You have to meet the participants, find what they want, and encourage them to offer you suggestions on how they wish to participate. Then, you need to reinforce the commitment of others by following up often to evaluate their progress.

Merely scheduling an introductory meeting with your deputies soon after you take over a leadership post and talking off the cuff is not the best plan. Put thought into how you present your vision. Put effort into it. Present it with enthusiasm and vigor. Be ready to sell your vision in order to make it a success.

TIMING IS EVERYTHING

Until you are ready to share your vision with the organization as a whole, you should share it only with someone whom you deem particularly skilled at helping you get more in touch with your own innermost dreams and wishes—perhaps a trusted mentor, friend, confidant, or a brain trust. While you may wish to get feedback during the initial construction of your vision, this must be done with a dose of caution and circumspection. The opinions of some of your friends and colleagues may distract you or lead you to a reliance on the justification and support of others instead of on your own instincts and ability. In effect, while others can be of some assistance, only certain people are skilled enough and experienced enough in working with you to help you in this way without interfering with your own creativity. If your vision is not related to the team as a whole, don't share it with everyone. Share it with those who are in a need-to-know position or who are going to be directly beneficial to its implementation.

As the leader, you should make it a policy to seek out people who support you, but are not yes men, people who can help you find your voice and refine your vision. Know yourself. Know the kind of input you need. Know when to invite differing opinions and when to keep out those who might undermine you.

For example, a while back I had a conversation with a leader in the sports world who was having difficulty deciding with whom he needed to share his vision. He was struggling with a decision about a player who did not fit into his larger concept for improving the team. His instinct was to trade or buy out the player, but when he asked the opinion of his peers, they told him that he would look cutthroat and would cost his team a great deal of money.

My suggestion was that his vision for restructuring the team with an emphasis on youth and athletic excellence was more important than any one player. This said, I advised that he not ask the opinions of very many people in regard to this type of issue, but to keep his general strategy to himself. I advised him to play his cards close to his chest and to share his plans with only a few select advisers. While it was important for him to listen to alternative ideas, he didn't need to generate so much conflict that it might discourage him from acting on his plan.

So, when *is* the right time to share your vision with the team as a whole? Perhaps the best time is an urgent time. A crisis—a failed P and L, lost opportunities, mistakes—can create the ideal time to shift direction and set new goals. I am not suggesting that you manufacture a crisis where none exists, but chances are you will foster a useful crisis mode by requiring commentary on what's been happening in the firm, by asking for feedback, by setting deadlines for replies, and by making decisive personnel changes—such as letting poor performers go or transferring people to slots in which they can perform better.

Review what is needed and what can be done to correct the mistakes. What are the specifics? What are the meta-concepts? What are the structural issues? Use the new-found awareness stimulated by these inquiries and steps to increase involvement in all critical processes. Then develop and implement new steps and new strategies in line with the new perspective. A sense of urgency provides much-needed momentum to overcome.

PREPARING FOR RESISTANCE

When Einstein articulated his theory of relativity, which radically changed the world's frame of reference, he met with resistance from the scientific world. The same thing happened to Copernicus in the sixteenth century when he proposed that (contrary to what the Roman Catholic Church at the time wanted everyone to believe) the sun, not the earth, was the center of the universe.

A vision is a blueprint for change, but it is also a source of motivation and a commitment to bring about what may seem impossible. Of course, this very new and different view of the world may prove unsettling for some, especially when it is first expressed. Most visions are at odds with the status quo, and as such may invite resistance from some quarters.

Therefore, it is wise to be prepared. When you share a new vision (whether it be announcing a specific change, new efforts to grow your organization, or your desire to make larger capital commitments), you are issuing a challenge to how things have been done before. While many will get excited about the prospects of change and challenge, others may react negatively.

Of course, disagreement is not always a bad thing. Dissenting opinions give you a chance to think through alternatives, and your associates don't necessarily have to agree with you on every aspect of your vision. However, conflicting ideas should be presented in a helpful, empowering way, and everyone on the team should have an entrepreneurial yearning to improve and grow.

The truth is that in order to achieve your vision, to make it real, you will need help. Even the Lone Ranger had Tonto. Don't expect to do this alone. You will need people around you who are willing to support your genius and originality. You need a team that will help you implement your vision and support you when the going gets rough.

Since some amount of resistance is to be expected, you should make every effort to present a compelling argument when you announce your vision. Your initial performance when sharing your vision can make converts of fence-sitters, dissolve resistance, and hopefully get everyone to align their own personal vision with the one you have created for the organization—if you communicate effectively and creatively.

IMPLEMENTING YOUR VISION

As the leader, you not only need to be able to envision your organization's future, you must also strategize the means for getting there. Rather than just aim at short-term goals, a vision gives your team an overarching target, a *raison d'etre* for committing themselves to working harder than they might have otherwise. A vision enables you to energize your employees by providing them with a clear direction and sense of purpose. When you offer them a vision, you are offering them an inspirational picture of their future within the firm.

If you have recently taken charge and are changing or adding to some of the values embedded in your firm's culture, it is important to keep underscoring your new values. For instance, you may want to instill sharing, cooperation, and teamwork in an environment that is entrepreneurial and competitive. Recognize and counteract the people in your organization who are resisting those values by encouraging communication and by making efforts to change yourself—letting go of old paradigmatic models in favor of new ones more relevant to the open learning organization.

Once you address these questions, you can map out all kinds of scenarios.

A few years ago, I had a discussion with Bob, a hedge fund manager. At the time of our discussion, Bob had recently completed an orienteering competition in Europe where he walked across the rural countryside for six days. It was a kind of a personal "Amazing Race," except it was not filmed as a network TV program, and there was no million-dollar prize for the top finishers. Our discussion addressed how orienteering affected his thinking about perseverance, plotting a course, and achieving a goal.

"I kept telling myself, 'I don't care what it takes; I am crawling to the end,' " he said. "The rules were I couldn't take any form other than my feet for those six days. I had to make it in those six days. I mapped out my course and milestones for the first few days by way of keeping myself on target."

As Bob and I discussed his efforts to complete two to three miles per hour over difficult terrain, we began to think about the similarities between his orienteering challenge and the challenges of leadership. Both required the origination of an idea, the development of the idea into a concrete plan and then the implementation of concerted effort so that the ultimate goal can be accomplished.

Like Bob, all leaders will eventually get to the point of fatigue and want to give up, but the great leader continues to put one foot in front of the other, checks his map, and keeps on hiking. Of course, great leaders also raise the stakes over time, going farther distances, working at a faster pace, covering more difficult or foreign territory. It's a way of testing and expanding your mettle.

Bob was inspired by the concept of an orienteering race precisely because it allowed him to plot his own course, a style of play that is compatible with his personality and reflects his mindset in managing his fund. As we continued talking, it became clear that as a fund manager, he takes delight in his contrarian trading style and plots his actions on stocks independently of what other "great" managers do with the same stock. He is ready to "take the pain" because he has his own unshakable vision.

To be a leader you too have to be comfortable with ideas that are outside the consensus. You have to be willing to be a contrarian. That's the variant perception—you know something or see something that the rest of the world doesn't. As the world begins to accept it, the trades start to take place. It may be uncomfortable at times because you are really embracing a new view about the world, which is different from rest of the world. But true leadership involves the development and implementation of an original vision that is unique from that of the pack.

A natural leader like Bob thinks continually about his objectives and gradually finds ways of achieving these objectives. Soon they become the natural manifestation of his thought process. He is naturally inclined to think this way and finds that the vision enables him to stay focused and to bypass fears and self-doubts. With a purpose, failures and errors along the way only serve as lessons for further self-examination and inquiry into what is needed and wanted.

The strength of the effort is the measure of the result. If you keep your eye on your efforts, the results will take care of themselves. You only need to stay focused on the vision. This sometimes requires a continual effort to overcome anxiety and naysayers, and it all begins with a vision that you have invented.

Before British runner Roger Bannister broke the four-minute mile in 1954, four minutes had been considered an absolute limit. It was believed that if you tried to exceed that, your body would break apart; that you would die. But Bannister proved that that wasn't so. He changed the paradigm. In the next 20 years, more than 250 runners ran sub-four-minute miles.

Promising the result publicly does the same thing—it changes what you believe is possible. You start asking yourself, "What's the paradigm I have in mind about what's possible?" Once you make a commitment and set a target, you've got to change your methods so you have a strategy in place designed to produce that higher level of gold-medal performance.

You will have to ask yourself tough questions. What beliefs do you hold about limitations? Can you see how much those limiting beliefs color the way you approach your trading, your management, or your leadership? If the equivalent of a sub-four-minute mile is your goal, how do you train, day in and day out, to achieve it?

Whenever I meet with a group of traders at a hedge fund, I go around the room asking, "How much will you make this year?"

Typically, I hear:

"Well, I don't know. How can I tell?" or

"It's up to the market," or

"I'm going to do as well as I can."

I make it clear that I am looking for actual numbers, not wishy-washy "I don't knows."

As I keep going around the room, I usually encounter tremendous resistance to the idea of setting a target. But finally someone—often the fund manager himself—will say something like, "I'm going to make $40 million."

There is often a murmur, "Forty million dollars? We're only running thirty-five million!" But by the end of the year, more often than not, that fund manager who has committed himself to a number will reach his goal.

Each time I meet with members of a firm and ask such questions, I get a little more cooperation. In the 15 years I have consulted at various funds, it gradually has become part of the culture at many of them.

There's no question but that people set outsized targets. When somebody has made *only* $3 million last year, and then says he's going to make $20 million, this year you have to question whether that is achievable or simply too big a leap. Nevertheless, if somebody made $20 million last year, maybe he can make $30 million this year. The question then is, what must you do to reach $30 million? Do you need another analyst? Two analysts? Do you need to do more work? Should you go out to dinner more or do more studying? Whatever it is that's essential to produce that result, that's what you have to do. It's reverse engineering: You set the target first and then work backward to devise a strategy that will get you to that target.

A phrase you hear often in the business world is "under-promise and over-deliver." I don't like it; it is the mantra of cautious managers who are playing to their boards of directors. Those who recite this mantra believe that if they over-deliver, they will look like heroes. I don't think they are. I think they are making a half-baked commitment to a goal. To promise less and deliver more is playing it safe, but it is not the inspirational leadership of someone out to win a gold medal or a Super Bowl ring.

When you promise a result publicly, you have made the first powerful, concrete stride toward turning your vision into a reality. In dedicating yourself to focusing on the vision, sharing your vision, and promising a result publicly, you are laying the groundwork for the mission ahead. You are in essence defining the value of your vision and getting ready for the next step—assembling a staff that can effectively carry out the work that is necessary to reach what may be a seemingly impossible goal. Nurture your vision; make it central to your thoughts every day; be openhearted and speak about it with those you trust. Then your carefully crafted, positive attitude will carry you and those around you to previously unimaginable and much greater heights.

CHAPTER 3

Assembling Your Team

Lance Armstrong is an incredibly determined and disciplined athlete who accumulated a record-breaking seven Tour de France victories after surviving testicular and brain cancer. However, as close followers of the sport of cycling know, Armstrong himself won only a handful of the one-day stages that make up the 23-day annual event. On the other days, Armstrong cared less about being first than about remaining patient, safe, and in contention. The strategy devised by his team's manager was to keep Armstrong, surrounded by his team members, within the middle of the peloton (or main pack of riders). This approach enabled him to conserve energy by drafting off other riders and to avoid the frequent crashes that occur when a single rider accidentally gets knocked off his bike.

"It takes eight . . . riders to get me to the finish line in one piece, let alone in first place," he wrote in one of his books, *Every Second Counts.* "Cycling is far more of a team sport than spectators realize. . . . When I wear the yellow jersey, I figure I only deserve the zipper. The rest of it . . . belongs to the guys."[1]

So how does Armstrong create the right team? First of all, he looks for riders who can play different roles as climbers, sprinters, and so on. Next, he looks for riders who are willing to commit to the team effort. These may not even be the best riders, since, as Armstrong notes: "Over the years, other riders have come and gone simply because they were so good that they were lured away to lead their own teams."[2]

What matters most to Armstrong is how much a prospect is willing to sacrifice to help the overall effort. "We called it 'Dead Man's Rules.' If you violated the ethic, broke the rules, crossed the line, you were off the team. . . . It was all-team or all-nothing. If a guy wasn't thinking this way, then we didn't want him, not even if he was one of the best riders in the world, because it wasn't a good fit for us."[3]

Armstrong's principles are very applicable to hedge fund leaders. Why? Because once you have accepted the responsibility of leadership, your very next step is to build a team of people who can make a difference, recognizing that superstars may not always be relevant to the process and may even be obstacles to progress. The group must include competent individuals who are team-oriented and willing to be guided by the larger purposes of the organization. The members of your team must be accountable to you and to one another and be able to work successfully within the framework of your objectives.

CONSIDERING RECRUITMENT

There are a variety of obstacles in recruiting. First is the limited pool of applicants; new hires often want to recruit people they already know, but may not want to poach from their old firms. Even when recruiting acquaintances, the manager of a new shop doesn't always know what the right slots are for these former colleagues. You cannot offer these recruits the same kind of guarantees they might expect at an established firm. You may not have enough expertise in human resources, preferring to spend most of your time on stock-picking rather than hiring. And the new team must learn how to operate in a collaborative environment. All these elements must be considered in the recruitment phase.

If you are extremely lucky, you may already have the people you need within your current firm. But often, when people are successful and have accumulated sufficient personal wealth and success, they are attracted to the extraordinary opportunities to raise capital that exist in the marketplace, and they may choose to leave to start their own firms. It then becomes time to replenish staff or add staff to develop new initiatives. In addition, numerous funds have a high-intensity atmosphere that can lead to a lot of turnover and a constant need for fresh recruits. Building a team thus creates recruiting challenges.

Case Study in Recruiting

In the following conversation, an experienced hedge fund manager talks about how he began his first firm and what he learned from that experience. He starts by comparing his initial efforts to starting a garage band.

Leroy: You know what instrument you play, and what other instruments you need to make the band. You hire people that you already know from up the block, and they come over and play music with you. Every hedge fund turns out to be a garage band. I didn't want to go out and take half my former firm's team. I wanted to leave in a respectful way. That hurts you because half the neighborhood of friends that you want to invite to your firm already belong to somebody else. So you are hiring from a limited pool of people who actually want to make a change in their lives, over that four-month window. It's a pretty narrow set. You are trying to kick an arena football through a field goal.

Kiev: Unless they want to change and stop doing what they've been doing.

Leroy: Exactly.

Kiev: Which they may not be good at.

Leroy: So we have a "best-available-athlete" mentality, but the word *available* took on a more significant meaning when we first started hiring than it does today. Now we hire at our leisure based upon our needs over time, because we can plan, and we are becoming an organization. I have a business plan. I go out and raise a bunch of money and I know what we need. However, in this case, I didn't take a team with me.

Kiev: So what happened?

Leroy: I have got to go out and build a team and recruit, train, and integrate. I had to raise two hundred and fifty million dollars, get through the legal documents and make sure that we have a facility that has both forms and functions. We had experts at almost every level—technology, marketing, finance, and portfolio management. But there wasn't one expert that helped us on HR strategy. If someone told me the biggest challenge that you are going to have as a hedge fund manger is human resources, I would have laughed him or her off the roof.

Kiev: Human Resources for recruiting?

Leroy: Yes. You need to really know what you are looking for and what type of person you want to hire. You need to be able to screen for that.

Kiev: Did you know what you wanted at that point?

Leroy: I thought I did, but I know a lot better now than I did three and a half years ago.

Kiev: Do you think five years from now you will know more than you know now?

Leroy: I hope so. It's an absolutely continuous process. We were hiring for a combination of skills that I thought were important back then. On the analytical side, number one, I want somebody that works very hard. I think work ethic is a big differentiator—high I.Q. and a desire to be a generalist. We only had four analysts, so you need to cover a lot of different territories. So if somebody came in and said, "I am a hard worker and I am smart and I only want to do financials," we said no to that person. We can't only do four sectors. We have to do all of them.

Kiev: What other recruiting issues did you face?

Leroy: There was a further constraint. As a startup we could only sell them on the opportunity of being a part of our mission. But we couldn't promise them big guarantees. At the time we hired the people, we didn't know whether we would have a hundred or two hundred and fifty million to manage. So you are talking about a million to two million dollars of management fees. You are not out making a half-a-million-dollar guarantee trying to compete with people from the larger, more established firms.

Kiev: Were there other constraints?

Leroy: Morally, I would only hire somebody that I knew would be getting a good deal or a great deal. There was something about my own sense of personal responsibility. One guy we talked to—his wife was expecting twins, and he had made a million dollars as an investment banker. He would have been a good fit for everything else but I couldn't do it. Emotionally, I couldn't have that baggage. My first concern was to get him to a million dollars so he was going sideways before I worried about myself, my family, my business, making investments. It was just the wrong fit. So all those things needed to come together and we hired who we could.

Kiev: What happened next?

Leroy: Then as we built the team, the success built the assets, and this track record and assets built the firm's reputation and the capacity to raise more assets—a virtuous circle. We were so busy building a track record that we would be responsive to reverse inquiries. Somebody would call me up—someone that I have known from the past—and say, "Hey, I have been in private equity for eight years; now I want to be in the hedge fund business. I would love to come talk to you. I hear you guys are doing great." Or, "I don't like my current job. I want to join you guys." So we were not actively recruiting, but we needed people. But there weren't enough hours in the day. I am trying to put together a portfolio. We only have four analysts. The first second quarter of 2001 was an interesting market environment, in fact '01 and '03 all have been interesting markets. So trying to build resources from a resource-constrained standpoint is really hard.

Kiev: What would you have done differently?

Leroy: If you would have asked me in 2001 to prioritize I would have said, "Portfolio, portfolio." Training the team that we have today, recruiting and attracting new people. Nowhere would I have ever said, "And by the way, define for yourself what it is that you are really looking for. Put on paper what makes a good analyst." Try to design a way to screen for that before you actually hire them, so that you don't make a recruiting mistake. With hindsight, the hiring decision is ten times as important as any stock decision that I make. Yet I was spending one tenth of the amount of time on hiring decisions that I was on any individual stock investment. In other words, I was not spending enough time on hiring decisions.

Kiev: You were looking at their stock-picking ability or their track record?

Leroy: Not track record, because the other thing that was important was that this firm is going to be managed by me. I was going to be the only portfolio manager and in fact, I still am. So you had to find somebody who was talented, but didn't need to be the big shot. They were comfortable working in the same environment. They are willing to be an analyst in a collaborative environment. If somebody had a great track record as an analyst and he or she is looking to monetize it, they can go to one of the larger funds and they will get a good deal. If they were ready for that, there were a lot of places to go. So just like there are value buyers of stocks, we were value buyers of analysts.

Kiev: Can you explain that a bit more?

Leroy: We were trying to look through people's resumes and find perfectly talented people who had imperfect backgrounds, so that the price-value equation made sense to us. So one person that we hired that is still with us today was doing long and short equity in Europe and wanted to move back to the United States and the compensation philosophy was more European than U.S., so it was easier for us to compete.

Another person I hired was an assistant on the junior sell side, an analyst doing one industry. He wanted to be multi-industry; he wanted to be buy side. He didn't make that much money on the sell side. I hired my wife's cousin out of college. The fourth person was somebody who had gotten fired from a well-known firm and then he joined us.

Kiev: You weren't necessarily picking the best people for your long-term needs. You picked the best available people given your economics.

Leroy: Part of the answer is, with limited resources you are going to do the best you can, and you're not going to do the best there is. We accept that and that's part of the startup. In addition, what we failed to do is spend the right amount of time digging, so I spent four weeks searching for capital on a road show, meeting with investors, trying to get the capital to start the business. I did not spend four straight weeks searching for the human capital. It would have been a better idea to do that as well.

Kiev: What was the end result?

Leroy: Well, massive turnover and poor performance. Then we hired a junior analyst, and at the end of April, someone who now has his own hedge fund. I knew at the time I didn't have time to build a team, so I said, "You come join me, and you can morph into the number two role here. You will help, train, and develop analysts. I am resource-constrained. I don't have enough time to do this myself. Be a revenue producer, and then come help train and develop the people. Then, you will morph into the number two role over time." Horrible mistake.

Kiev: In what way?

Leroy: He didn't have the skill set. I have known him from idea dinners where he sounded knowledgeable. I never even put him through a formal interview process. I assumed success. I am an optimistic person. I tend to presume that everybody has got a good Midwest work ethic and looks out for everybody else. So I assume that naturally people are more impressive than they actually are. Management teams fool me sometimes and other investors fool me sometimes. I so wanted to believe that he could fulfill that role that I am not sure I ever even tested for it.

Kiev: How long did he stay?

Leroy: Fourteen months. The emperor had no clothes. It was a massive organizational distraction; people wouldn't work for him because he was abusive. I never interviewed anybody that worked for him. Had I, I would have known that. He didn't command the respect of the organization because he wasn't very good at what he did. He wasn't detail oriented, and in a street basketball game you have got to know your game or you're not going to get any credibility. I don't care how fancy the jersey is, or how fancy the brand name, it's how you play on the field that commands your respect, period. He came into what was a very hungry work environment

> with people who were very, very motivated, and very, very bright and he came in with an inadequate skill set. So A, the organization didn't respect him. B, he turned that around by treating employees with less-than-perfect respect. We had organizational chaos.

The above description of this fund manager's unsystematic approach to building his team is fairly reflective of what one commonly encounters in the hedge fund industry. *Too many new fund managers spend a huge amount of time raising money, doing research, and picking stocks, but not enough time picking and researching analysts or traders.* In retrospect, Leroy realized that assembling the best team possible, with people who complement one another, is as vital a part of a start-up as lining up investors. You need to interview as many people as possible, discern their reasons for wanting to join your firm, and carefully review the nuances of their past performance, their attitude, and likely fit with your organization. This often requires considerable due diligence. Ideally you want to find people who have the requisite skill sets from the start, since rarely is there enough time available to teach those skills.

Leroy's firm probably had a better grasp of what was needed than many up-and-starting firms. He was looking for someone with a combination of skills, but most importantly a new hire had to be able to cover different territory. In addition, because it was a new start-up, he was looking for "perfectly talented people who had imperfect backgrounds, so that the price-value equation made sense to us."

He hired one person who had been doing long and short equity in Europe and wanted to move back to the United States. Because the compensation philosophy was more European than American, it was easier for his firm to compete. Another person Leroy hired was an assistant on the junior sell side, an analyst doing one industry, but he wanted to be multi-industry on the buy side. He also hired his wife's cousin right out of college and an employee who had recently been fired from another firm.

"With no disrespect to any individual there," he said, "It was a more rag-tag team than anything else . . . (but) as we built the team, the success built the assets, and this track record and assets built the firm's reputation and the capacity to raise more assets—a virtuous circle."

Case Study on Recruiting an Effective Team

Leroy's experience is unfortunately not unique. Too many new fund managers spend a huge amount of time raising money, doing research, and picking stocks, but not enough time picking and researching analysts or traders. But assembling the best team possible, with people who complement one another, is as vital a part of a start-up as lining up investors. In this dialogue, a top hedge fund manager named Jonathan and his senior analyst, George, talk about how they created a culture of teamwork by consciously recruiting for values and character as well as skill.

Jonathan: I am interested in finding people who are team oriented, who are willing to work to maximize profit by working together rather than working independently or competitively with others.

George: Jonathan told me five years ago when I joined the firm that investment returns were important, but that equally important was whether or not a person adds to the culture of the firm. What's critical is to have a lifestyle and an environment that is positive.

Kiev: I had lunch recently with a top sports executive who told me that his key to picking people is to tell them what he wants and only hire people who are willing to commit to his particular work and behavior ethic. He is really big about guys working, not partying late into the night, not missing practice. He wants people who are really willing to commit to being on the team. He also supports the notion of the team self-policing itself and leaves a lot of things up to the players to maintain team morale. It sounds like you are encouraging people to take the lead in these activities as well. Do you believe that individuals do better when they know the direction, but are left to their own devices to make things happen?

George: There is no adversarial system here. If there is a hole in your thesis or your work, Jonathan will mention it. But the fact is that no one is watching over your shoulder, as opposed to some other firms that were successful in the past, which would pit people against each other and tear apart each other's ideas. You would be challenged in these other firms. You are never challenged here. We have people who are self-motivated. We have people who probably put too much pressure on themselves, and it does create emotional baggage so they can't tap into that creativity, but no one is micromanaged or humiliated.

Jonathan: Most people who start their own hedge funds call on me. I say, "Here is the most important thing—number one, think about how you want to live your life as you're starting your fund. You need the opportunity to create an environment and culture where you could live the life that you want to live.

Unless you think about it, you're going to allow the business to dictate the life you want to live. You may end up being a financial success and a personal failure. The decisions you're making now are going to dictate so much about what you're going to create and the kind of people you hire, and even the kinds of investors you want as limited partners."

Kiev: What questions do they ask about starting a fund? What reaction do you get when you raise these issues?

Jonathan: It's very eye-opening. A lot of them are so anxious to raise money that they don't give a lot of thought to what kind of limited partner they want. They are so anxious to hire the right person, the big name, the profitable guy or gal, that they don't think about the impact of the person on their culture. The things that I put down in my original vision document are things that I explicitly share with other people, particularly those who are starting firms. I really try and get them to focus on starting out with a strong perception of how they want to live their lives and the culture they want to create.

Obviously, Jonathan has spent a lot of time thinking about selecting his team and fostering productivity. He takes into consideration not just what kind of traders and analysts he wants, but what kind of people will be most comfortable in and contribute best to the environment he wants to build.

Even with limited resources, you too can define your needs, interview as many people as possible, discern their reasons for wanting to join your firm, and carefully review the nuances of their past performances, their attitudes, and likely fit with your organization. Ideally, you want to find people who have the requisite skill sets from the start, since there is rarely enough time available to teach those skills. Even without the human resources personnel or finances to do this on a large scale, with more due diligence most hedge fund managers can recruit more effectively.

CONDUCTING THE TALENT SEARCH

While the search for talent requires some creativity, it is imperative to develop successful recruitment strategies that will differentiate you from your competition. To save a lot of time and eventual disappointment, it should be standard operating procedure to obtain not only a CV, list of references, and performance statistics, but also some examples of the candidate's work product. This might include a list of his best current ideas or samples of his analyses. These types of materials will help vet the quality of his thought process and how well his talents can be integrated into your plan of action.

If you are not personally doing the hire, you should make sure that everyone is clear about what you want and what skills and what personalities make the best fit for each position. You also must be certain that you translate the investment needs of the firm and its investment style to your business development person, who should understand the investment process and how new hires must be integrated into different teams.

I also recommend that you involve your current portfolio managers and analysts in the recruitment process. They often have a keen sense of who will fit into the firm culture and can assess candidates by skill sets, market savvy, and how well an individual's strengths fit the available slot. They also can be very effective in mitigating the natural anxiety of recruits about coming to a new firm.

The due diligence process is part instinct and part objective evaluation. If you are the one doing the vetting, you might draft a list of traits and background data that need to be assessed, such as:

- Resume—the obvious starting point. What is the person's education and previous employment?
- Skill set—the job candidate's investment experience
- Savvy—his or her understanding of the way your fund operates and what new roles he or she might have to learn
- Idea generation—what the candidate says about where the ideas come from and how he or she tests them before taking action
- Personality—how the candidate interacted with you and other interviewers and how he or she might mesh with those already on board
- References—what do other people have to say about the candidate?
- Feedback—your summary of the candidate's interviews along with reaction from others with whom he met.

I think it is useful to package all such material about each potential new hire into a memo.

I am also a big proponent of clarity about job expectations. The more a new hire knows what is expected of him, the more easily and comfortably he will adapt to the firm. Give some thought to a career path for analysts. Some may want to build teams of analysts; others may want to become portfolio managers with an opportunity to take and manage risk. Be clear about the job opportunity so that there are no surprises. For traders, this extends down to the details about capital usage, limits on the percentage of longs and shorts, as well as drawdown limits, even a down and out number.

Try devising a rough cost analysis of a sample P and L to reduce the anxiety of new hires who might have concerns about costs.

When recruiting talented people in the hedge fund world's highly competitive job market, you also have to use your network and offer people more attractive opportunities that meet their career needs and contribute to their desire to grow. By suggesting that you will mentor younger people and help them become more capable in their space, you are offering an additional incentive that the perceptive ones will appreciate.

"Don't be afraid of training and mentoring people, because you will never lose your job if you create people," said one fund manager named Thomas. "For me, that is the greatest satisfaction. Some leaders don't want to see others progress. A lot of the biggest and most well-known hedge funds haven't developed a number two person on the investment staff, generally because the head of the firm has wanted to retain control or had an element of jealousy in seeing protégés being successful. But there are other big funds that set up investment committees to manage the firm and share the responsibility and the credit and the ownership. The only way to keep talented people working with you for a sustained period of time is to give them more responsibility and empower them."

Indeed, the chance to work with already-established traders and portfolio managers is a powerful argument in recruitment. And of course, as competition for talent increases, you need to be prepared to make it financially worthwhile for the best people to stay.

Finally, remember that the contract process should begin without delay while there is still momentum from the recruitment process. You want to keep moving things toward completion and past the real risks that a candidate's present employer may make him a counteroffer or that the recruit may get cold feet. Be prepared to go into full-court-press mode. One market wizard I know was able to turn around a recruitment challenge by spending his entire Sunday nailing down the contract. He was willing to go the distance to close the deal, and it paid off.

CHANGING NEGATIVE PERCEPTIONS

Unfortunately, recruiting can become more of a challenge when potential hires are reluctant to come to a firm because of certain misperceptions that exist about it. So, among the first things you need to figure out is how your firm (or you yourself, if you are starting a new one) is perceived on the Street. If the perception is negative, you have to determine what elements of that perception are accurate and therefore what needs to be changed to improve your firm and burnish your image.

How do you discover your true image? Depending on the dynamics of your situation, you might start inside your current team, asking your newest members directly what their beliefs about your firm were before they joined. You might also have a trusted adviser solicit the opinions of recently interviewed recruits who decided not to join you. What influenced their decisions? This kind of feedback can be invaluable in creating an atmosphere and incentives that are appealing to potential hires.

For example, when seeking such feedback for one company, I discovered that there was a lot of misinformation on the Street about the place. Some interviewees suggested that the sales force on the sell side needed to be better informed about what went on inside so they could disseminate more positive views. Investment advisory firms also needed to be educated, since they relied on hearsay in writing up negative reports about the company and still perpetuated certain legacy issues that no longer applied.

A conversation with one recent hire made me realize that occasionally perception becomes reality when a trader brings with him specific warnings about his new firm. Arthur is a trader who told me in great detail about the stories that were circulating among traders at competing firms. Among his perceptions were pieces of gossip that he felt were true, such as the fact that in his sector there was high turnover and that the firm was short-term oriented (and as such, that some companies would be less receptive to taking meetings with analysts from the firm). As a long-term fundamental analyst, he also believed that there would be less interest in longer-term ideas—something that he eventually discovered was not true.

The more I talked to him, the more I realized that each person sees only a part of the situation, but tends to believe his own limited perspective. The bigger and more successful a firm is, the more stories that circulate. And no one ever gets it all right.

For instance, some may consider a firm highly competitive; others find it intellectually challenging. For every criticism leveled against a firm, there is usually an opposite view that someone else holds. Some think the leader is gentle and very accommodating; others say that he doesn't suffer fools gladly, and so on. And of course, much of the word of mouth about a firm may come from disgruntled former employees or from general misconceptions.

By correcting misconceptions and prompting a more positive image, recruiting can become a much easier job. If there is skepticism on the Street about your firm, find out what it is and why. Ask what you can change to make your firm more welcoming without changing the good dynamics that may already be in place. Remember, residual negative or inaccurate opinions gradually can be corrected by developing a team that feels empowered and energized. When your earliest team members tell others you have created a tremendous intellectual environment and offer an opportunity to grow, you have overcome a key barrier to hiring the people you want.

IDENTIFYING INDIVIDUAL STRENGTHS

The best leaders have an uncanny ability to recognize individual strengths and talents and to encourage people to focus their efforts on what comes naturally and what they do well. This approach enables the good leaders to tap the deepest wellsprings of motivation in their team members, to find others whose strengths complement the strengths of the existing team and to spend most of their energies in producing outstanding results rather than correcting weaknesses.

Therefore, after you have established your team, it is imperative to determine and define what it is that you expect of each team member. It is critical that you lay out the tasks and approach people with the expectation that they will buy into your vision. You also must be able to get past any fixed biases you may have about the limitations of other people. In fact, it is vital to consider how to tap into the strengths of the people in your organization since that is the best way to encourage them to take ownership of the process themselves.

Any one of a number of tests can help you to identify the strengths of individuals. The most famous such test, which is widely used in industry, is the Myers Briggs test. An excellent and easily administered derivative of this has been developed in *Now Discover Your Strengths*,[4] which gives you some distinctions about strengths that people have and how you can help them deploy their strengths. A *strengths* test provides a common vocabulary for you and your people and facilitates the creation of a team with the requisite talents already in place, rather than assuming that people can be trained and developed into something they are not.

Case Study in Identifying Strengths

A portfolio manager whom I was coaching hired a group of analysts using one such standard psychological test as a screening tool to find the best candidates. I have included a dialogue with Fred to illustrate the value of this kind of psychological assessment for building and managing and maximizing the performance of a team.

Kiev: What are you looking for in the personality test results of a potential hire?

Fred: Managing this team for optimization is what I think we are going to try to focus on. The most interesting takeaway is that it gives your best people ideas about how to grow their strengths. That was the one thing that I hadn't thought about. It's one thing playing to the strengths. It's a whole other thing if you want them to get better at those strengths. I say to my COO, if these are their strengths, how do we incorporate that into our business? Our team is strong in goal-oriented individuals—nine out of twelve people, all of whom rank high in competitiveness as well. How would you manage a group of competitive goal-oriented individuals?

Kiev: What is it that such a person wants out of his day? What makes him get up in the morning and gives him a sense of accomplishment at the end of the day?

Fred: He needs to have tangible and measurable results, so you might focus on specific targets, performance metrics, and feedback. What does such a person need to learn? How can you help him upgrade his ability to produce results? As long as you foster an environment in which he can keep producing results, he is going to feel very empowered.

Kiev: How do you do that?

Fred: It's important to understand what makes your people tick. People don't leave because they don't get paid enough. People leave because they are not getting recognition or approval for their achievements. Focus on empowering them in terms of their strengths. If a guy is achievement oriented, he will respond to anything that will help him get better at producing results. If you are a goal-oriented guy and you are hitting two fifty, you could be hitting two seventy or three hundred. Or, you are hitting three hundred and you could be hitting three fifty. So you say, "We are going to send you to batting camp. We are going to bring in a special batting coach for you. We are going to send you for a seminar, because that is going to upgrade your skills."

Kiev: So to foster their achievement levels we need to ask, what can make them more successful?

Fred: The more successful they become, the more successful the organization becomes.

Kiev: What about a monthly competition among people who will want to out-do other people or out-do themselves?

Fred: OK. We could do that on ideas.

Kiev: How about a bar graph showing who is making so much money, and the winner gets Yankee tickets for the weekend?

Fred: That's a way to play upon their competition. New ideas would be phenomenal. I would give out the extra bonus for the most ideas. That's a good one. Competition is my number two personality trait after command. I raised a hundred fifty thousand dollars for the business school telethon calling alumni. Whoever raised the most money got dinner for two at Chili's. I would rack up the wins just to rack them up. But I don't know how to use people who relate well. I have a lot of those.

Kiev: Do you have that attribute yourself?

Fred: I have a personality that likes taking command, likes competition, to be active and focused, and I want to get credit for achievements. But I get mad at the trading desk for telling me I am wrong.

Kiev: Those with relationship skills are guys who offer to do this.

Fred: Relaters are the networkers. The most profitable trait that I have found is the talent for maximizing a skill.

Kiev: The more critical thing is you create an environment in which people can express those strengths. So you can get to the top of the mountain with intellect, idea creation, or achievement, but you've got to play to your strengths.

Fred: I agree.

Kiev: Do you have guys who relate naturally to others, meeting new companies or new talent?

Fred: I don't as much as I should. I have noticed a couple of things. One of Gary's strengths is his ability to concentrate and focus his attention on very specific tasks. If I e-mail him: "This is what we need," it is done. That is a great management tool that you just don't pick up that much. It costs you nothing. I just say: "Focus on these two companies" and I will get better research on those two companies than if I say, "What do you think of Neiman Marcus?" If I say I want to see work on Neiman Marcus, it is a completely different work product. I can't believe it. I can say the exact same thing and mean the exact same thing, but say it differently, and get different results.

Kiev: What matters is how the individual registers instructions, and how he is motivated. People are most motivated in terms of their strengths, which impacts on how they see the world. So if you ask them something in a way that enables them to get at it the way they automatically think about things, you are going to get: "I can do it that way." If you ask it in some other way, then the guy is paralyzed because you haven't registered with his motivation.

Fred: How do I get people to do what they are supposed to do? I say they are supposed to come up with seventeen ideas a year. Each idea should have three million dollars of upside, a million dollars of downside. They don't keep up with their goals. That's a problem.

Kiev: Are they not setting those goals?

Fred: They are very realistic goals that I achieved when I was at my former firm. It's one idea every three weeks.

Kiev: If I were here being interviewed by you, are you telling me "Your task will be seventeen ideas this year that have an upside of three million each?"

Fred: Yes.

Kiev: Are they saying that they can do that?

Fred: Yes. But then they get here and they can't do it. Some of them do it. Gary had sixteen ideas year to date.

Kiev: Are you looking to see what it is that is keeping them from being on pace to produce the result you want? Are you outlining the work they have to do? What skills do they need? What additional help do they need to get to that? It's not like they didn't buy into the goal. It may be that you are not giving them the tools to reach the goals. You are assuming they know how to get there, but maybe they don't. They may not have a strategy or methodology.

Fred: Doug is the same way. It's very tough to get him to pick these targets.

Kiev: Can you give him a template, a template that enables him to screen stocks so as to find ideas? They may not have a useful methodology.

Fred: They're not achieving their goals and I don't know what to do about that without killing morale.

Kiev: You have got to ask yourself: "Have we put in place the methodology of helping them reach those goals? And if not, let's put some of the learning-inclined people on the task of finding out what are the methodologies that the successful hedge funds are using." Find more methodologies that can be used in standardized ways. It's the end of the year. Twenty percent of your guys are super performers. Seventy percent are medium. Then you have ten percent that didn't cut it. Are you managing all these people in terms of their strengths and in terms of what you want to get there, rather than saying, "I am paying them; they should do it." Your problem is you may not want to do that. Maybe somebody here does want to do it.

You've got to have a couple of guys here who know how to find it. You don't have to invent it.

Fred: I am a great believer in "no-need-to-reinvent-the-wheel" here. We can be very successful following the successful ways of others.

Kiev: You have got to provide do a little more direction and not simply assume people will know what to do.

Fred: We haven't talked about our goals here in a while.

Kiev: Then you've got to get people to buy into your vision. Then you have got to manage them in terms of aligning their efforts with the larger objective.

Fred: Won't that make them feel badly since every single one is below their goal?

Kiev: You want to make this a learning proposition—everything, every mistake, every failure, to reach the target. They're going to learn they weren't big enough; they weren't hedged enough. They didn't have enough high-conviction ideas. They didn't make enough calls and they didn't call the channels. It's a lot of work.

Fred: It's a tremendous amount of work. A lot of it is being wasted on stuff that doesn't matter because I can't understand how this work came out.

Kiev: How much are you directing the process, handing out assignments and then holding people accountable for their work. Seems to me as if you have copied someone else's model and have given your analysts too much autonomy before ensuring that you were getting them to work on the ideas that you had already developed.

Fred: I guess not enough. It's my fault at the end of the day.

Kiev: You could be managing with more focus. You keep getting Grant to give you summaries.

Fred: I think you are right. If my P and L is up ten million bucks I think to myself, "I can add forty million dollars to this." Then I say, "How do I get other people to see it the way I see it?" Why aren't they mad when they are not on track? I don't get it.

Kiev: You have got to get where they are at, what they are thinking, and how they are rationalizing their failure to be on track. They're not where you are. You have to listen to them. Part of being the leader is really tuning into where they are, then trying to understand. You can't judge them in terms of yourself. You are probably still failing to do all the managerial things that you really need to do as the leader to motivate.

Fred: I keep thinking: "Lead by example." That really doesn't work. Fascinating, Okay! Very helpful! It's a lot more work, but if you want to build a world-class organization, you've got to do it.

Kiev: You have got to start enjoying all of that. How many guys do you have? Do you meet with everybody alone once a week?

Fred: No.

Kiev: You probably ought to meet with two guys a day. Have lunch with one guy and breakfast with another guy. Just go over what's going on and get a feel of what's working and not working. What help do they need? How can you support them?

Gary: Do other top fund managers do that?

Kiev: Absolutely. Maybe you can learn to do it together and then you can follow some of the junior guys. You are going to have to get better at that or at least understand the process.

Fred: Is that why at least once a quarter my former boss would say: "Let's put it on the calendar to go to dinner or come up to the house on Saturday." I would go and Ritchie would be 4:45, I was there at 5:30. He does a ton of that. I didn't know why. We may or may not talk about the market.

Kiev: He is good at doing it.

Fred: It was pretty systematic.

Kiev: This is a smaller organization. You really ought to get good at it. I think it's not a bad idea. You want to take it to the next level.

Fred: I have such a hard time sitting with a guy who I think is messing up and not telling him that.

Kiev: Another approach is to have one of your senior analysts manage the process.

Fred: Here is the weakness. It's kind of bizarre. In a guy that I feel is not pulling his weight, there is an inclination to call him out on it and do it in a nasty way. Not necessarily publicly, but more like personally, on a one-on-one level. I find myself reluctant to give some people some of my ideas because I want them working on their own ideas. My ideas can be accomplished with a junior guy just the same as with a senior guy. I wonder if I shouldn't care so much about whose P and L is what, and more about the goal of the organization.

Kiev: Well, obviously, they are holding themselves back. Maybe you've got to start working with people a little bit more and see if you can help them.

Fred: I have made so much more money on XYZ by taking them away from him. I am a cold-blooded killer and I will maximize this position because I want the biggest P and L.

Kiev: Where you allocate the particular idea is another issue in terms of managing. You get a better feeling of what's holding them back and why they're not performing.

Fred: The guy wasn't performing long the sector. I say, "We are not doing that sector." I blew it out huge. He is saying, "You took that sector away from me. I don't know what I am supposed to work on." I say, "You had the sector for six months and we didn't make any money." I think there is great analytical talent there. I just can't get it to translate into ideas, into P and L. I don't think part of it is sharing credit in the problem.

Kiev: It sounds like you didn't really try to support him to get better at what he is doing. You have to work with him. Go over what he needs to do and what he is not doing until you understand what is holding him up. Again, you might not be the one to identify that. You might hand it over to somebody else to do.

Fred: We are trying to do that, but what about the mistakes? How do you deal with mistakes without hurting morale?

Kiev: A mistake is an opportunity to learn. You are always going to be making mistakes. You've got to create a safe place where it's okay to make mistakes. You have to keep asking: What can we learn from this? What did we fail to do? How did we get off our strategy?

Fred: I thought we didn't want a safe place. I thought a safe place wasn't a place for high achievers.

Kiev: You want a safe place where people are able to say, "I screwed up. I am not hitting the target." You've got to have people who are willing to tell you the truth. And you have got to be willing to tell them the truth. I would put a lot of value on candor.

Fred: One of the things that they do at another firm, which has gotten tremendous success, is attack the analysis, not the analyst. They really go through separating the idea—like, "That was a terrible idea you had." What was terrible about the idea? They really are not personalizing any of that stuff, but attacking the work. It's made this other organization definitely seem more open to the criticism, and gets stuff out of the portfolio that is not working. The head of the firm says: "I put my ideas up there for open criticism." It's very important.

Kiev: That's candor and a critical component of excellence.

Fred: What about guys that second-guess you? They say "You don't listen to me on that. Are we sure we want to do that?" I will say we have got to get bigger. Well, let's take profit. Then if that stock goes down, the analyst says, "You never listen to us. You don't allow us to give you our input because you don't want to get second-guessed," which is what exactly happens. I don't feel like I am maximizing all my ideas because I don't have a cheerleading squad behind me. I am not as big as I should be because I get a lot of resistance.

Kiev: The way they are communicating with you isn't supportive. This is something you need to assess and discuss with your team. If indeed they are afraid to tell you because you're going to blast them for second-guessing, then you are shutting off your feedback.

Fred: I want to hear from everybody. I want the open environment. But then I don't want second-guessing. It's not helping the P and L. I hear what you are saying. I know the risks. But pointing out the risks in everything I put on the sheets—I don't need it. It slows me down.

Kiev: It may be valuable to have that view. Perhaps you can discuss how you would like to hear that feedback.

Fred: Let's say I have a stock and there are ten positive notes out on it. Someone says, "Did you see that note where they were concerned about the margins?" I say, "Did you see the other ten notes?" That little stuff gets in my brain, and I start saying, "Maybe that guy is right." Now I am short, fifty thousand shares, and it goes up seven. I am not crying about it, but I am still saying I could have been bigger.

Kiev: There is some value in getting the contrary view. How much of it can you take and how can they deliver in such a way that you find it useful?

Fred: That's one thing we are going to work on.

Kiev: Is it a question of tone?

Fred: There is a tone—like, "We know this better than you do."

Kiev: That may be what you are reacting to.

Fred: You're right. It's the news delivery, not necessarily the message.

Kiev: If it's really problematic, you want to ask, "Is this guy on the team?"

Fred: Right.

Kiev: They need to have a conversation about communicating criticism that is helpful.

Fred: Communicating in a way is an art.

Fred focuses a lot of attention on defining each analyst's natural abilities and how he or she will fit into the development of an overall management strategy. He puts a lot of value on figuring out how to motivate his analysts and traders, recognizing that people hear things differently. He is careful in how he makes requests or gives instructions to them, knowing that how he says things is sometimes as important as what he is saying.

But Fred is not quite where he could be and still needs to learn quite a bit about managing people in regard to their abilities. He needs to look more closely at himself, be clear about the division of labor, set reasonable expectations, treat his analysts with respect, and stop competing with them.

MANAGING IN TERMS OF STRENGTHS

Of course, testing is not the only way to determine a person's strengths. Perhaps the best way to get to know someone in more depth is to work with him for a trial period when possible. After you work next to someone for a time, strengths, weaknesses, and other issues show up that were never apparent during the hiring process, no matter how good the due diligence.

Regardless of the method, the goal of every leader should be to not only identify the strengths of each team member, but to find ways in which to motivate him toward increasing those strengths and using them for the benefit of himself and the company. As the leader, you should ask yourself:

- What are the strengths of this team member?
- How can I incorporate those strengths into my vision for this firm?
- Given this person's strengths, what would he need to accomplish to feel satisfied at the end of the day?
- What would motivate this person toward greater achievement?

Perhaps this is one of the most underestimated areas of management—understanding what makes each team member tick. People don't usually leave a firm because they don't get paid enough. People leave because they are not getting recognition or approval for their achievements. Focus on empowering your team members through their strengths. If a guy is achievement oriented, he will respond to anything that will help him get better at producing results. If a woman is goal oriented, help her set realistic but challenging goals and then equip her with the tools she will need to meet those goals (further education or training to upgrade her skills, employing an assistant, providing new equipment, and so forth). Do you have a few really competitive personalities? Capitalize on that by developing a monthly competition.

Whenever possible, give team members specific opportunities to work using their strengths so they will feel more engaged in the investment process. For example, Peter told me that when investigating whether someone would be a moneymaker, he looks for one key trait—the ability to maximize advantages. He wants people who are willing to go the extra mile, who "play big." Such people are rare, he said, because so many otherwise fine traders are risk-averse.

The best way to manage such people is to give them the opportunity to make as much money as they want, he added. "We live by the sword and die by the sword. I try not to manage against them. I say, 'Let's do a little more work so we have more conviction that you should be doing that. You're on the right track.' I try to foster it."

Another analyst, David, was very goal oriented, but more important, had an uncanny ability at pattern recognition, seeing the confluence of seemingly unrelated events where others saw complexity. He also enjoyed the process of learning new things, wanted to maximize his efforts to achieve excellence, and liked to search for elegant concepts. The issue for the fund manager then was how to use these traits to motivate David toward greater performance. After some consideration, I suggested that David's ability to think originally suggested that he needed to be positioned on the cutting edge of the group, anticipating problems and finding new solutions, and using his natural abilities to help in organizational planning.

With this perspective in mind, the manager decided to give David several projects that tapped into his unique blend of goal directedness, originality, and intensity. He invited David to help structure the vision of the new fund and to identify leadership challenges involving training programs, risk management, and the development of the firm's infrastructure. David was appreciative of the opportunities and responded with enthusiasm.

As the leader, you should seek to create an environment in which your team members can express, develop, and increase their strengths. Remember, the more successful each team member becomes, the more successful the organization becomes.

MELTING RESISTANCE

Growth leads to change, and change disrupts routines. As you add people, you cannot be hamstrung by the limited views of vested interests or legacy franchises. You need to recognize that there are going to be reactions, and you don't want to be stopped by them, but you do need to address these issues so that you aren't subjected to a massive flight of talent threatened by the addition of new people or the new directions the firm may be taking. You must find a balance between the larger objectives and the need to make existing personnel comfortable and somewhat secure in order to maintain morale. This is a dynamic process. It involves a continual adaptation to the changing landscape within an organization.

Ideally, your vision should be broad enough to reach all of your team members with some common themes that motivate them to climb on board. Consider how each individual registers instructions and how he is motivated. Again, people are most motivated by their strengths, which affect how they see the world. So, if you present a new concept or ask a question in a way that registers naturally with them, then they will automatically think about how they can comply. If you present the information in a way that does not register naturally, they are often paralyzed because you haven't registered with their motivation.

Therefore, when you face resistance among team members, you need to begin by asking yourself some basic questions:

- Have you considered what it is that is keeping your team from producing the results you want?
- Are you outlining the work they have to do?
- What skills do they need to accomplish the tasks you have given them?
- Are there additional tools that you can provide that will enable them to develop or refine those skills?
- Have you put in place ways to help the team reach the goals you have established?
- How much are you directing the process, handing out assignments, and then holding people accountable for their work?
- Are you managing with focus and intent?

To overcome resistance and maximize the efforts of your team, you need to understand where they are, what they are thinking, and how they are rationalizing their successes and failures. Don't assume that your team knows how to reach the vision you have established for the firm. They may know how to get there, and then again, they may not. Clearly state your vision, and then outline the strategy you have developed for realizing it. Listen to them. Part of being the leader is really tuning into your team, trying to understand, forgoing your right to judge and finding new ways to motivate.

Of course, in any business situation there will be times when such open communication seems to backfire, when you as the leader may feel that you are receiving more criticism than support and are not able to move forward because the negative feedback is turning into all-out resistance. What's important to remember is that all communication—even criticism—should be expressed in a supportive manner. This is something you need to assess and discuss with your team. While criticism is sometimes hard to stomach, you have to understand that even those negative or contrary views have value. If the opinions are not being offered in the right tone or in an appropriate setting, then you need to discuss those issues with the team. Outline how and when you are open to feedback and determine ahead of time how you will react. If necessary, personally discuss the issue with individual team members. Remember, open communication is always the first line of defense against resistance.

Case Study on Embracing Negative Feedback

Hedge fund managers who want to build organizations to last need to be willing to listen to their severest critics. They need to be open to feedback and willing to face the often harsh music that those closest to them are able, but often hesitant, to give. In his efforts to perfect various analytical processes, John, the team leader, had been single-minded in his approach to his work and reluctant to include others until all processes had been perfectly developed. He was not always sensitive to the needs of others, and getting the job done often took priority over feelings. As a result, Greg, a senior analyst, and several other team members were feeling "excluded, out of the loop, deflated." Although they were facing individual issues, they were all very unhappy.

"The problem is that John is incredibly focused on his goal and doesn't feel the need to tell others where he is headed. He says that we should just trust [him]," says Greg. "That's fair, but leaves people to feel pigeonholed or excluded. He is very reluctant to make anything available to broad criticism before he thinks it is ready to stand up to criticism." John has a difficult time asking for help. That's another way of saying he is very self-reliant. His great strength is his ultimate flaw, as in Greek tragedies. Because he is very successful and wants the team to succeed, he doesn't show his hand until he is reasonably sure something is going to be successful, which in turn means he comes across as secretive.

Greg and some of the other team members found John's management style not only alienating, but also intimidating. Although John was very driven by the goal, his drive often superseded his connectivity to the people around him, and his sense of personal responsibility led him toward a possessiveness of his projects that made it hard for him to let go of the control until he was sure that everything was right. Despite all of this, John sincerely had a strong desire to interact with others and build strong relationships. Still, his initial response to the criticism was mixed emotions.

"I view myself as pretty damn selfless," he said. "It has always been for the good of the team or the collective. That's always how I felt about it. So, that's why I never considered I needed to let people know or explain to them what I was doing and get their buy-in. A lot of time, it is lonely when you have a vision and you can't convince others that it ought to be pursued or that this makes sense. Very early on, I learned to go ahead and develop my plans without trying to deal with the resistance of those around me. It's got to be a two-way street. This is not just about managing down. It's about their managing up as well. It's about being sensitive to their needs, but also they have to be sensitive to my needs. It's got to start with me at some level. They have to trust me. They are invited into the project when we want them to contribute. We don't necessarily want it at inning one or hour one."

The strength of John's style is that he is very conscientious and focused on the achievement of the goals he has set for himself and his team. He takes the project on and wants to make sure it gets done. This is the driving force behind the success of his fund. The weak side of this very successful approach to processes is that all of this takes precedence over paying attention to the needs of the people in his organization. He hasn't been factoring this into his approach to the tasks at hand.

Therefore, John needed to understand that the team wanted him to pay a little more attention to their emotional needs, their need for recognition and acknowledgement, and to be included in the process. Of course, some of it is an exaggerated sense of not being included, which very competitive and achievement-oriented guys are inclined to feel anyway, irrespective of how you run the organization. But his inclination to not pay more attention to them was rubbing them a bit because of their own needs to be recognized and applauded.

Despite John's defensiveness, he was willing to listen to the criticism and began to see some dimensions of the problem that prompted him toward change. I told him that by recognizing the problem, acknowledging it, and periodically addressing it he would minimize the significance of this as a contributing factor to tension or morale issues. It is always useful to let people know that "you are working on it." If a project or an idea is not ready for discussion or publication, let the team know that as well. There is no problem in letting them know this even though they are not being included now, they will be at a later stage. This will mitigate the problem of their sensitivity to being excluded.

John did not want to relinquish control to others, yet this is precisely what he had to do to empower others. As John worked at involving others in the process, he became much more cognizant of the need to delegate responsibility and to pay a bit more attention to the desire of his team leaders to participate. He genuinely derived satisfaction from supporting others, but did not fully recognize the impact of his focused and deliberate interpersonal style on the emotional responses of others. This took some time, but John was eager and dedicated to making this work for the long haul. Eventually, he began to see some benefit in trying to include the team more in areas that were of perhaps lesser importance to him.

"There are also things I am less interested in handling, and I am delegating those functions to these guys," he said. "This takes some of the burden off me and empowers them to become more involved in leadership projects on the team level. I don't need to be doing everything. I can start it, and someone else can take it to another level. This is what they are clamoring for. I told them today that asking for more responsibility is great, but they are accountable for what they have asked for. Don't ask, get it, and then drop the ball. That's the worst-case scenario. It is tapping into their leadership abilities and desire to be more responsible for the process. I am psyched that we have people who want to contribute at that level. I want their input. It has to be when I think the vision is fleshed out a bit."

These conversations with Greg and John help to underscore the sources of misperceptions and tensions that often develop in a relationship because of the differing priorities and personalities of the people involved. Of course, John and all leaders need to understand that some of these views will continue, because you are the leader and people will be projecting on you all kinds of things from their own past experiences. This is natural and goes with the territory. If you understand that this is part of the leadership role, you can respond to these requests and demands in a more realistic way. You can create a dialogue that factors these things into the discussion so as to reduce or neutralize the tension.

The more participants discuss these tensions, the greater the chance everyone's interests will be aligned with the team's objectives. Indeed, having the conversation is more critical than resolving the differences. To the extent that there is room to consider these psychological and emotional issues, the team is likely to become even stronger.

Of course, mutual feedback should be more than a series of judgments about who did something right and who did something wrong. It should provide your team with a greater understanding of what more each individual can do to achieve the goals that have been set. It can also shed light on which team members are interfering with maximum performance and allow individuals to share views of how they wish to be treated by you.

Asking people for their feedback can be a stretch, and it may take time for your people to get comfortable in being honest with you about what they really think. But once you have created a safe space for them to air their issues, it will open the stage wider for more empowering dialogues.

DEALING WITH DEPARTURES

A certain amount of departures is inevitable, especially given the competitive nature of some firms. As I discussed before, the issue of large funds holding on to key personnel is an industrywide one. Kenneth Griffin's Citadel Investment Group, for example, was described in a magazine article as having a "reputation for being a harsh place to work. . . . A company where at least a half dozen former employees say that talented professionals haven't stayed for the long haul because the firm has grown too quickly and the biggest compensation years are behind it."[5]

Therefore, in thinking about how to retain the best people, it is worthwhile to examine the reasons why talented team members have left your firm. Often, their reasons are good—greener pastures, more responsibility. But sometimes the reasons have to do with the lack of opportunities and structural failings in the firm they leave behind. On occasion, people leave because they want to get away from having to share meetings with other analysts. They also don't like competing for ideas and trades, and they want to be the designated specialist in a sector. Too many firms build in redundancy, which protects a firm's interest but reduces an ambitious trader's sense of being a critical part of the firm.

Another factor in departures may have to do with the desire of ambitious people to expand their roles. Analysts may want to be portfolio managers, and some portfolio managers may want to be hedge fund managers. An important aspect of keeping key personnel is thinking about these types of issues and working to accommodate dreams within the alignment of your own firm's vision.

In the search for reasons why people leave hedge funds, I talked with an experienced hedge fund manager and his chief analyst about their experiences in retaining talent and why some people had left their firm. The conversation was illuminating. Raymond, the hedge fund manager, believes in a simple yet often-overlooked strategy for compensating his talent—providing a percentage bonus based on how much profit the entire firm earns. Raymond believes that this kind of incentive program encourages individual people to work as a team.

"[Most firms think] they can solve the obvious issue, which is that in a given year some analysts do better than other analysts. . . . Then they are also fearful about paying somebody a lot of money, having them shake your hand, and say, 'By the way, I am out of here.' So they want the deferral mechanism, which they will invest over time. [They think] it's just wrong for us actually to give people a percentage of the profit of what they make," explained Raymond. "The way we manage money—it's like gold. It's one pool. When your percentage gets up to a certain amount, if you can help another analyst increase the pool by ten million, that's much more beneficial. It's one less thing to fight for."

His chief analyst, Jack, agrees. "The way people are tied to the fund here is through loyalty. People appreciate that when a stock goes against you eighty percent, you didn't do anything wrong; it's just the way the markets work. The other people support you. There is an environment where you are becoming a better person professionally and personally. . . . So there are two pieces to it—there are no financial handcuffs, but there are a lot of other reasons to be here. Financially, it's very rewarding."

This kind of program is in stark contrast to the way many funds are managed. In fact, many funds pit employees against one another in an effort to maximize performance. While I do believe that competitions have their place, I also agree that to retain good employees, a firm needs to encourage teamwork, to make everyone feel valued, and to discourage adversarial relationships.

Again, it is in the interest of the long-term health of your fund to find and converse nonjudgmentally with people who are unhappy with their compensation or other sensitive and important issues. Keeping career paths open and maintaining key personnel assures continuity and progress within your organization.

Building a team isn't easy. Of course not, but it is essential in the process of reaching your vision. These issues—choosing team members, strengthening and using their talents, dealing with resistance, and developing appropriate incentives—these are all part of what is known as your corporate culture. Building a team is one of the early steps toward creating a healthy corporate environment and moving your vision one step closer to reality.

CHAPTER 4

Refining Your Team

During John Wooden's era as basketball coach at UCLA, future Hall of Famer Bill Walton consistently tested the limits of behavior acceptable to his strict coach. As the starring Bruins center in the early 1970s, Walton was very much a rebel who wore his hair long and worshipped the Grateful Dead. Over the years, Wooden had relaxed his dress code for players en route to away games from "requiring a coat, tie, slacks and short hair" to a more general "clean and neat appearance." Nevertheless, one day Walton showed up at the team bus looking like a scruffy hippie. Wooden would not let him board the bus and sent him home—even though Walton, a three-time winner of the NCAA Player of the Year award, was the team's best performer.

Wooden also required all his players to tuck their jerseys into their shorts even during practice. Was he just being silly? Hardly. He believed that "eliminating sloppiness and creating unity were very important" and "were effectively instilled by attending to such details."[1] It was all part of his attempt to establish in his collegians the notion that they were special and to have them cultivate a professional attitude. Walton much later said that Coach Wooden "taught by creating an environment that people want to be a part of " even though some players like himself were slow to learn that lesson.[2]

Whether you are new to the job, want to breathe life into an organization, or simply want to play at 100 percent, you too need to address the critical issues of leadership pertaining to your vision and values. After you have assembled your team, you must help them refine their behavior by articulating a new set of attitudes, values, and modus operandi. You have to restate your objectives and redefine processes in order to maximize performance. You may also need to find new methods for producing positive results or define a new set of values such as sharing, cooperation, and teamwork in a culture that may have previously been entrepreneurial and competitive. However it is accomplished, getting ready for the future and managing change calls for greater sensitivity and awareness of the tasks of leadership. Of course, you also need to expect discomfort, because leading your team in this way means challenging long-held beliefs and actions. It means pushing people beyond their comfort zone.

ALIGNING BEHAVIOR

Once you have communicated your vision to the key players on your team, you need to foster commitment to it. It takes some hard work to coach people to do what is necessary to tap all their resources or to understand what is getting in the way of a team's performance.

For example, let's say your team includes a trader and an analyst who are underperforming. You cannot simply assume that because they are smart or because they know their sector backward and forward that they will get what you want. You can't just tell them to do better. You have to go over in detail what their thought processes are, how they arrive at their conclusions, and then suggest more work for them to do. You must be explicit about the tasks involved and challenge them to work together to produce the analysis and the trades that accomplish their P and L goals.

It is up to you as the leader to define job descriptions, spell out what has to be done, and ask team members whether they are ready to commit. That's your job. If it becomes necessary, you may have to confront an individual about how he is approaching a problem, show him your solution, and then get him to do it. If, after all this, he cannot turn his performance around, then, and only then, is it reasonable to consider that he may not be the person for the job.

Case Study in Creating a Collaborative Culture

I had a chance to explore these issues with John Randall, a legendary manager who had grown his firm into a multibillion-dollar fund over a period of several years. The leadership challenge for him was to confront fixed, habitual ways of seeing the world and trading in order to realign behavior with the goals of the organization. In this dialogue, John talks about how he took control of his fund and his team members and brought them around to his way of thinking.

Kiev: How do you bring your people around to your way of thinking?

John: We have been implementing a lot of changes organizationally as we try to grow up and become a firm. I think sometimes the fear of the confrontation is a lot bigger than just coming out and saying it. What has made the conversation a little bit easier is that my job is to say what our goals are and no bull. We gave employees reviews for the first time and gave them titles and put them in 3-D work charts, and some messages were extremely positive and some messages weren't so positive. This gives us the ability to more clearly communicate exactly what expectations are and not feel guilty about the fact that you might be telling them something they don't want to hear. You know it really hit home. We have gotten a lot done in the last six months. I figure we are making an enormous amount of progress. People say if you end up firing a person or losing a person, you never feel like "Gee, I wished I had done that later." Either it's the right time or you wished you had done it sooner. It's kind of the same thing in terms of making changes that we're scared to make. As soon as we do, the overriding feeling is, "I can't believe we didn't do that sooner. It just wasn't that hard."

Kiev: What do you try to say, and what it is that you see that other people don't necessarily see?

John: It's funny, but there aren't really true partners in the business to start out. So very few people will come to you and just talk informally, whether it's on an investment idea or something about the business. People are very timid about coming to me and just looking at me and saying, "That makes no sense."

At this point, four years into our fund we have a lot of people who are willing to challenge me because of the negative experience we had in the portfolio in 2002. A lot of people are very qualified and have good resumes, judgment, and experience on investment issues, but they are not ready to say, "John, I know what your argument is, but that doesn't make sense." None of us has run a business before and I am the closest person having done it. Very few people feel like they have adequate standing to just look at it objectively.

Kiev: Sometimes people are reluctant to speak up, and the CEO, because he is accustomed to getting things done, is too willing to jump in with the solution, saying, "I'll take care of it." My view is that you have to learn to rely on your people by empowering them to solve the problems. You have to be able to invite people to tell you what their resistance is to your objectives or what their doubts are. Then you have to challenge them and get them to commit. You start off with the view, "We're at Point A and we want to get to Point B." That's the goal. "Are you ready to sign on to that objective?" Now that they are ready and willing to commit to that, then you are entitled to ask whether they are doing whatever it takes to do their piece of it.

John: There is no question but that I at times feel like the CEO that shoulders all the burdens.

Kiev: Most of the time you are going to run into resistance about things like "We can't hire consultants who want to work on the weekend." Or, "It's not done in the industry." All that stuff is resistance to moving the process forward. To the extent they are committed and you are really able to identify the resistance and get them to see it, that's what you are dealing with all the time—pushing and uncovering the resistance and then discovering your own participation in that process as well.

John: I agree. Many times I feel like the more people I have working for me, the more people I am working for. When the rubber meets the road, if something isn't going right, I try to come up with the solution and I am taking more and more on my plate. Instead of leveraging the organization—do you know the sneaker ad by Adidas where Kevin Garnett is walking down the street and a bunch of people are piling on top of him? He carries the entire basketball team on his back. It's almost like the inverse pyramid—the more people you have in the flow chart. . . . It's not that the CEO sits at the top. Sometimes it seems like the CEO is at the bottom and you just have more and more on your shoulders. You are right to say that in such situations we must clearly tell people, "Here is where we're going." It's a lot easier if somebody takes ownership of the process. I feel that the more people I have involved in the process, the more I am responsible for it.

Kiev: I've consulted with one CEO who functioned this way as well. He asked me to sit in on a task force and make recommendations about improving the efficiency of the team. In that corporation, there was one person who kept a log and who really knew what the action points were. I suggested that he appoint her as the expediter to monitor the ongoing tasks and time lines and to go back and make sure that everybody in this complex organization was in line with their targets and milestones. He resisted the suggestion on the grounds that she was young and new to the task force. My response was that as CEO, he had the capacity to empower her because he needed someone to keep monitoring the flow of activity.

John: That's exactly right. There are two aspects in our business where we have done that. The first is, we hired a general counsel/chief operating officer after the previous COO left to raise a family.

Kiev: How does he make decisions?

John: One of the issues is that people have been here for a while and this guy is new. No matter how many times I say to him "You're in charge; you're our guy; we hand-selected you. We gave you a ton of people," he is reluctant to lead. He is in his early thirties. So he is a young guy. We interviewed a wide range of people and thought he was the best qualified. But it is hard getting him to believe. It's not somebody's nature to come in on Day One and start dictating. A lot of times they want to build consensus and set expectations. They don't want to ruffle any feathers. You want to make sure they understand how things work first. In terms of positioning him, I need to continue to reinforce the idea that it's not just pure opportunity, but your obligation to take charge of these things, and to take ownership.

Kiev: What about getting past resistance in terms of analysts?

John: It's the same thing on the portfolio side. We hired a salesperson who had been at an investment bank to have him be traffic cop for the way research comes in here. Again, there was already a team in place. He didn't want to come in and take over too much and change the process. He was five years the junior of a lot of other people here. Again, no matter how many times I continued to tell him: "We want you to lead. We want you to reinforce," he resisted. There is one person who knows all the items and somebody is lagging. Because of his personality, and how long he had been here, and his own self-confidence, he didn't feel like he should go to that person and say, "You are behind task and it's my job to hold you accountable." That never worked out.

Kiev: I once had a nurse working for me who didn't know how to put the phone on call forwarding. This is the same issue. You have to define the job description, spelling out what has to be done and asking the potential hire whether he or she is ready to do that. That's your job. If by Day Two the guy doesn't do it, you have to say he isn't doing his job, as opposed to leaving it in his own hands so that he can figure it out.

John: In terms of my own newness as a CEO, I didn't do a good job of positioning it. Three days in, you are already beginning to fail. I didn't represent it like that. They were insecure and I knew the role of the organization. I was pretty insecure in my new role as a CEO. Therefore, it wasn't my initial instinct to just say, "Here is a hard and fast rule on how to do it." I wanted to give people some freedom to figure out what works and what we're going to do. The closer you get to that, which I believe was my core competency when I started the business, then the more command and in control and confidence that I have. There is only one portfolio manager in one of our funds and I make every investment decision. I feel quite confident that I don't care who is sitting on the other side of the table. All the money is here because they want me to make the investment decision. Not that I am always going to be right. We feel really good. There is a very clear "my way or the highway" mentality. Everybody understands that.

Kiev: Do you have the same mentality on other management decisions?

John: It's on the nonportfolio related issues where I didn't have that same approach, largely because I wasn't so confident that I knew what the right way was.

Kiev: Is there a right way in trading or is there the way that you discovered works for you?

John: Yes, there are a thousand different ways to make money.

Kiev: Do you think leadership is any different? Isn't leadership of an organization a signature activity just like trading?

John: I think so. I think one needs to discover that. You need to go through a process. I would not have started my firm, if I had not been an analyst for six years with another company. There, I had a laboratory with which to experiment, learn, make mistakes, and grow. Then I was qualified as an investment manager rather than an analyst. I agree there is a style that likely works for me. There may be different ones that work for other people. I didn't feel qualified initially in laying that out because for myself I didn't know what that was. So I still needed to go through an experiment with that which works for me.

Kiev: How difficult is it to develop a signature leadership style?

John: Once you figure it out, I don't think I would have a problem saying this is who we are. The progress that we have made in the last half of the year is that we are finally becoming confident that this is where we want to be. We want to be a partnership. Just the way we are going to have things in the reporting structure. So we are becoming more and more assertive on those things. I need to figure out what worked first.

Kiev: In what way are hedge funds different from other companies?

John: There is no other business which would have a CEO of a hundred-million-dollar revenue company without previous CEO experience. Would you appoint as CEO of a hundred-million-dollar-profit business somebody who has never been a CEO before? Only in the hedge fund business would you find that. It's not that I don't have a healthy self-confidence or respect for my own abilities. There is no reason why you would have a first-time manager in a business of that size. It's just silly. Look at the CEOs of the other companies that we own who earn a hundred million dollars. They have had considerable experience before they got the reins of a CEO. So in the hedge fund world, the training is all on the job, it's all trial and error. You have to have made some errors. We have, and we think that all we can do is be fast followers of people we think are smart about this, as well as try to be realistic about their errors and try to learn from them quickly such that we are not stuck in a rut.

As this conversation clearly shows whether you are new to an organization or are trying to streamline and upgrade your existing one, one of your main tests as a leader is the challenge of melting the natural resistance to new people, new products, or procedures, especially among those who have become accustomed to the "old way of doing things." John sees his efforts to melt resistance among his staff as a critical part of the leadership role. Many portfolio managers start in the same position. They start a firm without the kind of training that business executives in other companies typically bring to the job. As John grew more practiced and self-confident, he was able to find the right balance between control of the process and giving people the freedom and autonomy to follow their own creative vision.

A critical aspect of creating a stable culture where the vision, values, and processes are aligned with the people working in the organization is defining a compensation structure that aligns performance with the objectives of the firm. In hedge funds, which are often high-performance money engines, this is a critical structural element of the organization that often goes unattended. How people are incentivized varies from hedge fund to hedge fund.

Case Study in Incentivizing

The following dialogue describes one such creative compensation policy designed to motivate people, boost their morale, and improve retention. Formulated at the start of a hedge fund, it was designed to align the firm's long-term objectives with the interests of those working in the fund. Each fund obviously has its own compensation scheme, but since economic incentives are one of the big drives for pursuing hedge fund concerns, I thought it worth presenting one model against which you might judge your own.

Kiev: Do you have very explicit goals? Are they transparent? Do you say, "This is what we want to produce by the end of the year?"

Ryan: Yes. We target double-digit returns and four to eight percent standard deviation. We really try to keep the capital preservation very high. We have been in business four years. The core fund has done an eleven percent return with a four percent standard deviation. The biggest drawdown peak to trough is kind of unfair because you have seen weird volatility. I don't think we have been down more than a percent and a half for the year on any given day.

Kiev: When you manage people, do you manage them in terms of having them set goals that are aligned with a larger target?

Ryan: We do it a little bit differently and each team is different. We sit there and say basically, "Here is what our compensation system is. Here are two aspects to it. One is qualitative and stable and one is quantitative and upside. If you work here and you know what level you're at—analyst, senior analyst, or portfolio manager—and you continue to grow, you work hard and you're diligent, we see a future for you."

Kiev: Can you be more specific?

Ryan: We actually put a positive and negative boundary on salary. I copied this from one of the investment banks. If you're a VP, you know what you are going to make. You are going to make between four hundred and a million. The difference is going to be how well you do and as long as you do your job, you're not going to get fired unless the bank has a really bad year. Even if you get a little unlucky trading, you know the first year you're OK, and the second year you might survive; the third year it's still tough. You still give people some stability.

Kiev: But you have your own unique spin on the system?

Ryan: Yes! What else we do is unlike investment banks, which is why they lose a lot of the people. We say, "If you are a twenty-seven-year-old analyst and you have produced twenty million dollars worth of value we will pay you five million bucks." One of my friends was the number one gross in revenue VP at one bank. He made less than a million. He went to a hedge fund that paid him seven million dollars for doing the exact same thing.

Kiev: How do you present the compensation issue to junior analysts?

Ryan: If you are a junior guy here, you are not going to make five, ten, or fifteen million. What we say is, "Look, you have got a safe, stable environment. We are consistent. It's a good work environment. You keep growing, you are going to make three hundred, five hundred, seven hundred, a million, or a million and a half." Over forty percent of our total incentive fee went to compensation. If you have a really good year, you could be thirty years old here and make three million bucks. That's going to imply that you made us plenty of money.

Kiev: How do you come up with the numbers?

Ryan: We know at the end of the year what revenues each group has produced. For instance, I have a guy that does industrials, energy and utility, and a guy who does telecom services. I can look at the numbers and at the compensation meeting go to the other partner and say, "This guy produced four million dollars of revenue directly to the firm." Then we sort of triangulate the pathway, plus the actual dollar amount to figure out where you want to put people. So far, it's been good. And again, I don't think we are doing anything new here. All we are doing is having a plan about how to run compensation.

Kiev: Do you announce your performance?

Ryan: Our performance is known to everyone. We have real-time attribution by position. It's very transparent. I have had a lot of friends who are at a firm where they don't know their attribution and then they go into their conferences very insecure. If people have that bias, they always think they are more right than they actually were.

Kiev: How did you correct that?

Ryan: We calculated attribution every day and we pushed with the entire firm. You know where you lost your money. What happens with the analyst, too, is it helps create an environment of responsibility and that transparency just removes a lot of the emotional psychological responses. A guy can't say, "The telecom book; it's not me," or "It's not you; it's us." We either succeed together or we fail together.

Kiev: Sounds very pragmatic.

Ryan: This is like any other business in the world. At some point it's going to come down to real estate, human resources. You know, maybe human resources is going to be the key. The issue is, you got to treat it as a business. You've got to see the connection between managing a gas station and doing what we do today.

Kiev: How do you manage a guy who has now made thirty or forty million dollars?

Ryan: OK, let's talk about what we have done with our structure. What we did with our structure is the following. We launched a core fund, which has three pieces. What we did then, though, is we launched a consumer fund. Our consumer manager by far has done the best in the past four years. He has been more than half of our returns.

Kiev: How did you talk about this?

Ryan: We said, "Why don't we capitalize the structure that is an exact replication of what he does in the core fund?" So we capitalized that structure and it has two hundred and fifty million. We have got seven fifty in the core and two fifty there. So we are about to capitalize my structure on July first. What happens is, the fund is an exact replication of what we do. So, there is nothing I can ever do in core that isn't done in my fund. There is nothing I can do in my fund that isn't done in core. The only difference is, if I buy a one percent in the core, I buy a three percent in my fund. The big problem is when guys begin to get good. They always say, "Now I have got a little bit of money. I don't want to get caught in the big pool, because what if everyone else loses money and I make money and I get messed up?"

Kiev: How would you state your values about profitability?

Ryan: A single pool will work if you are really big and the management is really committed to investing in the business. Most people aren't committed to investing in the business. They are only committed to taking money out, not putting money in. I think that multiproduct is stronger than single product. Let's say we have got three sector funds and we have got this big pool. So we have got four products. Let's say consumer does real well and the other two areas stink. There will still be some money left at the core but that money can be used to maintain the other two teams. Then with that consumer money we can gear more of it toward compensating those employees. Again, if you run a single-product firm, it's like any company that runs a single product. If you sell blue widgets, and blue widgets don't do well, you are going to have problems retaining your people.

At the same time it also gives people upside on a growth path where they say, "I see how hard it is to start a fund. It's a ton of work." They see that. But they also say, "But here I might get twenty, thirty, or forty percent of the economics if I become a really senior person. Furthermore, I could eventually become a partner in a multiproduct company." This new vehicle hedge fund, as I just said, is exactly identical to asset management firms, except for the fee structure and the flexibility. I think what we will do without a doubt is, we will look to eventually add different growth people.

Kiev: So in addition to compensation, you offer a major career path?

Ryan: People ultimately want a career path. There are a few people out there that say I want to go out and trade five years and make thirty million bucks and get out. A lot of people say that and then they live through one down year and their story changes pretty darn quickly. What I am saying is just in reality, businesspeople who are patient and lay out a business plan and evolve and understand the business ultimately make more than a quick-buck artist.

Kiev: So you've got to multistrategy, multiproducts, and so on. How do you retain people?

Ryan: My view is you have two levels of retention. On one level, you allow for economics at the product level, not necessarily ownership. Every product is owned completely by the parent company one hundred percent. You allow for ownership of the product level, though, in terms of economic ownership, and then you offer the carrot—you let your people know there is ownership in the parent company. A guy can say, "I am going to keep my head clean and try to make the right decisions. If I succeed, I am going to make money in my product and I am going to make money as a partner. If we have a down year or two or something that doesn't work, then I still know I have the ownership of the overall firm." To capture the benefits of scale while at the same time capturing the benefits of decentralization—to me it's not just having the different products. It's having this combined ownership where you own part of a big thing but you also control your own destiny. You're all in the same boat together.

In this case, Ryan has a thoughtful plan for incentivizing his people. Rather than try to compete with other shops that might offer huge payouts or bonuses to new hires, he is thinking about creating an investment banking type of program that offers eventual partnership interests, thereby discouraging too much turnover, which is so often a problem in the industry.

Case Study on Aligning Behavior

I sat down with two managers, Chase and Roy, to discuss the tension that arises when changes are being considered and how individuals can be persuaded to align their behavior for the good of the team. In particular, both leaders saw a need for new processes to be put into place regarding the development of conviction levels for new ideas; they balked, however, at establishing the procedures. While they understood the benefits that could be incurred, they hesitated at giving away any of their own control and feared the initial backlash from the team. They felt that establishing such procedures might make the team members feel forced, or pressured, into coming up with high-conviction ideas. Yet, they realized that without pressure, there would be no change.

"I think we have accepted that we complain, and they don't do anything for us," said Roy. "You've got to shake them up. If you don't do anything about it, then they're not going to do anything."

Chase and Roy needed to understand that setting expectations actually helps a team build a higher level of conviction. By setting up an institutional process regarding the conviction of ideas, leaders are not pressuring the team, but challenging them. Such programs help the team perform better and develop more confidence. So, in regard to this problem, I had some specific guidelines to help these leaders as they tried to align their team with this new objective. I encouraged them to:

- Develop a written system of communication: Develop e-mails or write-ups noting whether an idea is high conviction. While an idea may be initially shared verbally, it should always be required in writing. There is more commitment to the written word, and it enables you to track the idea over time.
- Ask specific questions: What is the expected price? What is the source of the idea? What is the price target? Are there any catalysts? Do you have a variant perception?
- Include your analysts: You need to set up a procedure that makes people who are doing the analytical work part of the process. It makes you much more aware of what they are doing, and it reminds everyone to size their positions.
- Know the stats: Where are you making the most profit? Which analyst on your team is providing you with profitable ideas? Are you making more money in old economy than in biotech? Are you making no money in tech? How about retail? Can you identify where the good ideas are coming from, and where the weak ideas are coming from and which analyst(s) need to be pushed more?
- Know as much as you can about the company. Make sure the analyst has done the necessary work to support the position. An analyst is your eyes and ears. The more he knows, the more you know, and the more

comfort you have leaving the desk, because you know he is out there watching your back.
- Challenge the team intellectually: If a person has a high-conviction idea and he does well, let him know that he has done well and that you appreciate it. If he is off the mark, let him know that too. The objective is to get your team to raise the level of the game.

Aligning your team is a process that takes time. It requires changing. There must be a vision and a willingness to go the extra mile. Positions should be sized in regard to overall goal and profit expectation. Then, everyone has to do the amount of work necessary to build higher conviction. If you get everybody involved in it, it's going to raise consciousness.

To become a good leader, you need to learn to empower your team members so that you can rely on them to solve the problems. Creating a safe space where people are not afraid to voice their opinions or to ask questions without fear of ridicule is one important facet of creating a successful organization. To this end, another manager, Donovan, commented on the importance of encouraging young analysts to not hold back for fear of making a mistake.

"They think if they mess up, they will lose their jobs. So they choose not to mess up by choosing not to play. What they don't realize is that by not playing, you have a much higher mortality rate than by playing and losing," he said. "This is a game of percentages. If you are really good, you should expect to lose thirty to forty percent of the time. The guy who doesn't want to take the at-bats is the guy who is detrimental. I do not look to fire somebody who loses money. I look to fire somebody who is afraid to play."

So, you have to invite your team to tell you what their resistance or doubts are to your objectives. Then you have to challenge them and get them to commit. You start off with the view, "We're at Point A, and we want to get to Point B. That's the goal. Are you ready to sign on to that objective?" Once they have committed to the objective, you are then entitled to ask whether they are doing whatever it takes to reach it.

PERFORMING EVALUATIONS

Performance reviews are a valuable way to assess how well individual team members are aligned with the firm's goals. They help build momentum and morale and are a critical aspect of creating a stable culture where vision, values, and processes are aligned with the efforts of the team.

Self-evaluation and performance reviews get people to think about what they are doing and how they are doing it, and the feedback that team members get from you will give them a sense of what changes they need to make to align themselves with your goals. This helps them feel reassured and motivated.

At one hedge fund, I urged the manager to request a self-composed performance evaluation from his direct reports. He drafted a memo that asked each of his team members to assess:

- Their own P and L generation
- Their development of ideas
- The success they had in communicating with those managers with whom they came into daily contact
- What changes they thought were required in their funds to do better
- What they thought they needed from management to do a more effective job, and
- Their short-term and long-term goals in regard to both actual numbers and career development.

Perhaps you, too, have requested such self-evaluations at times when your team is at a crossroad, or maybe you are planning to ask for them. Here are a few suggestions I often make regularly in such memos.

1. Ask people to review what they have done, but it is not a good idea to ask people why. *Why* has an accusatory quality. It assumes that people know why. A self-evaluation request itself is enough to get your respondents thinking about why they made certain choices.
2. Get your replies in writing rather than verbally, and set a relatively short deadline for the submittal of self-evaluations. A few days are fine; more than a week is too far away. Remember, the goal here is to radiate urgency.
3. Ask your people to limit their answers to a maximum of one paragraph per question.
4. Then, schedule face-to-face review meetings based on the evaluations.

While each review will be a very personal and individual process, there are some basic topics to consider. For example, performance reviews of portfolio managers ought to consider P and L and various risk metrics. Analysts can be evaluated by their P and L attributions, idea generations, precision in recommending position size, and so on. Evaluate performances by sector, by budgets, and by anticipated performance. You may want to ask such questions as:

- How is your year going so far?
- What is your P and L performance?
- How many good ideas have you generated?
- What innovations or initiatives have you contributed?
- What contributions did you make to recruiting or development?
- How well is your investment strategy working, and what are your thoughts on P and L, buying power, investment mandate (or sector footprint, if applicable)?
- How well did you communicate with team members and other teams?
- How would you rate the effectiveness of your team and their overall performance?
- How did you implement feedback from others?
- How good are your relationships with clients?
- What challenges do you face going into the second half of the year?
- In looking out over the next two years, what would enhance your overall career growth?
- In what areas do you need to improve?
- What additional support or training do you need?
- What are your objectives for the next quarter and next year?

While these reviews are important, you should remember that they are not merely exercises. They are genuinely interactive, real-world tasks that let the members of your team realize they are accountable for their numbers. They are a means to encourage them to spell out how they might improve. In a larger sense, by requiring such reviews you are pushing your team to institute a change in their belief systems.

Don't forget: A performance review of your own leadership style is always useful and creates a greater sense of openness with your team. Some firms use 360-degree performance reviews, in which a company requires team members to submit appraisals (often anonymously) of their bosses. Feedback like this is valuable for maintaining transparency of leadership and unearthing various unrealistic expectations that the team may be projecting on to the leader or that he may be projecting on to his team.

ENCOURAGING COMMITMENT

Good leadership provides a sense of optimism about the future, and thus connects with the emotional wellsprings of motivation. Therefore, refining your team requires more than just making sure everyone is going through the motions. It is also about an emotional commitment, a desire to create the future, and a willingness to take risks, all of which require the ability to inspire people and challenge their complacency.

Almost all the measures that a leader must take in building momentum have their underpinnings in an emotional commitment to a process of change. Change is about emotional commitment and desire, not so much about rational decision-making. The rational decisions are motivated by an underlying desire to create the future.

So, do whatever it takes to stir the pot and encourage people to take risks. Use metaphors, storytelling, and other emotionally rich techniques for inspiring people. In your review meetings, be tough and stimulating. If you have visual cues, PowerPoint programs, or anecdotes from earlier reviews like this, by all means, use them. Hold public companywide forums, and stimulate new behavior with emotionally charged ideas.

Remember that one way to combat complacency is to always be tough, but fair-minded. A good leader avoids playing favorites or being captive to the whims of a select few with territorial imperatives. I have seen otherwise fine leaders who made exceptions to their rules all the time, and this undermined their credibility. If you are a deputy of someone who plays favorites, you have to confront your superior about the need for everyone to adhere to the same principles.

Almost always, a leader can identify individuals with underused talents and turn them into key players. One strategy some top executives have sometimes used is to eliminate certain middlemen and administrative assistants. By letting people do more of their own assistant work, you help mold the training competencies of people in the organization who are smart but are often left behind.

Conversely, a leader needs to be careful not to allow those with seniority to have a sense of entitlement even when they are not performing as well as they should. Such senior people can easily become obstacles to getting things done. They don't follow instructions. They may try to continue to get away with fair-to-middling performance. They may count on the fact that they know their leader needs to be liked.

There's no room for ambiguity in establishing a leadership role. Make your directives forcefully and then allow your direct reports to make mistakes. If you don't, people become afraid to make decisions because they don't want to be criticized.

Once your associates see how meticulous and excited you are about achievement and accountability, they will understand. You are translating your conceptual vision into actual goals that they themselves are helping to define and are motivating them to function beyond their narrow ideas, beyond the constraints of their intellect.

The amount of potential you can unleash in this effort can be mind-boggling. You will find that most traders have a deep desire to make good things happen and to feel a greater sense of contribution to the overall effort.

MOTIVATING IN MOTION

The recurring task of leadership is to keep focusing on a broad promise of the future and day after day to keep letting everyone know the direction the firm is moving toward and what behavioral patterns are most valued. The more you understand what people feel and think and how far they can be stretched or pushed, the more you can move them in a new direction or the direction of your choice.

How do you do this? Continually define the cutting edge. Keep refining the objectives of the mission. What I'm suggesting is not complicated, but it requires a firm hand at the tiller. Does everyone at the firm know what you want from them and what you intend to do? Are you willing to make changes and to stick to them? Are you ready to put new procedures in place that accomplish the change?

Besides tapping into feelings, it is imperative for the long-term health and growth of an organization to encourage members of your team to learn how to become leaders themselves. You can do this most readily by delegating some functions to others, and then monitoring their performance.

For example, one manager, Martin, has mapped out an important shift in the management of his team. Instead of monitoring each individual's work, he aims to have the most creative team members become more autonomous, playing to those whose strength lay in the area of original thinking.

"In structuring responsibilities for the guys on our team, I have already alerted them that my expectation is that they will keep me informed when they're considering changes and solicit my input before the changes are made. I want them to take us to another level, but also I want them to know there are responsibilities to manage up on their part," explained Martin.

"I also told them we are going to do a team leader weekly meeting. It might only be a few lines, but they have to check in. I am asking: 'Are you addressing those responsibilities?' So that's going to be our checks and balances, so I know that they are staying focused. I don't feel like I need to micromanage it."

In choreographing this creative shift, Martin doesn't have all the steps blocked out yet, but he has a picture in his mind of the eventual outcome.

I encouraged him to also discuss with his team leaders what they have learned each week in regard to their management issues. At some point, they are going to run into things they can't do. Ideally, you want them to say, "These are part of my skills. How can I improve upon them? Maybe I need to take a course. Maybe I need to get a little therapy, maybe I need to find a co-head for this unit." One of the most important parts of becoming a leader is knowing when to ask for help. In this way, your team will get more in-depth in the process. Reverse engineering a strategy by first defining the goal is a powerful way to build momentum.

Again, I think the critical thing is developing a methodology for managing people according to their natural abilities or proclivities. You learn the kinds of things that motivate them, what turns them off, and how they get in their own way. This lets you guide them by what naturally excites them. Once you find these keys to understanding your team, it becomes possible to interact with a lot of people around very specific challenges, as long as these people are compatible or are approaching the challenge in regard to their natural talents. With this kind of understanding you can work more closely with people to help them tap their hidden potential.

The more you can identify these patterns the more you can really relate to the people in the group that you are leading. You can keep asking, "Do I see him for what he is good at? Am I tapping into these natural motivational channels? Am I reaching him?" Moreover, you can ask questions about what in your own style of leadership expresses your own natural talents and abilities. What is it that you like to focus on? What turns you on? How can you tap into that as a way to lead others?

This is similar to playing a complex Beethoven sonata. It takes time to advance to the stage where you can do that with alacrity. It takes a lot of experience and practice. The same holds in managing people. Find the multiple you can handle based on your ability to see what makes people tick and how you respond to that, and how they respond through enhanced performance. There will be an increase in satisfaction, not just achievement.

So, don't wait: Do what you have to do as soon as you can, whether that means downsizing or right sizing or eliminating unnecessary bureaucracy. Do the painful things fast and get them out of the way. Focus on the efforts and solutions. Don't go looking for problems or people to blame. Pay attention to strategy that others can implement. Don't hide bad information. Make sure your deputies keep you informed so there are no surprises. Search your organization for underused talents that you can tap. Locate the strengths of key personnel and capitalize on them. Make it clear that you want problems solved at the line level rather than passed up to you to solve. Eliminate committee decision-making, and encourage individual responsibility.

Remember, if you value cooperation and communication, give everyone a chance to participate and reward those who cooperate and communicate most effectively. If you value risk taking, then you align rewards with that. If you value empowerment, create a culture in which people can express themselves and speak up without fear of reprisal.

Some leaders would rather plan and think about a firm's direction than oversee the implementation. But when you encourage your team members to build on their strengths without fear that they will outshine you, you help ensure a better outcome. A great leader does not hesitate to share his or her expertise with others in the firm so that they learn from him. A great leader takes a proactive part in becoming the kind of role model who encourages others to share their expertise within the firm, thus creating a learning organization that adapts to the new requirements of the marketplace.

CHAPTER 5

Building Momentum

In his best-selling book *Good to Great*, Jim Collins uses the image of a 25-ton flywheel—the kind used in heavy machinery—as a symbol for a company. Just as it is difficult to put this massive flywheel into motion, it may initially be hard for a leader to get a firm into motion. But once you make the effort, and keep the effort going, the flywheel begins to spin faster and faster until you reach a critical point where its own speed is generating tremendous energy. Collins calls the result of moving a company to this point the *flywheel effect.*[1]

Realistically, it means that a moment should arrive when the hard, day-to-day work of leading a hedge fund starts to generate great returns without any huge new effort. You should reach a stage where your profits accelerate even though you are pushing your team with what appears to be the same amount of force. At that point, you will be building momentum that can catapult you and your organization toward a higher level of success.

I have had the opportunity to observe this phenomenon in several funds. I have seen smart leaders put together an expert team of analysts, traders, and support personnel and then watched as traders increased the size of their high-conviction positions, and the combinations started to click. The returns grew; the fund started producing outsized results.

At that point, the leader may choose to add still more analysts who provide a bigger range of perspectives on stocks, bonds, interest rates, and macroeconomic elements so as to better anticipate and catch mispricings. The fund may diversify; perhaps new funds are created in addition to the original; more people are hired to keep everything at the shop humming and to allow the leader and his deputies to spend their time on what they do best (analyzing and trading) rather than on other management issues that they might not enjoy (such as handling the research flow). Eventually, there is a critical mass. The leader is able to do far more with the organization than he was previously; profits jump exponentially. That's the flywheel effect.

You can do the same with your sector, your team, or your firm. You can work day after day building up a head of steam until there are synergies that let you uncover information that you didn't have before, see unseen relationships, and make even more breakthroughs than you thought possible. Before you know it, your returns will start to make exciting leaps in profitability. You will feel the energy, the rhythm, and the flow as you walk into your office every morning. At that point, the most important thing is to sustain that momentum—to keep it spinning without letting it spin out of control. I discuss more of that in the next chapter. For now, let's concentrate on how to build this kind of momentum in the first place.

A TRANSFORMATIONAL PHASE

What Collins calls the *flywheel effect* I think of as the *transformational phase* of leadership. The process of transformation means getting to the essence of things and into truth-telling. It means making hard-nosed decisions to maximize efforts and minimize distractions. It means aligning everyone with the firm's objectives. By making a handful of key moves, you facilitate change around you. We have already discussed several of these types of changes. In this chapter, we take things one step further.

Initially, you will be grinding out the results. Over time, you should be able to spell out what kinds of information you need to fit your investment style, consider what questions must still be answered, and identify templates for formatting ideas. This builds momentum, and you rapidly progress to the next stage of actualizing your goals. On the way, you may run into resistance, but as you begin handling it, you begin improving the results from your team and begin to feel the release of energy.

Case Study in the Flywheel Effect

With this flywheel effect in mind, I asked Todd, a fund manager, whether he could sense the tipping point—the actual moment when everything suddenly became easier to accomplish.

Kiev: Have you had experience with the flywheel effect? You know, when you start building momentum, and then finally with one little extra push you produce breakthrough results?

Todd: A lot of times, portfolio-wise, you will feel like you are on a different page than the market. Then you will slow down your pace and find a period where you feel you are more in sync with the market and its psychological dynamic. What's going on? Then you feel yourself hitting a stride. You are well in tune with the way stocks are acting. We feel that once we see those opportunities in an industry or a market, we definitely press, and we spin wheels really fast.

Kiev: When does this happen?

Todd: We have an unusual number of very large up months because of that factor. So when we find that, we are on to something, we figure out a way. It's a lot of pattern recognition. It's a practitioner's feel. So you feel that organizationally.

Kiev: You are actually geared up to identify those?

Todd: Absolutely!

Kiev: Is change a big variable?

Todd: Absolutely! We have done a good job of looking one to six months forward. Here are some things that could go either way—let's identify them and figure out the early warning indicators. If we were ever to hit on one of those early warning indicators, what would we do with those? Then, when it happens, we are able to get that wheel up to speed much quicker.

We had tremendous success with healthcare stocks in September and October 2004, primarily in the pharmaceutical chain. We had gotten a lot of work done since July. We knew exactly what to look for. There was literally one data point that we were looking for. We bought twenty percent of the portfolio on the long side. We never added any healthcare names. We could see the data point starting to happen, and the market start to happen. We had the calendar laid out so we could feel that whole process. The capital moved quicker and therefore the returns spun.

Kiev: With the same identification, do you pick up the momentum, stock picking, and the P and L?

Todd: Yes. You can see our assets are growing more because our performance is there and our organization is bigger. Our organization is bigger because we said that our asset is going to be there. So that whole interaction is spiraling up.

Kiev: Are you producing results beyond what you anticipated?

Todd: Success begets success in a momentum-oriented nature. Our business has three factors: assets, people, and returns. If we start that process interacting well, if we get the people right, and we start out with a reasonable amount of assets, then our returns are going to start to move forward. If our returns are there, and we have an adequate number of people, then we can start to grow assets. Then the assets go up and help us get some more people. Then we go back to the returns. So there is a spiral up and a spiral down among those three elements. That carries tremendous momentum.

Then there are some ancillary effects besides reputation in the marketplace. Then you get additional information visibility. So there is definitely this spiral-up case, which is contingent upon all the engines humming together. There is also a spiral-up case when there are a number of people on the team working well together. If there are a couple of spokes in the wheel, the wheel doesn't turn very fast. Once everybody gets going, it just frees up the time. Then actually twenty percent of the time gets spent on offense rather than defense, on opportunity rather than problem-solving. The less time I am spending on noise and troubleshooting, then the performance is there, the asset-gathering comes, and the recruiting comes.

Kiev: Does this manifest itself in morale as well? Everybody feels high energy, being in the zone?

Todd: Of course.

Todd's observations are spot on. There is a very clear-cut interaction of complex variables that create an upward spiral, generating enormous momentum. He is cognizant of these factors and makes every effort to find data to support his trading thesis, to find patterns in the market at micro and macro levels, and to size his positions accordingly. Meanwhile, the interplay among stock picking, assets under management, and key personnel adds further to the momentum and success of the firm. Balancing all of these variables creates an increase in momentum followed by sudden acceleration. This flywheel effect that drives the success process at this fund comes from attention to detail, by watching for telltale pointers, and then picking the moment for one last push.

GOING FOR SHORT-TERM VICTORIES

One way to get the ball rolling so as to reach the transformational phase of high-percentage gains is to go for short-term victories, to look forward one to six months, as Todd noted in my discussion with him. You've hired the best people; they are committed to your goals as a team; there is nothing better to keep the juices flowing than for them to achieve early short-term wins. It's like putting a quick half-dozen points on the scoreboard early in a basketball game. Early success provides more momentum and motivation and helps people overcome inertia, fear, and other obstacles.

How do you create early victories? You promise the outcome in concrete, achievable numbers. Clarify the criteria for short-term wins, the kind of research needed to build conviction so that you can size high-conviction ideas. Outline the short-term goals and the steps for reaching those goals clearly.

Brett, an MIT-trained portfolio manager specializing in technology stocks, followed this advice. His goal was to put up $5 to $10 million for the first three months of the year and then ramp up so that by the end of the year he would be using $200 million of capital. He thought he needed to hire an additional analyst to spread the workload. He planned to do more intensive work so that he could better prepare for the long-term investment and could keep adjusting his trading perspective as aspects of his basic model were challenged or changed over time.

Although Brett was very willing to go to the next step, he also acknowledged that there was some psychological risk in digging deeper. It required more accountability to spend eight hours on a weekend day on one company and to be willing to "put your ass on the line" based on the work. He was reverse engineering, that is, doing the research to support his goal of ramping up with larger amounts of capital. This was a shift from covering 10 companies and just being comfortable, because he only expected a third of them to work out anyhow. By outlining the specifics of his strategy he helped map out what was immediately needed to begin working toward the goal.

Like Brett, you have to be clear about what you want. If possible, provide a template for how you want analyses done so that the analysts can prepare their research reports to fit your needs. Establish a way of measuring performance so expectations are clear. Then, keep reviewing performance in line with the goals you have set. Ask everyone to commit their important theses and strategies to paper as a way of increasing compliance with the strategy and providing a model against which to measure and track performance. This will encourage people to size positions commensurate with levels of conviction and targets and enable them to reverse engineer their portfolios in the light of goals.

MANAGING RISK-TAKING

Another critical aspect in pushing your fund toward this process of momentum is getting your traders and portfolio managers to reduce risk when in a drawdown and to take more risk as their profits increase. Both conversations invite them to enter new psychological territory beyond their previous limits. It is your task as a leader to help them to embrace this *stretch strategy* until they become comfortable with being uncomfortable. Pushing others to take on bigger challenges may be a stretch for you as well, but can ultimately produce extraordinary results and greater satisfaction.

You may want to start by defining a clear set of rules with regard to portfolio management so that the risk manager can monitor risk at the enterprise and individual portfolio level. This set of investment rules should be based on your experience. You should consider for yourself and each portfolio manager on your team:

- The maximum size of a position as a percentage of buying power
- What kinds of companies you will not invest in based on minimum market cap so as to stay within reasonable liquidity constraints
- The maximum number of longs and a set of rules for shorts
- Rules about how net long or net short you want the book to be
- Other such risk-management considerations regarding portfolio construction

You will probably also want to set rules for stop-loss on trades as well as certain drawdown characteristics that are thought to be desirable. All of these guidelines will help the portfolio manager construct his portfolio in line with firm objectives and will serve as guidelines for managing the portfolio. A risk management system can also help measure such factors as total P and L; average profit per trade in both dollars and percentages, P and L on both long side and short; and the average P and L for both long and short sides. Also include transaction stats (number of positions taken, number of daily transactions, percentages of winners on both long and short sides, and average holding period for each) ratios (accuracy win-loss ratio, percentage of P and L reflected in top and bottom 10 percent of trades), and P and L by sector. When you use a commercial risk system or develop your own customized system, you should be able to determine where and when you are losing money so that you can reallocate resources to reduce losses and maximize profits in your highest-conviction ideas.

Another good way to ensure that appropriate risk-taking is being encouraged is to organize a structured meeting process where the analyst presents and defends his ideas to the expected standards. The intensity of such a process boosts morale and empowers the analysts to dig deeper and to build conviction in high quality ideas, which become the core positions in the portfolio. Whether analysts work on the portfolio manager's ideas or their own ideas, most benefit from direction and strategic guidance so that their efforts are really having an impact.

Of course, the portfolio manager and his analysts should know how much they are each contributing to the overall P and L, where they need to be doing more work and recommending position sizes better. The same would hold for books being managed by anyone else, such as execution traders and some analysts who have discretion.

Specific profit targets help the risk taking and risk management process. You can keep the core positions and trade around them with stop losses and good risk management principles. You can have shorter-term trading stocks based on catalysts to give you the profitability to pay for your more volatile longer-term ideas. You may even want to have analysts report to specific portfolio managers so that the bulk of their work is done to support specific efforts.

In doing this, you should also give analysts space to express how they feel about the use of their ideas. Sometimes analysts are reluctant to present all of their ideas because certain ones are ignored. This is a potential roadblock that ought to be discussed so it is at least out in the open and communication can be improved. When every team member is respected and made to feel appreciated, risk-taking (in addition to many other uncomfortable situations) can be less frightening.

While all of this may seem cut and dried on paper, it isn't necessarily easy. As we have discussed before, there may be resistance when you encourage people to modify their approach to trading or investing.

In such cases, statistics provide a powerful tool to help motivate reluctant portfolio managers to rethink their limiting beliefs and to use more of their capital in a risk-controlled way to get bigger in high-conviction ideas so as to increase their profitability.

One risk manager I know, Jared, recently had this discussion with a portfolio manager named Mitch. Jared used Mitch's trading statistics to point to the feasibility of taking more risk in high-conviction names so as to produce greater profitability. He noted in particular that Mitch had an excellent batting average, a high slugging ratio, and a good distribution of winning trades in all time buckets and could take more risk in his best ideas.

Case Study in Getting Bigger, Taking More Risk

As the following dialogue illustrates, Mitch slowly began to see the benefits of letting go of his cautious conservatism and taking larger, more concentrated bets in his high-conviction ideas.

Jared: The key metrics are percent of winning trades and slugging ratio. This year, sixty-two percent of your trades have been profitable. Anything over sixty is great. There is also your slugging ratio, one point three one. That is simply the ratio of the average P and L in winning trades to average P and L in losing trades. The combination of sixty-two percent winning trades and slugging ratio of one point three one is excellent. Think about it intuitively: You make money on two out of three trades and on the ones you make money, you are making a dollar thirty. So that's a recipe for success.

Kiev: Anything else Mitch can look at?

Jared: Looking at your holding period analysis; you make money in each of the holding period buckets in the longs and shorts. Looking at position size analysis, you definitely put on some large positions. The largest long was almost twenty million dollars. Your average long is about two point three percent of your buying power, which is probably in line as an average.

Kiev: Would you say Mitch could increase the size of his positions in high-conviction ideas?

Jared: Yes. The biggest challenges that we have talked about are using more capital. You can do that in a number of ways. One can be making positions larger and the other is trading more names or a combination of both. In both the long and short side you haven't been afraid to put on size when the conviction is there.

Kiev: Can you talk about the number of different positions?

Jared: You have averaged about twenty names in your portfolio—ten long or ten short. So in terms of using more capital, can you put more positions on? That's a function of how many stocks you're comfortable with and your coverage universe. The other question is not only do you take the best high-conviction ideas that may come along a couple of times a year and put them on in size, but you do that with medium- to high-conviction ideas that you seem to find more frequently.

Mitch: I agree with that. I need to use more than one point five million dollars in my everyday positions. I think that amount needs to be five million dollars.

Jared: Right. You have got buying power of seventy-five million dollars, but your average capital or gross market value for the year has been only about twenty-five million dollars.

Jared: You are clearly using more this year than last year.

Mitch: I was just talking with Ari about getting bigger. I am actually committed to it and I have been trying to get bigger. Next year, we are definitely going to do that. The question is, what's the most effective way or the easiest way to get bigger? The prescription that we're going to follow is to start any idea at three point five million bucks before we even do really deep research. Basically, three point five million dollars to five million dollars initially, and then with conviction and proprietary edge, it goes to ten million dollars. Then if it's great, it goes to twenty to twenty-five million dollars.

Jared: In terms of single position?

Mitch: Yes, and I have two analysts—one senior and one junior analyst. I want them to have three to five types of these positions all the time. When we know it's a good idea, it's ten million dollars. Whereas this year, when we knew it was a great idea, it was ten million dollars. The only reason that twenty-million-dollar position was there, it was a real outlier. A once-every-five-years kind of idea, but ten million is more of the level where this year we thought we had a really good idea. Let's make sure we are big in it.

Jared: If you follow this logic here, and even if you stick with the average number of positions in the portfolio, which are twenty, then you're going to get there in a hurry.

Mitch: I don't think there is liquidity to do that. I don't think that is such a big leap. Whatever was a huge leap or massive change from what we're doing. It's just incrementally upticking everything about fifty percent.

Jared: That would actually blow a hundred million dollars out of the water and we could talk about more capital, which I think we would all be excited about, even if you are just sitting there with five of the good idea names in the ten-million dollar range. Five positions, there are fifty million dollars. What about expanding your sector coverage? Is there a plan to increase your coverage? I guess it's a function of your analytical support. Get more familiar with more names and maybe have more stuff on the sheets.

Mitch: They have given me a little bit more room to do that. I hired one guy and I am still basically trying to make it work with him. When he becomes a real moneymaker then I think our plan is to increase our coverage size a little bit more via another junior guy. I have the capacity and the place for it. I just need to be able to monetize this coverage list as it is. It's not like we are making a lot of money in the sector. We are making money and we used to lose money, so that's an uptick. I need to get him to a better level. We need to make money more often.

Jared: I hear you. You don't want to get bigger just for the sake of getting bigger. I have seen people who have literally walked in the next morning after this kind of conversation and doubled their position. There is a risk of too much, too fast.

Kiev: I don't think that's going to be a problem with Mitch.

Jared: Right, it doesn't sound like it. It sounds like you have a good plan. Clearly, this is an exaggeration, but my view isn't that you just walk in and say, "OK, look at my portfolio; just go double everything." I think you put a program in place, which is what you're talking about here. The bottom line is you put more capital to work this year without any dropoff in performance. Your '03 rate of return on that investment capital was about fifty-five percent. Right now you're at a run rate of fifty percent. So a slight dropoff but more dollar P and L. They're all good statistics. I am pretty confident that none of this will turn negative. Is it possible that some of these statistics that we're looking at now next year drop off a little bit? It's always possible, but it could have nothing to do with the fact that you need more capital. These are specific to the time frame we are looking at. Markets are different and a lot of factors determine what generates these numbers.

Mitch: The only real question is what happens when people increase their capital? Obviously, their net exposure is going to increase. I know it doesn't have to necessarily, but I think it probably does, and I know mine will. What would you say about how should I think about net exposure?

Jared: I don't recall your being on my radar screen for net exposure. Your point is, that could change as you put more capital to work. At seventy-five million dollars, you probably have a thirty percent net limit, which is standard. That gets you room to get up to a longer short, twenty-two point five million dollars. If you start to get positions up in the order of twenty to twenty-five million, you could exceed that easily with one or two positions, at which point you could increase your use of indices to reduce your exposure. If you are running thirty million long, but it happens to be from two positions that are high conviction positions, that may be the right thing to do at that point.

Jared: One quick note about position size—if three point five to five million dollars is a good initial size target on the sheets when you have some conviction, that amounts to three to five percent of your buying power, which is fine. Next you can try to increase the number of positions from sixteen to twenty, for example. If you follow this sort of sizing criteria, you do increase the size, and you also get the benefit of being that much more comfortable and intimate with the positions you put on the sheets. Then you can add a few twenty to twenty-five-million dollar positions when you have very high conviction. That's one way to grow into your capital.

Mitch: All right, cool!

Statistics provide a powerful tool to help motivate portfolio managers to rethink their limiting beliefs and to use more of their capital in a risk-controlled way to go bigger in high-conviction ideas so as to increase their profitability. Such conversations don't always go smoothly. Sometimes you may encounter resistance when you encourage people to modify their approach to trading or investing.

In this conversation, Mitch agreed that he needed to use more capital, but was somewhat constrained by his natural cautiousness. Even with a plan, Mitch still battled his cautious personality and was worried about his overall risk, and Jared had to continue to reassure him that the potential rewards, based on his proven statistical performance, was very much worth any added risk.

As Mitch demonstrates, taking risk is difficult for most traders. It is intuitive and natural to hold on to losers, hoping they're going to turn around, instead of operating counterintuitively and cutting losses so as to reduce the burden of having to make it all back. Conversely, the natural inclination of many traders is to sell their winners too soon to take the profit rather than hold on to positions and wait for them to reach maximum price targets. Like Jared in our earlier example, good leaders have to help their team members to accept the anxiety, to be counterintuitive, and in the process to get rid of losers and to hold on longer to their winners to increase risk and profits.

Case Study: Building a Team, Developing Conviction

In this following dialogue, I discuss the impact of one such goal-stretching conversation that I had on a previous occasion in which I had challenged a portfolio manager and his team to add more analysts so as to build conviction in their ideas to take more risk and increase the chances of greater profitability. While these portfolio managers followed my suggestions, there was some general resistance to my proactive and confrontational style.

Kiev: When did we last meet?

Randy: It was the end of November.

Kiev: What did you do after we met?

Randy: We got bigger in positions where we had real conviction—that was the first thing we did when we got back.

Kiev: How big did you get in the high-conviction ideas?

Randy: We were at one or two percent in these names and we made a conscious effort to get up to four percent.

Kiev: What was it like getting up to four percent?

Randy: It wasn't too bad. If they had all gone down fifteen percent it would have been a shot. They would have had to go up a lot.

Gill: We had a few big down days, but on those days we bought some more, which is something we wouldn't have done in the past.

Kiev: You would have gotten out?

Randy: There was a bit of noise on the big position we had, I think. We probably would have sold seventy percent of the position, but actually we bought more. The other thing is I was really struggling with it, absolutely obsessed with looking at the screen all day long. I was obsessed with the market going up and down. "The market is going down—we had better sell some," and "The market is going up—we had better buy some."

Kiev: Are you spending more time getting off the desk?

Randy: A little bit—but we could probably do more.

Kiev: How much?

Randy: Sort of weekly dealing with the analyst—we see more external analysts here during the day now.

Kiev: During the middle of the day . . .

Randy: I think the weakness is probably high in these other skills. I think we still spend a lot of the day on the phone.

Kiev: You talked about getting a younger assistant.

Randy: We are looking at a guy now to get some more conviction. His brief is going to be to attend company meetings and speak to external analysts a lot more. You know, just start up a regular dialogue with all sorts of external analysts and try to do the stuff we find hard to do, because we don't have enough time. I think what we haven't done is gotten a junior guy to answer the phone. I don't know whether you think getting this guy and building conviction is enough. This guy is going to do a lot of good. He is a clever guy.

Kiev: With several billion dollars under management, how much of a support structure can you create? You are only talking about one guy who can talk to the analysts?

Cyril: Well, you have to do it. We have all this resource in-house. I think we could do a lot more. We've got Don and an assistant, Jeff that works with us—he is not a junior.

Gill: The three of us sit down and talk. I think our reach has always been sort of market timing market awareness. We've been great at picking analyst tips, but we don't do the work ourselves.

Kiev: Maybe the question is how much are you missing because you haven't built a large enough support team? And how much more could you get if you built a support team? You have gone to two to three percent in the month of January. Previously you were only doing one percent a month. So, if you were to say what do you need to do to get to four percent a month or three percent a month consistently, how much more conviction do you need? How many more data points do you need or analysis do you need? How many more people do you need visiting companies? It's on some level closer to infinite than just one more guy. I don't know how many more you need. I am suggesting that you probably need many more than you think. If you want to raise the level of the game, you ought to consider what you need. Can you raise your level of conviction through deeper analysis, and how much can this contribute to your P and L?

Gill: We've got sixteen in-house sector analysts to do that, but they don't work directly for us.

Kiev: For whom do they work?

Gill: Various funds within our organization. They have their own hedge fund as well.

Kiev: Can you get them to do what you want them to do?

Randy: Up to a point. We can't dictate their whole day.

Kiev: If you had somebody that you could send to Madrid, would that help? If you got Madrid and you wanted to send somebody to Germany or some place else, would that help? I don't know how many you need. I am just suggesting one guy whose task is get all the in-house ideas and talk to the companies or the analysts, and then another guy to visit Madrid.

Gill: I think we are quite good at screening ideas. Once we have the ideas, we can back them one hundred percent. We can push those ideas once we have done the screening, then come up with new ideas. I think we are good at screening ideas from all the sources we have. We are lacking in backing those ideas.

Kiev: You need more support and more conviction. So how many more people do you need to give you that much more conviction—that's what I am suggesting, not that you get arbitrarily bigger.

Randy: In my mind, the thing that stops me from going crazy is—we've been together for seven years—before that, I was on my own for five years. I guess I am scared of changing things too quickly. I am a bit scared. Maybe I am wrong in saying, "Get three guys in," and let's settle it.

Kiev: Maybe you get one at a time and you define the function and maybe you are clear as to what you are expecting from them. And then maybe you begin to see to what extent the additional perspective is giving you the confidence to size your things. And then you say, "We need another guy," or maybe "We need another guy from a slightly different angle." When things are broken, you want to scale it and meet more conviction. To get more conviction, you need to be able to tweak the idea a bit better. Your own models—not necessarily rely on the Street. I know that you said the edge was getting the early call. I know the early call doesn't exist much any more since Reg FD.

Gill: It's a difficult one to describe—I have always had just a feeling for stocks. You kind of wait things out and overall, we think this is a good idea. We get more right than we get wrong. The early call is definitely on its way out. I think our edge is feel and market awareness, knowing our stocks. We are quite unemotional about stocks. We don't think we are cleverer than the market; we are quite humble. There are all sorts of little things that give us an edge. The early call from the broker used to be much more valuable. We do need to get to the next step.

Kiev: What about some of the other things you have done?

Cyril: If we get this guy in, see how he goes for three months, and then see if we need somebody else. We are trying to get more in-house analysts, and I think we have made quite a bit of progress in that.

Kiev: Are they supposed to respond to your request?

Cyril: We are not good at giving requests so far.

Kiev: You are not managing that process. Are you allowed to?

Cyril: We tend not to ask.

Kiev: Do you have them presenting to you?

Cyril: All of them or some of them. Sometimes, we do a sector review.

Kiev: My view is that you have to set the expectations for them to do the work so as to build a high level of conviction in their ideas.

Cyril: We don't want to force them.

Cyril: We don't want them to come in just for the sake of it.

Randy: You are saying we should put pressure on them to come up with it?

Kiev: You see what you're saying? If you are saying, "You are an analyst and you are working here and we need your help. We need high conviction and I would like you by next week to give me at least one high-conviction idea." What you are saying is, a guy is going to come in and say, "I have a high-conviction idea," when it's not. That's not acceptable. You want a real high-conviction idea, and you want to challenge them on it and find out if you have the high conviction and make him feel a little bit more heat. If he has a high-conviction idea and he does well, let him know that he has done well and you totally appreciate it. If he is off the mark, let him know that too. It sounds like you are not getting as much mileage out of it because you are being too courteous. I am not saying you have to be nasty about it, but people respond to a bit of pressure. If you challenge them intellectually, you get them to think a bit and raise the level of their game. I would even suggest that you get half a dozen of them in and do it in a group situation where there is a bit of competitive pressure to raise the level of performance.

Randy: It does make sense and I do think we should be asking him to do more.

Kiev: Set it up as an institutional process. You will get better work and that will give you a bit more confidence.

Burt: Yeah.

Kiev: Whom do they report to?

Anthony: The analyst team, which we know really well.

Kiev: Fifteen analysts, probably two ten-minute presentations per week? Do these guys send e-mails to you? Do you have a format for their write-up, noting whether an idea is high conviction, what is the expected price, and what is the source of the idea? Is there a record, so the guy is forced to commit himself? So you can read it on the weekend. If he has an immediate idea, maybe he can tell you about it verbally, but there is value in having it written. There is more commitment to the written word, and besides, it enables you to track it over time.

Gill: This network thing is like a computerized thing we are getting. There is an automatic software measuring system, so you can see who has been doing well. That starts next week. I think it will make the internal analysts focus a bit more. We haven't quite worked out how you take the next step to really incentivize the approach with it. It's going to be much more formal than just getting the only one conviction.

Kiev: This sounds good, especially if you can get the level of conviction, price target, catalysts, and the variant perception—what you know that nobody else knows yet. If you have a better sense of why and when to do it and if you have a good relationship, at some point you can ask him to make a recommendation. While you make that decision, it can be helpful to have your analyst make a sizing recommendation. We are talking about two things: one is content and two is procedure. You are setting up a process that makes people who are doing the analytical work part of the process. It makes you much more aware of what they are doing and it gets you to drive the process; it reminds you to size your position. It's not comfortable because you are comfortable with the old way of doing things. If the head analyst is on your side, get him involved in the discussion and let him set it up. I take it you are using more of your capital.

Randy: Yes. We have gotten it up. We are up at a hundred percent right now.

Kiev: That's quite an improvement.

Gill: Definitely. It's been easier to use more because we haven't been in the margin. We have to take bigger position sizes. Every time prices drop, we have been buying more and it's working, and that's getting the gross higher. We are buying more when it's coming down.

Kiev: How about the shorts?

Gill: We haven't really had any high-conviction shorts. Most of our shorts are just hedges. What's changed in the market, I think, is where you have a high-conviction short, typically with fifty other hedge funds. These shorts never go down. It's hard to find shorts in the market. Sometimes, I think we are bit scared of them.

Cyril: I am scared of some shorts.

Kiev: Are you holding the winning trades longer?

Randy: Definitely!

Kiev: You are sizing things better?

Randy: Yeah. I think one of the things is that you know you don't have that many great trades. What we haven't done is taken all the trades up.

Kiev: Are there any trading statistics available? Do you know how much you are making in your wins versus how much you are losing in your losses? If your methodology is such that you are making more on your winning days than you are losing on your losing days you are going to make more money overall when you increase your use of capital. If you don't change anything, you can take it up as high as you can take it up.

Randy: I guess if you increase the conviction then, . . .

Kiev: The reason I am saying, "Increase your conviction," you want to increase your edge. If you just kept doing what you're doing and just get bigger, you can make absolutely more. If you get bigger with the higher-conviction ideas, then you increase the value of that three percent of your trades that account for most profitability in most portfolios. If you look at where the profit has been in terms of which positions are giving you the most money, you probably didn't have too many of those trades.

Randy: In our fund we limit ourselves to thirty percent net exposure. We could change that but that by definition makes it hard to get really big numbers. It can only be twenty-eight percent.

Gill: When we started the fund we took a market-neutral approach. People wanted lower risk. I think now we've got more of a hedged fund with a very limited downside. I think that is where we could take the conviction up a bit more. Every time we do that, we come up to the thirty net ceiling.

Kiev: You could be net long thirty percent and get bigger in one third.

Randy: I think we probably could use some more ideas about getting away from the desk. I think the three of us don't communicate during the day.

Kiev: What do you talk about when you do talk?

Cyril: I think we have an edge when something spikes up or goes down.

Kiev: Does being on the desk add that much to your performance?

Randy: I think at the margin, it does add; I think we are so consistent because we are always on top of it. But we don't all need to be there.

Kiev: Or can you have somebody else there who is tracking it and can go into the office and tell you what is going on so this whole system becomes scalable? You have to build in people who can do some of that, so it can free you up, so you can sit back and think a bit. You're functioning like a trader as opposed to like a portfolio manager.

Randy: That's my edge. I think my edge is sitting down with the account.

Kiev: Getting a feel for the market.

Randy: I have a special relationship with my brokers. We do that—the three of us have our contacts.

Gill: You think the answer is to get somebody else in.

Kiev: You don't have to leave the desk. It just means you have a little more flexibility. You have somebody who is watching it for you while you are going off the desk to have a meeting.

Cyril: With the three of us, there should be enough to keep an eye on it.

Kiev: When things are slow in the middle of the day, what do people do? They talk to analysts. They are reviewing their portfolio and they are discussing ideas with their analysts. They see how much work is needed. Do they need more assignments? I think what we are talking about is, if you are setting the objectives to produce three percent a month, you need to understand the ideas better and get on top of the analysts a bit more in order to use more capital to get bigger in high-conviction ideas.

Cyril: Perhaps we should try that.

Kiev: To do that requires a bit more commitment to the result and then backing into all the steps that you have to do. That's what you have to do to make the thing happen. Resistance is expressed in "That's not the way we are, we don't like it; we've always been doing it this way." It's all true, but that's the stopping point. That's the importance of periodically reviewing the quality of ideas. It may mean badgering a bit. This is a process, which takes time. It requires changing. There must be a vision and desire and willingness to go the extra mile. It's statistics—being able to see where you are making profits. Which analyst on your team is providing you with profitable ideas? Are you making more money in old economy than in biotech? Are you making no money in tech? How about retail? Can you identify where the good ideas are coming from, and where the weak ideas are coming from, and which analyst(s) need to push more.

Gill: We got the data.

Kiev: So you know.

Gill: Yeah, but we don't do anything more with it.

Kiev: Do you see how this is related to performance?

Randy: Yeah, I do.

Kiev: I would suggest that you assess personality profiles with various psychological tests to see which analyst fits. You know, "Is this guy a good communicator? Is he good at relating to others, or totally withdrawn?" I would have a schedule of activities with some exception if there is some crisis going on. You ought to have a regular agenda.

You are reasonably organized about your trading and methodology and in that framework I think you can change the numbers and raise it to three percent this month. Do you ask that question: "What do we have to do to make three percent this month?"

Anthony: I think we look at it more on a daily basis.

Kiev: If you can make money on a daily or weekly basis, by all means do so. The critical thing is to commit to a stretch target and then develop a strategy for reaching it. This is important—what's the target? What do you have to do now? What do you have to adjust in order to reach your target? Whatever the number, design your portfolio in terms of expected price targets and the overall profit objectives.

Randy: How do we do this?

Kiev: You size your positions in terms of your overall goal and profit expectation, and then do the amount of work necessary to build higher conviction. If you are going to put on a ten percent position, you really want to make sure you know as much as you can about the company and make sure the analyst has done the necessary work to support a position of that size. You want to make sure he is digging deeply to learn all he can to support his trading thesis and make sure he has called around to find out what the expectations and the sentiment are on the Street. Are you losing trades pretty often?

Gill: Yeah.

Kiev: The last time I was here, it sounded as if you had a lot of low-conviction ideas. I remember specifically when you said, "We are spending as much time with our low-conviction ideas as with our high-conviction ones." Is there something about your analysts suggesting that they might resist this approach?

Gill: Not at all.

Randy: I think we have accepted that we complain and they don't do anything for us. You've got to shake them up. If you don't do anything about it then they're not going to do anything.

Kiev: Who chooses them? It's not like you went out and had a budget to hire your own analysts so you could direct them from the start. You do have some leverage over them so you could direct them, if you took that on as a critical step in building your own level of conviction or size? I mean, this is a billion-dollar fund.

Randy: In my view, the way we can get this to gross up, we could add another five or six bigger positions on the long-term conviction. Now we know what the problem is. I think being realistic, if you have six or seven ideas, they are not high-conviction ideas. I mean, you can't have fifteen great ideas.

Kiev: Why not? What's the limiting factor in whether you have a high-conviction idea?

Randy: With the amount of information we have got at the moment, to get more people working.

Kiev: So you could double the number of positions with the existing personnel. You want your analyst to know your target and you want him to give you three confirming data points to help you fortify your level of conviction in the next three to four weeks.

Gill: In any trade, the analysts don't know if it's high conviction.

Kiev: Why not? I talked to somebody today and they said, "When is there too much information to handle?" Your analyst is your eyes and ears. The more he knows, the more you know, and the more comfort you have leaving the desk, because you know he is out there watching your back, and you feel more empowered and part of the process if he knows that he is your eyes and ears.

Kiev: If you get everybody involved in it, it's going to raise consciousness.

Randy: I think this is my point, that it takes up a bit of time, but I think as a rule that we must make money there.

Kiev: At the end of the year, most of your money is made in a small percentage of your trades and more than likely in high-conviction ideas that you held for three weeks or longer. If you can strengthen the process of raising the conviction level in your best ideas by getting the analysts involved in these trades, it will work to everyone's satisfaction and create greater profitability.

CHANGING CORPORATE CULTURE

I have included this dialogue by way of suggesting one approach to keeping alive the intensity of a commitment, which is not necessarily always so pleasant. It is my view that the firm leader must encourage this kind of dialogue throughout his organization. I believe that the portfolio manager must encourage his analysts to do enough work to turn low- and medium-conviction ideas into high-conviction ideas. But changing corporate culture is not a one-time event. The recurring task of leadership is to keep focusing on a broad promise of the future and day after day, keep focusing on the longer-term objective in line with how much encouragement and challenge people are willing to accept in line with their strengths and motivations. The more you understand what people feel and think and how far they can be stretched or encouraged to reach their full potential, the more you can create a dynamic and effective culture of success.

So my prescription is simple: Identify publicly those aspects of your firm's culture you want to keep. Then, follow through, so your changes keep up a head of steam. Continually define the cutting edge. Keep refining the objectives of the mission.

What I'm suggesting is not complicated. But it requires a firm hand at the tiller. Does everyone at the firm know what you want from them and what you intend to do? Are you willing to make changes and to stick to them? Are you ready to put new procedures in place that accomplish the change? Are you willing to articulate your vision and invite others to share in it and commit to it? Are you willing to hold yourself accountable to this strategy and to hold others to their commitments as well?

After establishing and communicating your vision and the values you hold dear, you pay attention to some other elements of leadership, always taking the initiative, remembering that when you act firmly and transparently, you send a powerful message. Don't wait: Do what you have to do as soon as you can, whether that means downsizing, or right sizing, or eliminating unnecessary bureaucracy. Do the painful things fast and get them out of the way. Focus on the efforts and solutions. Don't go looking for problems or people to blame. Pay attention to a strategy that others can implement. Don't hide bad information. Make sure your deputies keep you informed so there are no surprises.

Search your organization for underused talents that you can tap. Locate the strengths of key personnel and capitalize on them.

Move fast rather than too slowly. Keep the ball moving up the field. Let it be known you want problems solved at the line level, rather than passed up to you to solve. Eliminate committee decision-making; make other individuals responsible for decisions.

Evaluate performances by sector, by budgets, and by anticipated performance.

Evaluations of individuals can include a range of data such as:

- What was your P and L performance?
- How many good ideas did you generate?
- What are the innovations you have contributed?
- How well did you communicate with team members and other teams?
- What contributions did you make to recruiting or development?
- How good were your decisions?
- How good is your relationship with clients?
- What new initiatives have you generated?
- How did you implement feedback from others?
- In what areas do you need to improve?
- What additional training do you need?
- What are the objectives for the next quarter and next year?

You change people's behavior through emotional messages that motivate them to change, to tap more of their own potential. Thus, a lot of what leads to excellence is your willingness to step into the abyss yourself, to state the vision of change or excellence, to promote a culture that rewards a willingness to take risk and to learn from experience. At a hedge fund, this invariably means setting larger targets and developing more high-conviction ideas.

Whatever the value you instill, you have to reward it. If you value cooperation and communication, you give everyone a chance to participate and reward those who cooperate and communicate most effectively. If you value risk taking, then you align rewards with that. If you value empowerment, you create a culture in which people can express themselves and speak up without fear of reprisal.

ABANDONING ENERGY-DRAINING BEHAVIOR

In *The Effective Executive*, author Peter Drucker succinctly explained time: "The supply of time is totally inelastic. No matter how high the demand, the supply will not go up. There is no price for it and no marginal utility curve for it. Moreover, time is totally perishable and cannot be stored."[2]

This inherent problem with time demands that successful leaders realize the importance of harnessing energy and effort. To build momentum, leaders must learn not to waste any time on nonproductive or counterproductive behavior.

Perhaps the most effective way to begin to learn how to manage time successfully is to begin keeping a log of how you spend your time. A time log will help you pinpoint areas of wastefulness, decide what can be delegated to others, and help you shift your priorities.

This was the case with Phillip, a macro fund manager who consulted with me because of problems with "procrastination and laziness." Because he failed to devote enough time to the pursuit of his vision, he was lacking in conviction and "afraid of committing."

I challenged Phillip to consider such questions as:

- Why are you hesitating?
- Are you afraid to make a decision?
- How much time do you think you need to make preparations before taking action?
- Are you taking too much time or too little time?
- Can you make a schedule of activities to better manage your time?
- Do you have so many things to do that you don't get to certain things?
- If so, could you hire someone to help you?

Phillip needed to take his vision out of the realm of "I think I should do it *someday*" to "Let's get started *now!*" He needed to organize his time better by prioritizing and delegating and not succumb to his negative self-characterization as a procrastinator. He needed to develop a to-do list and to rein in the support of his associates. By hiring additional people, Phillip also found that he was able to handle extra work. All of these actions helped develop a structure for finishing small jobs as well as big ones within a certain time. In effect, he began to use his strategic perspective to create viable solutions for solving business problems and moving toward his vision.

Case Study in Eliminating Nonproductive Behaviors

Of course, the process of time management and behavioral modification can be daunting, but successful leaders not only have to learn how to manage themselves, they also have to learn how to empower their team toward self-management. To get more perspective on this, I met with Chad, a particularly thoughtful CEO who had spent considerable time thinking about his interactions with his associates.

Kiev: Have you ever had to deal with anybody who was engaged in energy-draining behavior?

Chad: Yes, we had one employee who couldn't show up in the morning. Once every two weeks he would miss morning meetings. He was also missing deadlines with respect to timely production of work.

Kiev: How did you handle this?

Chad: I felt it necessary to sit him down and tell him that it was vital to make the meetings and deadlines. First, he was giving lame excuses. So the first thing we did was confront him and say, "You need to be at the morning meeting. It's the vital time for us." It happened a couple of other times, and we immediately hunted him down on the cell phone. At one point he just overslept. It happened two more times. We terminated him. He was a family relative who had been with us since Day One. So, he was close personally. It sent a message to the organization that "I don't care who you are. There is just some basic behavior you need to observe. You are clearly not giving it to us. That is not fair to anybody else around here." It's just a no-brainer. You can't be everybody's friend.

Kiev: Is that tough to do?

Chad: It's unnatural for me. I think, in general, I avoid confrontation. I would rather not deal with confrontation unless that is the only way to go. I would rather go around something than through something. It's not natural. We had a new employee who was extremely talented analytically, but he just talked too much. It's a hard thing to sit across the table from somebody and say, "I like you, and I respect you, but you talk way too much. It's disrespectful of my time and your teammates' time." I said it two weeks in. I wouldn't have said it before, but I know I am supposed to say that now. I feel bad because I see him struggling with it. He is not relaxed around me. He is very self-conscious because he has this natural tendency. So what do you lose? You lose the fact that we used to have a little more relaxed relationship together. But I am also comfortable with the fact that I would rather have him feel his tension, than the whole team listens to him gab on. We have a job to do.

I was very at ease talking about "Here is how you need to lay out the numbers. Here is how you need to look at the business. Here is how you need to carry yourself." But this was an intensely personal conversation. It was harder for me. I felt like I was telling him how to behave as a human being. Those are harder conversations for me. You lose a comfort with that person because you are putting them on the defensive.

Kiev: That's the next level of optimum performance—helping your team get past their anxiety and get rid of energy-draining, unproductive behaviors. This sometimes means that you must meet with resistance head-on, that you must be confrontational and even challenging.

Chad: I worry that they won't embrace that (getting rid of energy-draining behavior) as a better way to get to the performance and that they will, therefore, reject it and get frustrated with it. With another employee we have had four years of tremendous communication issues. At times, it's embarrassing when he is going through a conference call with a CEO. The unprepared things are not consistent with the level of professionalism we normally bring to the table. We view a half-hour call to the CEO as the most valuable thing that we can do. We want to gather as much information as possible. I have gone through several times with that individual the way in which he could improve the clarity of his communications internally.

Kiev: Do you think he understands what you're trying to teach him?

Chad: He has trouble seeing himself. He thinks that my criticism is unfair. He looks at his work, and he says, "It's the same thing as this guy and this guy. Why are you picking on me?" He doesn't see his own failings. It's almost like I want to take an audio recorder and leave it on the next time we have a conference call and make him listen to it. It just seems cruel.

Kiev: You want to teach the performance dimension of the job, the interaction skill. The more he can see himself, the better. It's not so much criticizing him as it's saying, "I get the sense when you're talking, you're a little uncomfortable. Tell me about it. Let's talk about it. I used to be uncomfortable, too. I know what it's like. You are talking to some big-time CEO. Sure you're going to be uncomfortable. These guys can handle it. It's natural to be uncomfortable." So then you begin to talk about how to practice doing it.

Chad: I can't make a dumb person smarter, but I can help a smart person think more intelligently and act more efficiently in our business. I wonder if these are people skills that I haven't had any experience in. Trying to mentor people in public speaking—that is kind of a natural fear. Somebody is afraid to raise his or her hand and ask the question. He doesn't want to sound stupid. He gets up and he's trembling. He's very uncomfortable. Some people do it more readily. In my own observation, certain skills either come naturally to people or they don't. Our business isn't good at training or developing those things. From your perspective, are there a lot of success stories in things like communication or people skills? Or are there simply the haves and have-nots?

Kiev: It's like the fear of public speaking. That is uncomfortable, and all you can do is just get up and do it until it becomes comfortable. It can all be learned. It's not so much condemning the person; it is more like coaching. "Let's do some interviews until you really learn how to do it. Let's videotape it. Let's go back and do it again. Let's get a speech coach to coach us through some of this." It's something you definitely can learn. It's not about being critical. It's about opening people up and helping them to get to the next level.

The discussion with Chad touches on one of the most critical challenges faced by hedge fund managers. Helping your team to get rid of their nonproductive behaviors might actually begin with getting rid of one of your own—your efforts to gain approval. As hard as it may seem, to navigate the minefield of egos and complaints effectively, the leader must let go of any need for approval that he might have. Everyone wants to be liked, but it's best to wean yourself from the desire to be thought of as a "nice guy" or "helpful"; ideas might lead you to act contrary to what is in the best interests of the firm. Of course, you have to be sensitive to the feelings of others, but you have to balance this against the needs of the firm and the maintenance of discipline, work ethic, and certain standards of performance.

To build momentum, you must learn to ride out a range of feelings and sensations while focusing on the task at hand. You need to be transparent, authentic, and willing to find new ways of resolving many of the human issues created in your organization. This includes, but is not limited, to learning how to balance the desire to be liked with the need to make decisions in the best interests of the firm.

Ultimately, momentum builds as you address and master these and many other critical psychological components of leadership. As you begin to transform how you think about the world, you begin to see and understand the links between your thoughts and the results you produce. From this, you will recognize the power of envisioning the future, focusing your thought processes, and developing a mental blueprint for reaching your objectives. Then you will be able to engage others in the critical activities that are consistent with your objectives. This is how you build and, in fact, sustain momentum. The process never ends. The more you approach things in this open and transparent way, the more you will grow and mature. And the more you grow and mature, the more you will be able to create and accomplish and sustain that exhilarating flywheel effect.

CHAPTER 6

Sustaining Momentum

Several years ago, a young climber named Aron Ralston startled the world by performing an action that turned an almost certain-death situation into an opportunity for salvation and, eventually, personal growth. He was solo climbing in a remote Utah canyon when he nudged a boulder loose. It tumbled down from above and pinned his arm to the canyon sidewall. For three days Ralston was stuck. Finally, he decided the only way he could be sure of getting out of the spot alive was to cut off his own arm with a multitool and then hike to safety. Ralston has since written a book, *Between a Rock and a Hard Place*, and is back to climbing with the help of a prosthetic hand.[1]

Ralston's experience is an extreme example of turning a breakdown into a breakthrough and calls to mind Napoleon Hill's assertion that "in every adversity is an equal or greater opportunity." If he could use such a grisly experience to find an opportunity to grow and develop, then you too can find opportunity in the breakdowns that you and your team may experience in the course of your everyday work.

But, as we discussed in the last chapter, setting the flywheel in motion is one thing; keeping it in motion requires yet another skill set—constantly examining what is and what isn't working and installing procedures that revive or reestablish the momentum; in other words, developing a *stretch strategy.*

THE STRETCH STRATEGY

When you have begun to build momentum, you can only sustain it by keeping the pressure on to continue building. This stretch strategy—is inherently uncomfortable. Why? Because you are boldly making a statement. You are saying, "Our target is X, and we shall do A, B, and C to reach it." You are promising to accomplish a certain result. Your declaration of intentions requires you to act every day in quest of that result with a single-minded focus that gets others on board as well. You need to stick with your program, but more important, you need to get others past their own resistance to such an effort and preference for the safe route or status quo. This is the ultimate challenge for the leader, to get people to go past their own fears and embrace the power of the stretch strategy. And that can be tricky, particularly when others are holding back. There is always resistance to such an effort because most of us prefer the safe route, the status quo. But to the extent that you follow the rules you have agreed upon, and insist that others follow the rules, then you are in a position to build something going forward, and you won't become a hostage to the possibility of resistance or even antagonism that can come into play when others are distressed.

The stretch strategy involves living in the gap or venturing into new territory between where you are and where you want to be. Living in the gap is doing the uncomfortable until you get comfortable being uncomfortable. As you swim in these uncharted waters, you'll gradually (or perhaps suddenly) begin to feel the adrenaline kick in. Then you realize that the feeling of discomfort is actually a feeling of excitement, maybe even of exhilaration. When your conscious mind labels this feeling exhilarating rather than "Uh-oh! I'm in deep water!" you begin to adapt to this state of mind rather than try to escape it. Soon it dawns on you that it not only feels good, but more important, it enables you to perform at peak levels. This is the zone.

Case Study in Sustaining Momentum with a Stretch Strategy

To explore this theme further, I asked an extremely talented hedge fund manager how he approached the issue of stretch strategies. The following dialogue reveals how much creativity involves nonconsensus thinking and a willingness to emotionally commit to the target and keep trying to find new ways of generating a high velocity of quality ideas and trading performance. Take note also that this is a particularly difficult topic to explore even with one of Wall Street's brightest young managers.

Kiev: Any processes for sustaining momentum?

Mort: We pride ourselves on being creative and trying to stay ahead of the competition by constantly pushing the limits and trying to figure out new ways of making money or develop new processes. The stretch strategy is a natural stimulant for helping us to recreate ourselves every few years so that we don't lose our creativity.

Kiev: What processes do you have in place that makes this possible?

Mort: The most critical step is to hire the right people who are willing to think creatively or outside the box.

Kiev: How do you assess that?

Mort: I knew Jack very well. I knew he was very creative. When there are people that I don't know, I look at their process for making money and whether it is original or similar to what everyone else is doing. Originality in their process for making money is the key.

Kiev: Even creative people reach a plateau. Do you have any methods for boosting their creativity?

Mort: I think setting up a target puts pressure on people to create. It forces people to get out of the comfort zone and attack issues in new ways.

Kiev: To what extent does the goal impact the creative process?

Mort: For an organization that is setting aggressive goals, it impacts the creative process a lot. We have come up with new strategies for making money. We wanted to make more money; this forced us to do things that we weren't doing before.

Kiev: Was this uncomfortable at first?

Mort: Part of this is because you get resistance from people. They don't buy into it.

Kiev: Is it the risk that creates discomfort?

Mort: We are only creative when we are playing offense, when we have built up some P and L and know we can think out of the box.

Kiev: So it's easier to be creative when you are ahead?

Mort: You are freed up to think bigger picture. Part of this is that you are thinking longer-term as well. That's why it's important for people to see how these ideas fit into the larger vision. It is an emotional and time commitment now for something that isn't going to pay off for a year or so.

Kiev: Does this get into the business of level of conviction, doing more work to support the idea?

Mort: Absolutely.

Kiev: How do you deal with complacency, slippage?

Mort: Depends on the maturity of the team and the individual.

Kiev: How do you handle that?

Mort: Tough. People are getting marked every day. It is easy to know if you are doing well or not. With people who live and die by their P and L, when it is very good, there is a tendency to become more complacent. Some stop doing the same work, some don't.

Kiev: It's important to be aware of that, isn't it?

Mort: For some people, their confidence and complacency level is totally correlated with their P and L. You have to be careful not to give in to demands people make when they are up a lot of money. I know one hedge fund manager who called up his investor at the end of last year called and said he wanted to raise his fee retroactively. And he hadn't made money for three years. His investor said, "If you don't make money next year, it's going to be pretty bad. If I do this, and you don't live up to your end, there will be a problem." He was getting too complacent and cocky because he had made money.

Kiev: Do guys coast?

Mort: Our guys don't coast. That's because it is an "eat what you kill" environment. All the incentives are aligned. People are generally very focused. The PMs and the analysts are aligned as a team. You try to work as a partnership. You don't cut your analysts' legs out, which generates a lot of resentment. We view the analysts as partners in the process. Their economic interest is aligned with ours.

Mort is aware that he must help his team to strive toward larger goals to avoid the tendency to rest on their laurels. The discussion also indicates that sometimes it is hard for others to buy into longer-term goals. He understands that setting those goals is his job as the manager—part of "playing offense," and developing a meta-concept or larger vision of things to come as well as monitoring the process to guard against complacency and slippage and always reinventing yourself and your team. This is what makes for excitement and growth and generates energy and creativity.

NO TIME TO LET UP

Sustaining momentum is almost as hard as building momentum. It is not a time to slack off or let up. While the wheels may seem to be turning of their own accord, you have to be ever-vigilant to make sure that nothing gets caught in the spokes.

To sustain the momentum, you, as the leader, must continue to nourish change and to strategize so that everyone stretches for the next goal. You must seek answers to the following difficult questions:

- How do you sustain the momentum in a firm with young analysts and traders who may have different time frames from you?
- How do you determine whether they will stay with you for the long haul?
- What is the cost of, and return on, loyalty?
- How do you judge whether what you are offering is enough to keep momentum going?

Go for short-term wins that build confidence, and if you hit a wall, examine the breakdown in your plans. Figure out what's wrong, make an adjustment, and turn that breakdown into a breakthrough. Make sure you have enough members in every area and that everyone is pulling his or her own weight. If the situation calls for letting people go or reorganizing your team, make the adjustments you need while remaining transparent and honest. Tell people what their strengths are, and in termination proceedings, allow those being dropped to learn from the experience rather than simply shoulder blame. Most important, continue to be open to both failures and successes, so you can make those small course corrections that keep you and your firm on target.

Sustaining momentum as Mort has described it is not always easy to do. Sometimes there is actually a failure to sustain momentum as the following case study illustrates.

Case Study in Failure to Sustain Momentum

This case study with Chris, a long-term veteran in the hedge fund world, underscores one of the more difficult challenges of maintaining momentum—the retention of talent. I include it by way of demonstrating the kinds of problems that have traditionally plagued hedge fund managers so as to underscore the value of some of the solutions that I will explore in the remainder of this chapter.

Of the many obstacles to sustaining momentum, most hedge fund leaders, including Chris, agree that the most common and disconcerting obstacle is staff turnover. Unfortunately, many leaders believe that most portfolio managers and analysts eventually leave even the most successful firms for "greener pastures" because of personal ambitions and a lack of loyalty to the firm that developed their talents. While there is no generic answer on handling staff additions and subtractions, it is obviously a problem that needs to be addressed when considering how to sustain momentum.

Kiev: What has been your experience with retaining or terminating people?

Chris: Guys want to be your partner and friend when you're making them a lot of money, but when times get tough, even when they bear a responsibility for tough times, they bail out. When I started up thirteen years ago, someone warned me: "You're going to be very unhappy with the people side of the business. If you hire a good guy, one of two things happens. They will hound you to death over compensation, no matter how big the numbers are, or they're quick to compete with you. When you hire a deadbeat guy, one of two things happen: They lose a lot of money, and you're justified firing them, but you are still left with the losses. Alternatively, they figure out they buried you. They have no future. They quit and leave you with the losses." That's been my experience.

Kiev: Can you give me an example?

Chris: One guy called me ten times looking for a job. The tenth time he called me, he says, "I will come to work for nothing; give me a chance." An associate said, "He seems to be a street-smart kid. He is hungry." He was making fifty thousand dollars a year as a junior analyst. I hired him and said, "Fifty thousand dollars—no promises, no guarantees. Lock yourself in an office, go to all the conferences, learn the business, and if you have something intelligent to say, come and visit me." It's exactly what he did. So nine months went by, and he was just learning. We have a good year. I give him a hundred thousand dollar bonus on top of his fifty thousand dollar salary. He makes a hundred and fifty thousand dollars. Next year, we have another good year. He does a good job. I am very pleased with his performance. He gives me some new ideas for the portfolio, which convinces me to increase some previous existing positions. I am happy. I call him in December. Again, he had no contract, no guarantee, no nothing. I say: "I am going to make you a partner in the carry of our management fee. You can make three and a half million dollars." He is now twenty-four years old. As God is my witness, the first words out of his mouth were: "Is that all?" I say, "You just ruined my day."

Kiev: So, you were upset that he didn't appreciate how far he had come?

Chris: Eighteen months earlier he was a twenty-three-year-old kid begging for a job. I voluntarily pay him three and a half million dollars, and that's the first thing he has out of his mouth. I dismiss him from my office. That night he sends me a fax. He says, "Please, I think you misinterpreted me. I love working for you. I have learned a lot. I am very aggressive." The guy was confident.

The next year I get the crap kicked out of me. My fund is down six percent. So, I make a decision; since the equity guys had nothing to do with the losses of all the emerging market guys, I am going to pay out my entire management fees to the staff, which is unheard of in the fund industry. I paid this fellow a million and seventy-five thousand in a year where I lost twenty-five million dollars of the investors' money. That night he sends me a fax at home that says, "I now know the pain associated with being a partner in a partnership," meaning he was affected by other people's results. I call him up at home that night. I say, "You are lucky you're not sitting next to me. If you were, I would grab you by the scruff of your neck and choke you to death. What is the pain that you, Mr. Twenty-Five, are talking about? You made a million and seventy-five thousand. I just lost twenty-five million dollars. I lost a billion dollars of client funds in withdrawals. I go out of my way to run my company and break even to keep the young guys. You don't know what you are talking about. You are [as] dumb as the day is long."

Kiev: What happened after that?

Chris: The next year I have a big recovery year, and I make a great deal of money. I make a decision to share it disproportionately with the young people that basically were not responsible for the losses the previous year. I paid the young man thirteen and a half million dollars, which he never deserved. I am a good manager. I understand people. Two weeks later I noticed he is not coming to the morning meetings with any degree of regularity.

I walk into his office and ask: "What's going on? We are in a war, and you are not coming to the battle every day."

He first says to me his girlfriend got relocated for five months.

I said, "This is a problem I have to deal with?"

He says, "No, no, I don't know that I am challenged the way I want to be challenged."

So I said, "I know I made you a great deal of money. I heard from the grapevine you bought a new sports car already and a big apartment. This is something I have to weigh in my staffing the firm."

He says, "You are very insightful. You are very smart. I've got to figure it out. I have got to think it through. Give me a couple of days."

I figured immediately he was thinking of leaving. So I said, "Fine, of course, but you will come back to me in a couple of days and tell me where your head is at."

He came back to me two days later, and he says to me, "I am leaving to go to another firm. I want a new challenge."

Kiev: How did you respond?

Chris: I said "Sixty percent of your P and L last year was ABC stock. I owned it before you joined the firm. You just convinced me to make it a larger position, which was the right decision, which I appreciate, and why I am sharing this with you. If you leave, you have to give me back four million dollars of your cut. You are not smart enough to understand that [at] age twenty-six, you never deserved to make nine and a half million dollars in this firm, which is something I created. I am sharing the money with guys that are long term. You're going to say you got screwed for four million dollars." Then he left.

He is a bright, capable guy. I like him. I respect his opinions. The bottom line is, what as a manager should I have done differently? He was like a partner in the business in every respect. He told me I was like a second father, and he learned a great deal from me. Sure, I am a demanding guy, but I am the hardest-working guy in the firm. I treated him like he was my partner. He had no contract, no guarantee. I paid him with the hope of having a long-term relationship with him.

Kiev: Did he get a bigger percent? What percent did he make relative to what he brought in?

Chris: He made over half. It was very generous. There is no question in our bad year he didn't make what he would have made if the firm did well. The characteristic of being a partner in a partnership is that basically you have to be exposed to the economics of the partnership. I isolated him from that by paying him even though I lost money. If it were like most other hedge funds, he would have made nothing.

Kiev: Is your experience a little similar to a lot of other people?

Chris: Yes. One of my closest friends went after one of my old analysts. He and my friend had a fabulous run for eight to ten years. They were up like eighty to ninety percent, and they each made two hundred million dollars. The guy was dissatisfied and basically broke up the firm and left to start his own. He didn't have a sense of gratitude and appreciation and have a long-term vision.

Kiev: Do these things happen because people want to have their own firms or because they can't restructure? Could they have had their own firms within your firm?

Chris: I don't run that kind of business, no. I think the bottom line is the nature of the beast. An expression that these macro guys love to use that I hate, but I recognize, is, "eat what you kill." I hate it because I grew up in this business for twenty-five years in a culture of cooperation and supporting each other.

Kiev: More like partnerships.

Chris: Yeah.

Kiev: Why can't that model exist in the hedge fund world?

Chris: Guys are very greedy, and they're in a hurry.

Kiev: How would you prefer to deal with the new generation?

Chris: I am a very steady guy. I have been married forty years to one woman. I wanted people to join me that would look at this as their last venture if I took proper care of them and gave them incentives and treated them fairly.

Kiev: Do you think the hedge fund world is changing?

Chris: It's just a different world we live in. So what's the lesson you learn? What happens is, when you pay them, you empower them to take risk.

Kiev: In retrospect, maybe you just pay them what you agree to pay them and not that much more.

Chris: You've got to give them a bonus. You have to be competitive, but you don't have to go over the top. I treated them like they were my partners. I went over the top.

It is clear that Chris feels it is not always possible to sustain momentum because younger analysts and traders do not have the same loyalty to a firm that he believes they should have. While there is no one particular answer to the problem, I believe that enlightened hedge fund leaders can make a difference in the frequency and amount of turnover in their firms. By frequently reassessing goals, helping traders turn breakdowns into breakthroughs and redesigning the team when necessary, leaders may be able to take a more proactive approach to the problem instead of acting defensively when departures take place. It may not be easy, but sustaining momentum is possible. Let's explore how.

BURNOUT AND EUPHORIA

As a leader, it is important to always take note of the mood, motivation, and general level of enthusiasm within your team. In this way, you can monitor when euphoria is giving way to an exaggerated view of importance or when your team is facing burnout, either of which can lead to risky behaviors and unfruitful extensions of time.

During peak times, everyone must be prepared for late nights, long hours, and working weekends. But under these circumstances, even though profits may be extraordinary, some traders become physically exhausted, and some fund managers become too busy to handle the increased number of decisions that must be made. When too many decisions are delegated to others, managers are often dissatisfied and distracted when their expectations aren't met, which sets the stage for further frustration and eventual burnout.

Additionally, the pressure to continually maintain high performance and replicate success weighs heavily on some traders. After several years of managing a portfolio or a fund, they may long for some free time, for a chance to try something else, or just for a long vacation to recharge their batteries. Perhaps the thrill is gone and they no longer want to put in 80-hour weeks. Obviously, this type of burnout can lead to decreased performance and turnover.

"I think the biggest problem with burnout is the lack of objectivity for the next year," says a fund manager named Joe. "That negativity reinforces itself. You tend to focus on what can go wrong today rather than where is the opportunity for you. You can put a smile on, but if you are not fully convinced that you are coming in to work to make money today, it probably doesn't happen. You lose the eye of the tiger and the ability to recognize patterns. It's a self-perpetuating cycle of self-defeating thoughts and a self-cycling negative spiral."

Despite a temporary dip, Joe has been in the trading game long enough to recognize burnout for what it is—a temporary pause. His attitude is that if he cannot avoid burnout because of the unpredictability of the markets, he can ride through these feelings by switching to smaller plays and waiting for his positions to strengthen on the basis of fundamentals. He acknowledges the burnout and doesn't let it get the best of him. And he has the right idea—not only for himself but also for those under him. Leaders should monitor themselves and their teams for signs of burnout such as boredom, depression, and ennui.

If a trader show signs of burnout, then as a leader, you would do well to step back a bit from your day-to-day management and find out, "What's the piece of this business that this trader seems to enjoy most?" It's possible that he is burned out on some aspects of his work but still gets a kick out of trading, research, recruiting, teaching, or mentoring. What is he naturally inclined to do? Help him build on that part of his professionalism. While you might not be able to remove him entirely from the aspects of the job that he is burned out on, you may be able to at least temporarily reassign or delegate some of the tasks that he is finding boring or repetitive.

Another answer may be to suggest that the trader simply take a well-deserved vacation to relax and rejuvenate. Whether you are burned out or the members of your team are, the point is to find a way to turn that breakdown into a breakthrough and to sustain the momentum that everyone has worked so hard to build.

Surprisingly enough, euphoria (which often results from success) can stop momentum just as quickly as burnout. Euphoria can lead to expansiveness and excessive risk-taking. Ordinarily conservative and methodical traders may all of a sudden think they can do anything and start overextending themselves. This pattern ultimately ends with disappointment.

As one manager told me, "I am always trying to tone down irrational giddiness and remind my people that this is a long race, and we should not be reading our own notices."

Of course, it is sometimes hard for leaders to accurately keep tabs on team morale, especially when most others are inclined to sugarcoat their communications with you by way of protecting their turf or interests. Therefore, you may want to enlist the help of a trusted personal adviser or coach who is trained to be objective and supportive and who reports only to you. He can help keep your team on track, especially as your success grows, your responsibilities increase, and you are pulled in various directions by multiple constituencies. This person ought to be able to tell you when your team might be spinning wheels or flying off the rails.

In addition, when you stick to the principles of a flat organization, rather than allow hierarchies to block your view or to keep team members from speaking out, your always-open lines of communication will help you recognize when your team members are nearing the end of their rope, whether from exhaustion or distraction. Even when it is hard to retain the truly flat model, you need to encourage your senior people to call diversions and mistakes to your attention. And you have to honor your promise to listen when people do speak out.

REASSESSING AND REDEFINING GOALS

Like climber Aron Ralston, a good leader has to accept the reality as it is, take action (no matter how drastic) to change the situation, and turn breakdowns into a triumph. If you fall below the monthly pace or periodic target, then you need to reassess what may have dropped out of a previously successful strategy or what strategies or personnel you may need to add to sustain momentum. You will remain in breakdown until, by focusing on the critical strategy, you get the momentum going again and are on target to produce breakthrough results. This comes from accepting the reality before you, whether it is a drawdown or some change of events that impinge on your investment thesis.

In addition, achieving a goal, while exhilarating at first, can lead to complacency or dissatisfaction with one's current job. So, as your team members approach a goal, you may see them losing urgency and focus especially after they have passed the last great surge toward its achievement. That is why you, as the leader, need to establish and present a new goal a short time before or immediately as the original goal is met. In this way, you create a new level of momentum as your team begins to wind down.

Ralph has no trouble remembering the precise details of a major drawdown that changed the course of his firm. After nine months of operation, his fund showed good performance, and he rapidly raised more money than he could manage. But, disaster quickly followed, and the fund's performance plunged. Fortunately, Ralph used this crisis mode to help him rethink his strategy and restructure his investment staff.

Ralph: We found ourselves in a crisis situation. So what did we do? Number one: We used the turmoil to give ourselves a little bit of a backbone. It was a very, very good wake-up call.

Kiev: So you decided it was time to play hardball. Did you shift psychologically because the crisis gave you the license to do it?

Ralph: My moral compass said I have a responsibility to my investors, to the people that are here, to everybody, and the fact that the performance shifted. I was so scared of offending people along the way as to how I managed or the way that I did things. I was trying to solve this multivariable equation that everybody can be happy. It's like if you have a big family, and you try to get everybody to agree on where to go on vacation. Sometimes you cannot possibly make everybody happy.

Kiev: How did you manage that?

Ralph: The way I have managed up to that point was nonconfrontational. It was, "Look, I am going to try to figure out a way where everybody can do what they want, and the investors can get what they want, and I can get the performance that I want. We are all going to be this kind of happy cohesive unit." When the performance was so bad it was very easy to use that bad performance and say, "Enough is enough! That's not working." One set of people got screwed so far—that's the investors. Your collective wishes didn't work, so now it's time for me to do it the way I want to do it.

Kiev: What had you been doing up until that point that wasn't the way you wanted? Were you aware of it at the time?

Ralph: In part, but I am impossible to argue with. I am a pretty good debater. Some people are logical and some people are intuitive. I am a hundred percent on the logical scale. When we talk about an idea, there are things that sometimes offend my sense of logic, but I don't want to discourage the analyst from being productive or embarrass them in front of their newly formed peers. So I would ease off. But that performance reinforced the fact that I can't ease off. I am supposed to be the voice of the investors who gave us their money and if somebody around the table is fragile, that is no longer my problem. They don't belong at the table. I am going to stop trying to figure out a way to compromise everything. I am going to start representing the investor.

Kiev: You needed a drawdown and the threat of redemptions to get you to face that?

Ralph: It wasn't just the drawdown. Organizationally, we were chaotic. We had too many personality conflicts. Working relationships broke down. There was too much personal sensitivity to worry about. There were too many hoops to jump through to try to get something done. The negative performance also correlated highly with that set of circumstances.

Kiev: Was the entire organization permeated with a sense of chaos?

Ralph: No. But it permeated me. I am the person in my family that just wants to find the solution and make everybody happy. My own needs are for peace and harmony. I don't want to deal with complaints. That's my own personality, with this human dynamic of loving people on a research team. My solution has always been to try and find a way to accommodate.

Kiev: So how did you change?

Ralph: When the crisis hit, I learned that leadership is not about accommodation. Leadership is stepping up and saying, "Here is what needs to get done," communicating expectations and reinforcing expectations. Empowering people to go out and meet those expectations. In the event that somebody is not interested in doing it your way, then shrinking the team and moving on to somebody else who can.

Kiev: You didn't know that before?

Ralph: If you had put me in a room and asked me a bunch of theoretical questions, then maybe. The answer is, I didn't spend any time thinking about it. I studied chemistry and finance in college. I have been a leader in sports. I was always in charge of things. I was an analyst at a firm. I was an analyst at a hedge fund. Now I am a CEO. Where was I supposed to learn to become a CEO? The answer is, as part of a hedge fund you become a CEO by trial by fire. As with any other endeavor, unless you get a good education and read certain books and get an MBA, and go through a bunch of leadership training experiences, how else do you learn? The answer is, like everything else, you learn from errors.

Kiev: Do you feel like a qualified CEO now?

Ralph: I am a work in process, a self-taught CEO. I know that our first eighteen months endeavor, while successful in many ways, was a miserable failure in a lot of other ways. As such, I have spent the last two years setting out an agenda for people, figuring out a way to hire, being more proactive at delivering negative feedback so that we can get positive performance, and dealing with people issues. Even if they are short-term painful, it's in everybody's best interest to do it.

Kiev: If all those negative experiences hadn't happened early on, do you think you would have just continued on the way you were going and wouldn't have learned these lessons? Was there value in having the experience to lead you to figure out that you needed to step up to the plate? Is there a lesson of your own from the breakdown, if you will?

Ralph: I think there are a couple of ways in which it could have happened. We could have had a board of advisers with a couple of great mentors who had been great leaders who could have tapped me on the shoulder the first year and said, "You know what? I see this happening to you."

Kiev: Do you think that would work?

Ralph: Perhaps. If somebody makes a business case for me investing my time, I will. So yes, if somebody could have enunciated it, yes, it clearly would have worked. One of my best investors, who is based in Chicago, didn't pull a dime. He said to me in August of 2001 at the depths of despair, "We love you because you're from the Midwest. We hate you because you are from the Midwest. So you need to have a little bit more New York in you as far as being a leader and kicking butt internally and not trying to be everybody's friend, but manage the business."

Kiev: Looking back, how do you regard this comment?

Ralph: Did I need to go through that in order to reinforce my responsibility as leader? I am sure that there could have been other avenues that would have been a lot cheaper for our investors, a lot less, [but] more personally painful for me. There weren't, and so this is the way it happened.

Kiev: Was it difficult to do?

Ralph: No, leading was a relief; crisis management was a relief. It actually comes quite naturally to me. I am not afraid to speak up when the case is clear as to why something needs to be done.

The performance made the case crystal clear as to why it needed to be done differently. One of the reasons that I might be a good debater is because I only take arguments that I am ninety-nine percent sure that I can win. Otherwise I am nonconfrontational. But during the crisis, the second half of 2002 felt much better than the first half of 2002.

Kiev: Could you all of a sudden have said in 2003 or 2004, "I have got to take charge a little bit more?" And what made your crisis management style tough for you?

Ralph: Part of it was that I was uncomfortable crossing the divide between being friends and being boss, because a lot of people who work here are generational equals with me. Many times we start out with the exact same job, so there are just some unique instances. Once I asserted myself as CEO, I just didn't go back. Once we got the equality issue out of the way and with everybody else we have hired, it's a lot easier, because I am presumed to be the CEO of a multibillion dollar company, not some twenty-one-year-old kid that someone knew thirteen years ago.

Ralph's story resembles that of many hedge fund managers who assumed the mantle of leadership with little preparation. The critical lessons to be gleaned from his account include being willing to take responsibility for the fate of the firm and making the hard decisions required for turning a firm around. For some of you, as for Ralph, this may involve relinquishing the need to be loved by everyone, and giving up the habit of accommodating to everyone to make them happy. It also means using your vision and your stated objectives as a lens with which to decide what steps are critical. Becoming a leader thus means taking the goals seriously, grasping the reins of accountability and laying out a strategy consistent with your goals. You must make demands of others, but especially of yourself. And you must tell the truth, even when it is not pleasant. The toughest decisions are personal ones, not so much financial ones, and it is in the personal arena that people require the most help and the most feedback.

To cope with the crisis, Ralph brought his team together for an entire day of reflection on what they had accomplished in four years. What was his intention? He wanted to clearly define how far the firm had come, to assess where he wanted it to go, and to get everyone to recommit to that effort. He felt it was important to do this in a structured way, and he wanted all participants to understand what changes he planned to make to push the growing fund toward continued profits, despite the fact that it was no longer the entrepreneurial little outfit that it had been at the outset.

Among the topics Ralph touched on that day were:

- Strategy (so everyone had a clear sense of the direction of the firm)
- Organization (he showed and discussed the firm's first organizational chart and a revised one)
- Compensation (so everyone would understand the philosophy behind the numbers)
- Careers (so individuals would comprehend the path to promotion and growth), and
- Balance (so the team recognized that he valued those who were able to find the middle ground between work and personal life).

Also, if you are about to undertake such a review, it is important to include time lines. Ask yourself: What is the amount of time needed to realize these goals? Once you have a time line, you need to mark it with milestones. Who will do what, by when? What are the various outcomes that might be anticipated?

These types of discussions are a form of risk management in that you are defining a winning strategy and probing for parts of that strategy that do not work. If your firm doesn't know what it is doing well versus what it is doing poorly and doesn't address the latter, it is likely to keep generating and creating more mistakes.

Sustaining momentum requires that a leader learn how to use these types of discussions in developing a stretch strategy to create and reassess a vision that he uses to pull him into the future. To be a good leader, you must learn how to be the quarterback. You must make decisions—especially the tough ones. You cannot delegate decision-making to others, no matter how much they want the responsibility. You have to make sure that you are piloting the plane, and at the same time you must open the channels of communication and learn as much as you can about the needs, objectives, and perceptions of your team. But perhaps most important, you must remember that breakdowns can be valuable experiences. You must learn how to take the difficult situations of life and use them to move yourself and your team toward a greater commitment to higher standards and breakthrough results.

REDESIGNING YOUR TEAM

Many firms have adopted the phrases "Who's on the bus?" and "Who's off of the bus?" from Ken Kesey's Merry Prankster antics of the 1960s in talking about who belongs on your team and who doesn't. Although there are obvious problems involved with losing team members, it must also be made clear that sometimes, to sustain momentum, it becomes necessary to weed out those people who no longer fit the parameters you have set for a successful firm or who do not buy into the ideas you believe are essential to the firm's success.

Letting people go can be brutal, but it does not have to be. The considerate and thoughtful way to reduce staff is to develop performance criteria and reviews that allow you to manage expectations so there are no surprises. In a culture of performance measurement, people know when they are not measuring up and may even take themselves out of the game when they realize they don't fit in or don't want to develop the requisite skills to boost their performance. In any case, in such a culture of excellence, there is some chance for preparation and expectancy that if you don't perform at a certain level, you will be cut.

As I discussed in an earlier chapter, performance reviews provide a framework for assessing an individual in terms of his strengths and weaknesses, helping him to understand what he does well and what he does poorly and why it is that he isn't fitting into your organization. Periodic reviews should help determine whether the individual can do what it takes to upgrade his performance so as to better fit within the culture of the firm or at the end of the day help him to assess his own performance and (with your help) determine where he might find a more suitable fit for himself. To the extent that you are able to guide an individual to find a better opportunity for himself based on his skills and natural proclivities, the exit interview may actually be an opportunity for him to get a better sense of what might work for him in the future.

Of course, a poor fit may be the employee's fault or because he is not trying hard enough, or it may simply result from the fact that he lacks the requisite talents and skills needed by the organization at the present time. While someone may have had the necessary talent in the past, he may no longer have what it takes and would be better served being in another organization more suited to his talents, the enduring abilities and perspectives that characterize his way of being in the world. Thus, if someone is trying, but still underperforms, it's not a matter of weakness, stupidity, disobedience, or disrespect. It is a matter of miscasting.

I am inclined to agree with the approach of some organizations that hold the view that the best managers practice a mindset of tough love—uncompromising standards of excellence balanced by a genuine care for the employee. Tough love means no compromising with the standard. When asked what level of performance is unacceptable, the answer is "any level that hovers around average with no upward trend." How long can someone go at that level? "Not very long."

Here is a list of questions to consider when thinking about letting people go.

1. What is the vision of the firm over the next three years?
2. What are some of the strategies being considered to implement the vision in regard to hiring?
3. Does this individual add value to the firm? Does he fit into our current vision and direction for the firm?
4. Is the firm being fair by keeping him on board when he is not contributing or maximizing his potential in his present role? Would he be better off elsewhere?
5. Does he detract from the firm? Does he represent the firm in a way that is not representative of the new direction, concept, and image of the firm?
6. Does he take energy and resources from the firm?
7. Can his lack of value be remedied, or have repeated attempts to improve his performance failed?
8. Is there value in retaining him in some capacity?
9. What can the firm do by way of providing for a soft landing; that is, can you provide an outplacement specialist to help the employee find a new job, if he is willing?
10. Can the firm give the targeted employee time to either improve or come to the realization that they face termination by year-end?

There are additional questions to consider when facing extensive layoffs or downsizing.

1. What are the fallout effects of terminating a large group of people at once, if any?
2. How will we address the questions that may be raised by those who remain behind?
   a. Are there going to be more terminations in the near future?
   b. What are the criteria for continuing in the firm?
   c. How does my role fit into the firm's vision and strategy?
   d. What can I do to make a greater contribution?
3. What are the negative consequences for firm morale?
4. How transparent is the rationale for restructuring or downsizing?

5. Can a major change in personnel be done in a gentler way so as to reduce the potential negative fallout about our firm from this exodus of people?

You will inevitably have to cut employees at some point, either because they simply are not contributing or because you have a larger plan for restructuring your firm. But viewing performance in terms of natural talents or strengths frames the termination conversation in a supportive and meaningful way.

Ideally, the discussion ought to be focused on talents and natural abilities and the environment in which the individual can thrive successfully. This can also be tied to performance metrics so that it is based on hard facts. This kind of conversation will provide the employee with an opportunity to look more clearly in the mirror and to learn much about himself from the experience.

Unfortunately, reality dictates that sometimes letting people go is the only way to move forward and to sustain the momentum you have worked so hard to build. Stay consistent and always make staff changes as humanely as possible. As much as you can, have your firm take part in the outplacement process, using your own network to help employees find a new job. This sends a powerful message to the market about the care and concern your firm gives to its employees. It is also a way to demonstrate your appreciation for the contributions of the people who have worked with you.

CHAPTER 7

Transcending Self-Imposed Limits

"Do you believe in miracles?" That phrase, exclaimed by broadcaster Al Michaels, has become synonymous with perhaps the greatest U.S. Olympic team sport victory of all time, when the U.S. men's hockey team of 1980 upset the Soviet team, which had been the most dominant powerhouse in the hockey world. No one believed that the Americans, a pick-up group of inexperienced college players, could challenge the Soviets in Lake Placid—no one except the American players themselves.

The U.S. players were able to achieve this David-versus-Goliath triumph because, as one journalist wrote, their leader, coach Herb Brooks, had "crawled inside the team's collective brainpan and "rewired" it so that the players had no idea how outmatched they were."[1] Brooks employed all kinds of unorthodox coaching maneuvers en route to the showdown to erase the idea from the minds of his players that they were inferior to their opponents. Once the rewiring was in place, he told them, "You were born to be here." Brooks then stepped back and let his fired-up youngsters attack the Soviets in an upbeat and fast-paced style of play that enabled the Americans to bring home a gold medal in what today is referred to as the *Miracle on Ice.*

You do not need to be a hockey coach to do with your team what Herb Brooks did with his. You can achieve the same kind of transformation by erasing limiting notions with images of outsized trading performance. But first, you need to examine and transform your *own* limiting notions about what kind of a person you are and what kind of a leader you can be.

You may not think you can accomplish the creation and sharing of a vision. Openness and vulnerability to members of your team, listening for hints of resistance, and appealing to people's emotional centers may be concepts that you have never considered using in the past. Implementing such tools, however, will allow you to see by your own performance that you are capable of being a visionary and communicative leader. As such you will need to discard the outdated profile you harbor about yourself. By trying some of these concepts, you may discover that your notion of what kind of leader you are is not an unchangeable image set in stone, but simply a series of thoughts that you can give up. It will take practice—plenty of it—before you become adept at this. But positive change starts by questioning any of those ingrained ideas (what I call outdated *life principles*) that you have of yourself.

The first thing you need to do is to encourage yourself to see things in a totally new way—to grasp reality *independently* of your interpretation of it. This means giving up preexisting and limiting beliefs about yourself based on your current view of reality, which, in actuality, may only be an interpretation and not necessarily the truth.

To do this, you need to understand how longstanding life principles may be governing your attitudes and behavior, oftentimes without your being conscious of it. The more you become aware of how these patterns from the past influence the way you experience the world, the more readily you can change the way in which you function. Let me be more specific about this.

THE LIFE PRINCIPLE

Until you start examining your automatic and emotional reactions to events and relate them back to longstanding life principles, you may not have a clue that you are acting on a whole range of response patterns conditioned early in life to meet parental expectations. A life principle helps impose order and predictability on the events of your life, but as you mature, it is often no longer as adaptive as it was in childhood.

How the Life Principle Works

The life principle is a set of beliefs we all developed in childhood so that we could impose order on events and behave the way we thought parents expected us to behave. We cling to the life principle out of habit as we grow older—even when it doesn't necessarily serve us well—and we are hardly conscious of how much we have internalized it. The trouble is that an ossified life principle prevents us from expanding our horizons and trying out fresh, more adaptable ideas.

Most people don't realize how much their lives are governed by their outdated life principle until they see how it impinges on their lives. Thus, you may be afraid of implementing a new strategy for your traders, or fearful of becoming more open about your feelings at business meetings. These fears may have their roots in something that happened to you as a child. Indeed, you may be like most people, who are not fearful, angry, or hostile for the reasons they think. Until you examine an immediate reaction to an event and relate it to your automatic thinking from the past, you may not have a clue that you are acting on fears dating back to your childhood.

Among traders who work for you, an outdated life principle such as the need to please a father may show itself as an overwrought concern about whether a decision to buy is acceptable to you, the boss—even when that trader's own instinct, based on the research he has done and his experience with the stock, tells him that this is the right decision. For years, I have seen traders who sell too soon, who hold on too long to losers, who are afraid to get bigger, all because of an outdated life principle that lives in the mind like a dormant mental program or acts like a sensitive thumbscrew triggered off by events.

The following dialogue exemplifies the source of a portfolio manager's life principle. It underscores how early life experiences often create certain fixed ways of responding to events such that years later an individual is still reacting to difficult circumstances in the same ways as he learned to respond many years before. Only by identifying these patterns can he or any individual learn to extricate himself from the habits and attitudes of the past, which may be blocking him from being as creative as he or she can be.

Case Study in Examining the Life Principle

In this dialogue Ted, a portfolio manager, discusses how he thinks a life principle has carried over from embarrassing moments in his childhood. He links it to the anxiety that is inhibiting his present work and causing him to make mistakes.

Kiev: What do you think is causing your discomfort?

Ted: Just a streak of bad things going on. The worst part of it is I can identify some psychological things that I am thinking about or over-concerned about. You know, messing me up. When we talked before, a year ago, I was like, "I stink," and after a half a day of writing something on paper I stunk twenty-five thousand times. I laughed at myself. So I don't particularly think I stink, but I do notice myself making mistakes.

Kiev: You think you are under stress.

Ted: I think there are sort of lazy things that have probably always been there.

Kiev: What personal psychological issues are showing up?

Ted: I have never liked to confront bills. They seemed to come in every day—everything from like the phone bill to the American Express bill to whatever. I don't really have a problem spending money in that my dad was horrible and my mom was always so cheap. My dad had what I considered was a Depression-era mentality, always afraid of being without money. It really always irritated me growing up that they were so cheap.

Kiev: In what way?

Ted: If we were to go shopping at the supermarket, my father would tell me I should bring coupons. We didn't need to use coupons and no one I knew used coupons. I was embarrassed. For the savings of five dollars or whatever, Mom would hold up everyone in line to use these coupons. I always felt they were so tight with money. When friends and I were going to the movies and she wanted to be dropped off. The movie theater was taking me totally out of my way. Or the bill came for dinner and she offered to pay half but it wasn't half. It was like, "I don't want to bring it up." A kind of cheap attitude. Another example I remember is, I went on a double date with a guy whose family had a lot of money. We went to get treats for the girls—sodas and popcorn. He asked the woman behind the counter what was the price difference between a medium and a small coke. This guy is worth tens of millions of dollars. That would be to me the most mortifying thing ever, to be like that.

Kiev: How do you think it affected you?

Ted: As a result, I think I am a bit of a spendthrift. I have somehow managed to make money. It comes in because I am always motivated by trading more for the idea than the actual P and L, which is something I probably have to change.

Kiev: So you are not trying to make money, you just want to get the idea right? You want your thesis to be right?

Ted: The thing is, I am not looking at the screen thinking, "How am I am going to make money?" I am looking at the screen thinking, "What is the driver here? What is something interesting going on that I can latch on to?" If I can see that there is a big opportunity here, I can make money on it. I would put it in a box and out would come the money. I would say, "We have got to do all this to get the money." So the money is a way of showing my thesis was proven correctly.

Kiev: Are you saying you push away from even thinking about money because somehow [or] other it activates a sense of being cheap and frugal and penny-pinching?

Ted: Yeah.

Kiev: You want to actively avoid being like that. So you have to become more cavalier in your own trading.

Ted: Not my own trading—my own spending. My trading isn't cavalier.

Kiev: Have you considered that by trading as the person that tries to figure out the difference between a medium and a small, you are trying to get better execution of your trades?

Ted: Well, I am. When I price an option, I ask twenty brokers and then try to maneuver it out and get the price I can. You know I will go in and I will see that there is an arb to be done, so I will do it.

Kiev: So it doesn't interfere?

Ted: No, I am fine with that. So the other thing I have in the back of mind is that my attitude—not cavalier, but my nonmeticulous attitude—toward personal money is going to leave me someday wishing I hadn't spent it. So there was more of a feeling of doom back in my mind somewhere.

Kiev: That your attitude is going to be costly.

Ted: That's the general backdrop on how I am feeling about money. Even my friend's wedding—I was supposed to put the hotel room on his credit card. I just noticed myself delaying for a couple of days for no apparent reason. I mean, I am going to pay the money. It's a friend of mine. It's what I spent. I saw his e-mail, and I just ignored it. So that kind of stuff I feel myself doing with a yen trade. I was long euro-yen and we were long because we thought oil was going higher.

Kiev: The euro was going up and the yen was going down?

Ted: Yes, that would be the best expression. The Japanese economy is very oil-sensitive. If there were a global slowdown, the euro would probably benefit. So that would be the ultimate expression of how oil slows the global economy.

Kiev: So you thought it was a good idea.

Ted: Good idea—the oil slows the global economy; bad instrument to use it for. We actually wound up making a little money at first. It went up a little bit. Suddenly, I saw it wasn't trading correctly and I hedged my position.

Kiev: Meaning what?

Ted: I had my options.

Kiev: Did you put something else on?

Ted: The call option on euro-yen was worth thirty million euros. Instead of getting rid of this whole thing, just selling it, I have to pay the bid offer. It's only been a week and I have to take a small loss. Now volatility is going down. I will trade the hedge back and forth. Basically, I started ignoring it, thinking it was hedged, and I traded the hedge. That whole exercise cost me money and I should have just gotten rid of it.

Kiev: Is that a reflection of your attitude toward money?

Ted: I feel like the same way I would ignore a bill for a week that I would owe a friend.

Kiev: You would ignore the potential loss. You ignore the risk.

Ted: I wasn't dealing with it immediately. Yes, I could argue with myself, "Oh, I will trade the hedge effectively and maybe it's not over." Obviously, I hedged it up there because I knew something was wrong. Basically, I never traded it on the way down. Then I spent all my time hedging and worrying. In the back of my mind, something was still wrong and it was.

Kiev: What are we saying? We are talking about minimizing? Not handling the problem? Avoiding the problem?

Ted: Avoiding behavior.

Kiev: Avoiding it because you don't want to be too finicky about the trades. You don't want to be like somebody that has got coupons trying to save money.

Ted: I think it's as simple as facing bad news. Bad news would be the American Express bill. The chickens are coming home to roost because you spent this money. You ordered five movies on demand and now you have got the bill. It's like, if I don't look at the bill, that somehow it's not happening. Of course, in reality, it is happening. By not addressing it, you're thinking it actually works.

Kiev: How does it tie in to the kind of feeling going back to being embarrassed by your mother's coupons? Is it that you don't want to be the person that worries about managing price or wins and losses? Do you say to yourself, "I just want to do it"? You don't want to be thought to be cheap in your own mind, having learned how to be precise. If you get the bill, take care of it.

Ted: Every Sunday we balanced the checkbook. It's only in the last year or so I find myself avoiding the huge stacks of mail I have to deal with. I used to not have a problem. So if it had to deal with the coupons in the supermarket—it's somehow connected to the trade. It may or may not ride into the same thing. But another thing is happening: My back has been killing me, so I haven't been able to exercise in three weeks. Usually that's what gives me the ability to focus in mind. Maybe I am trying to put everything behind me.

Kiev: It sounds like you might be under tension. This is all very stressful. It's not your back that means putting something behind you. Have you had back problems before?

Ted: Yes, it's a distress.

Kiev: Everybody has got some vulnerable part of his or her body.

This conversation demonstrates how incidents lurking in the back of your mind, such as a frugal family attitude toward spending money, can come back to haunt you even when you are well into adulthood. How much do you cling to an erroneous interpretation of the world based on past experiences that keep you from becoming all that you can be? How much are you still governed by certain notions about who you are and how you must behave, which limit your flexibility and freedom to adapt to new and challenging circumstances?

To tap into your leadership potential you need to identify and then act independently of longstanding beliefs and habits that limit you and reduce your adaptability to present circumstances. Only then can you respond to situations with greater creativity and originality.

Discovering the life principle that influences the way you function as a leader or trade as a portfolio manager is facilitated by finding cutting-edge situations that trigger off automatic responses colored by a longstanding life principle. Discussions about risk management statistics, performance criteria in the management of your team, handing out assignments, and issues such as bonuses, particularly ones that uncover significant differences between people, are some of the more common themes that bring out into the open the life principles.

The following dialogue illustrates how the life principle of being precise and in control was identified by one portfolio manager in terms of how he was managing his team of analysts.

Case Study: How the Life Principle Gets in the Way of Managing a Team of People

There are various ways in which longstanding habits and attitudes get in the way of creating the kind of organization that you want. The following dialogue shows how the life principles interfere with the creative process.

It offers another example of how you can get in your own way and how to lead others successfully requires that you learn to get out of your own way, transcending those self-imposed limits. As you will see, Brent's problem is letting go of control, trusting his team, and delegating functions to them in line with their strengths. What is getting in the way of his success is his reluctance to trust them by giving up control.

Kiev: What are some of your principles of leadership?

Brent: Some years ago I read somewhere about the notion of Kick Kiss Kick. It seemed to work really well. So what I would do is try to set a goal for people, like, "You need to close ten accounts this week," and they would go do that. Then I would say, "Congratulations; it's amazing." Then I would slack off them. Then the following week I would do the exact same thing—set some stupid goal, like "The next person to get an account will get a trip to Cancun." So it was always kicking me in the butt, then telling them that I was raising them, and then kicking them in the butt again.

Kiev: Do you look at it differently now?

Brent: Now, my thoughts are: "Why I am constrained?" and what I do here now is give up little bit more control, so that sales people have a little bit more control of their own destiny. I mean numbers, people they call, visits equal sales. It doesn't necessarily translate into making money but what I can still feel that I need that write-up. I need that number of data points. So that's what I have been doing with Curt more now. With Tom, it's gone slower. I haven't had the ability to kick yet. Last week, I had a bunch of things for them to do. So now, if I don't get them by the end of this week, then the next couple of days I will be asking, "What happened to this?"

Kiev: Within that framework, do you have any limiting notions?

Brent: Well yes, that's how I think about it. That's the way I did it in the past. That's limiting in the fact that I have never managed people in a long time other than Curt and Jim. Jim's essentially a clerk. The notions that I have are from my past experience where I did manage fifteen people.

Kiev: You think they are limiting because that model doesn't necessarily work in a hedge fund?

Brent: I don't know whether it's limiting. I don't know whether it will work or not. You asked me "Are you scared?" I have been thinking about that. How do I get all these people motivated? There also is this certain intrinsic value. There are certain relationships I am going to have. Each person is different and motivated by slightly different things. Curt is motivated by getting the job done. He is not really motivated by the money. He is motivated by pride, which is good. I don't know what motivates Jim or Tom yet. Until you know that, you don't know where you have to kick. With Curt you need to say, "OK, look—you said you were going to do that." It's kind of a blow to his pride if he didn't do a good job. I don't want him to think we didn't make the money. The money issue is obviously on his mind, but really what motivates him is his pride and doing a good job. So he really needs to feel like he worked.

Kiev: So this is a good way of managing your people. You find out what motivates them and work with them in terms of that. What about your own self-limiting notions that might interfere with implementing your leadership strategy? There must be something that you noticed about yourself.

Brent: I feel like I don't trust somebody unless I really checked his or her work, and that's limiting. If you are really going to scale, you can't talk to each man on your team. So you need to make sure they are doing the steps, and to get that comfort, I need to be checking their work. So what's limiting me now is just simply time. All right, it's just Monday, Tuesday, Wednesday, and Thursday.

Kiev: Is there a way of building a methodology that ensures that they ask the kinds of questions that you would have asked?

Brent: Yes. One of the things that I focus on in biweekly meetings is this process to ensure that we are moving our process to a more streamlined event. I wrote up the thesis at the very top. You start by seeing a change and then you develop a thesis. Then, with hard work and creativity, you then test the thesis.

Kiev: What do you mean by hard work?

Brent: Hard work is defined by certain things that you need to do: the 10K, the 10Q, the call of management, and the call of competitor. Creativity is how you get your edge. You don't just talk to other managements. You also talk to their competitors, especially as a third-tier competitor or a private competitor and that gives you an edge. If you have an edge, that leads you to conviction and that will lead you to success. Daryl added luck to the process. I will take luck, too.

Kiev: Since you started managing these guys, have you discovered something about yourself that you hadn't considered before?

Brent: This is how I used to do it. This is how I always thought about it but I have never written it down and what I have realized is Tom is really good at the thesis but he stinks at the hard work and the creativity part. Curt is all hard work, but he can't write a thesis.

Jim's lack of creativity is astonishing. He modeled for the past four years. They are different. So now what I have is three people who are all good at the three different steps and nobody who does that stuff in between. That's how I conceptually realize it, but what do I do? I have a list of things. I have a process, but now I need to actually implement the process so that people learn more about how I think.

Kiev: So you were doing the whole thing. Now, in working with them, you find that they're not doing all the things that you would have done, but you are not able to get them to do those things because you don't want to give up control.

Brent: Well, part of it is not giving up control. It's just fear of giving up control or fear that they're not going to do it right. It almost goes back to a year ago. Curt and I had been working together for a year and it just didn't work. So finally I said, forget it. I am not taking any of his theses anymore. Now I realize he could never develop a thesis. If I gave him a thesis to go test, he tests it, and he will come back with the right answer eighty percent of the time, which is good in this business.

Kiev: Did you get him working with Tom in the sense of Tom has the thesis and Curt does the hard work?

Brent: Yes. So that's how I changed it. I said Tom has got the thesis, but for the creativity part here, we need to do this. That's how this ABC trade worked out. It was like, here's the goal; find as many utility guys who are going to have contracts. We have got to call them all in Texas, Idaho.

Kiev: He'll do it?

Brent: He'll do it.

Kiev: But Tom won't know to do it or won't do it.

Brent: He won't do it. They're not used to primary research. They are used to secondary research.

Kiev: Do you think your function as a leader needs to get them doing what they're good at?

Brent: They are obviously always going to be better at one thing.

Kiev: What if you had them working on the same idea?

Brent: That could work.

Kiev: Does your personality get in the way right here of effectively leading them?

Brent: I think the biggest thing is that I don't have the faith in them doing the job well. Because of that, I haven't been able to scale.

Kiev: You have faith in Tom developing the idea?

Brent: Yes, because he comes in and pitches the idea.

Kiev: You have faith in Curt doing the other piece. What if you put them together?

Brent: Well, I did put Jim and Tom together on one name so far. So far, the modeling has been good; the thesis is there; but nothing has become of the synergy per se.

Kiev: Are you being too passive in putting them together as opposed to conducting the orchestra more vigorously? Are you reluctant to tell them what you need them to do? "This is a good idea, Tom. Jim, I want you to do X, Y, and Z." You've got to use your knowledge to lead them in the direction and stop worrying about trying to develop them. It's only going to happen if you direct it. Is there a piece of your personality that has to do with being a gentleman?

Brent: Yes, of not wanting to rant, rave, and yell. There is part of that. Part of it is the academic in me. I want to nurture them along. Maybe that is holding me back from doing more kicking.

Kiev: So that answers the question "What do you need to relinquish?" Maybe you need to relinquish that and put them on it. You are the conductor. You have got to figure out which part they play and then have them do that and then have them review that. Then maybe eventually they'll learn what the other guy does.

Brent: My partner Anthony, who runs a South American telecom company, and I have talked about that before. When I worked with Anthony, I realized that he just couldn't do certain things. I said, "Forget it. I don't want them to do those things. I don't want them to be half-assed accountants. I want you to be a very good salesperson and sales manager. Don't worry about anything else." He got a secretary to do the rest of the stuff. It's the difference between like an eagle focused on one thing or being a generalist. The problem is nobody wants to do the hard work.

Kiev: You say Curt doesn't mind doing it. Jim doesn't mind doing it.

Brent: They are good at two different parts of the hard work.

Kiev: Isn't it the role of the leader to hand out the assignment? The question is, how does your personality and style interfere with effective leadership? Are you getting them to do what you need in terms of their strengths, based on what you know is needed?

Brent: It's gotten better with Curt. I haven't gotten there with Jim and Tom. With Curt, I feel more like I know how to get him motivated. I feel like I have done a better job because the first year was a disaster and I realized why. I was taking responsibility for every position. Curt needs to be getting the data points in these positions but I need to know the thesis inside and out. Part of that is just being portfolio manager. You can't do that with so many names.

Kiev: How have you approached solving this?

Brent: If you get more capital, you do that and you need to have more conviction ideas. That means I needed more people. So I got an intern who helped me with one or two. Then I said I am going to hire two new interns for the summer. At the time, Tim and James were new. So now I have got what I think is scalable to two hundred million dollars. It's getting there.

Kiev: How do you get this team to give you the work that's going to get you to twenty?

Brent: That's what I am struggling with now.

Kiev: Then you have got to change the way you approach it, correct?

Brent: That's a work in progress, trust me.

Kiev: Yes, but that's also a concept that it's going to take time as opposed to "I have gotten it!" You need to say, "From now on this is what I want by next week" as opposed to "It's a work in progress."

Brent: I think I have gotten better with Curt but I need to find the levers to pull on Tim and James.

Kiev: You will find them by starting to insist on what you want.

This is a useful dialogue in pointing out to a portfolio manager how he needs to confront his own inclination to be passive and in control, in order to get him to step up his demands on his team to produce the results. This is not the only strategy that might be followed, but is one that suggests steps he can take to create more motivation and more performance. By overcoming his inclination to be indirect, polite, he can be as forceful as he is capable of being.

The value of the discussion is in laying out how one unearths the kinds of personal obstacles that are standing in the way of outstanding performance or maximizing performance and contribution of others.

As this dialogue demonstrates, Brent struggled with his own life principles of perfectionism and an appearance of control. Brent's inability to lead from a new perspective was inhibiting his relationships with his team. He was failing to trust them, to give them responsibility for their own work, or to delegate assignments to his team members in line with individual strengths.

"It's fear of giving up control and fear that they're not going to do it right," admitted Brent. "I think the biggest thing is, that I don't have the faith in them doing the job well. Because of that, I haven't been able to scale."

In effect, Brent was being too passive in putting together his team. He had three specific members who were each good at individual tasks. Alone, they couldn't get the job done, but in combination, they could do wonders. Brent needed to conduct his orchestra more vigorously. He needed to use his knowledge to lead them in the direction of his choice, but it was only going to happen if he directed it. Instead of directing activities, his perfectionist and polite tendencies were convincing him to step in and do the job himself.

Fortunately, Brent began to understand his need to redefine his role as a leader. In his mind, a leader was someone who got the job done—perfectly. But in effect, a leader is the one who hands out assignments and makes sure the job gets done by the people who can do it the best. By developing a proactive approach that encourages accountability for performance, Brent can change his life principle from passivity, perfection, and an appearance of control, to a reality filled with positive assertion, a passion for excellence, and effective leadership.

If life principles such as Brent's are so damaging, why is that we hold on to them so tightly? Why do we continue to view our worlds through such misaligned, outmoded binoculars? Simply stated—it is comfortable. Life principles help avoid the anxiety of dealing with the unknown, while creating a new anxiety all their own.

Try answering the following questions to see how much you see the world through the prism of past experiences and what you need to do to transcend outdated ways of seeing the world.

- What limiting ideas prevent you from making a commitment?
- What concerns and self-doubts surface before and after you have committed yourself to a larger vision?
- What obstacles need to be overcome to produce outsized results?
- What are the breakthroughs in your thinking and behavior that you must embrace?

Now, try this exercise. Ask yourself:

- Can you name a specific past event that has led you to a certain fixed notion about the way things are? For example, did something happen to you that led you to believe that you can't trust people? Or that no one cares about you? Or that no one will help you?
- Now consider, do you remember the event as it actually happened, or could it be that the details were different from what you remember?

- Are you holding on to a view of your experience based on attitudes and beliefs that were instilled in you at an early age? How limiting has this been?
- So, are you living in a "remembered" interpretation of a past event instead of what actually happened?
- Now, most important, I want you to consider how much you superimpose this interpretation of the past on present situations so that you don't see the possibilities before you as much as you can.

The value of this exercise is in helping you to understand how beliefs about past situations are blinding you to the reality of the present. It is as if you were hypnotized a long time ago and still see the world through a set of hypnotic suggestions.

The good news is this. You don't have to continue to live in an old interpretation of the world. You can invent or create new interpretations or visions to empower your life and can approach reality in a new and more powerful way. Change is possible, but you must believe it.

TRANSFERENCE AND COUNTERTRANSFERENCE ISSUES

All this brings me again to the huge impact of your emotional past on your current life and to what psychoanalysts refer to as transference and countertransference. Plainly stated, many people in your organization project onto you all kinds of irrational notions and beliefs and expectations derived from their own life experiences (particularly those things developed in the earliest years in relationship to parents and siblings). They expect all kinds of things from you. If they were in the psychiatrist's office, these projections would be the subject of the therapy—for example, why they think you owe them more than you do, why you should take care of them, why you should pamper them, and the like.

Attitudes of what is fair and reasonable and all kinds of demands hidden behind intellectual arguments are ever present. They are the source of much of the stress on the leader. For instance, if one of your associates had a father or mother who was domineering, that person might be extrasensitive to any kind of criticism from you or might overreact to very subtle hints of your strength or authority.

You, as the leader, need to recognize these attitudes as resistance to getting the job done or committing to excellence. You have to keep acknowledging people for their strengths and recognize that they are likely to slip or drift into complacency or entitlement or some kind of attitude. You need to keep pushing them to perform in ways you know they are capable of, for their own good and the good of the organization. For those unwilling to accept the challenge, they may be better off in some other career or some other firm. This is especially so for those who feel entitled to an ownership stake, even though they have not risked their capital or their reputations (which is why you, as owner, are indeed the owner). Of course, in a free society, they have the opportunity to go out and create their own entities. If they are good, perhaps you might invest with them. But don't minimize your own contribution to your own creation. It takes a lot of skill and guts to do what you have done.

On the other hand, countertransference relates to the emotional attitudes from the past that you, as the leader, project onto people around you. It involves earlier-learned attitudes and expectations from your own childhood experiences, which color the way you respond to people in various situations. You may, for example, feel people are leaning on you excessively or exploiting you, or you may feel they don't trust you, or that they're taking advantage of you. In fact, they may simply be relying on you as the leader, and you may be misinterpreting their actions on the basis of your own past experiences. It is important that you recognize this so that you don't allow your own emotional needs to create misperceptions that intrude on your business objectives.

Both transference and countertransference are concepts you have to become aware of because they are among the most important psychological mechanisms roiling below the surface of every organization. When a leader detects that people are depending on him, that they are assigning him wisdom, strength, and other very positive qualities, he often is inclined to take this adoration literally, and think he is as endowed with the charisma, power, and the breadth of vision that people place upon him. It may be only somewhat accurate, or not be accurate at all.

If you are a smart leader, you learn to notice countertransference so that you don't fall for it. First of all, it makes good business sense not to get too caught up believing in your own press releases. At the same time, a wily leader may take advantage of this esteem, saying to himself, "People think I'm king of the hill and are willing to go to bat for me, or work harder because I ask them to—I'll take advantage of that and use that up to a point."

Thus, good leaders need to be able to ferret out these attitudes. In doing so, they often also learn how to leverage the positive features of transference—the expectations people project onto you based on their experiences with their parents. Good leaders learn not get too taken out of their own game because of the negative aspects of the transference, since these are not personal; they are about how people project their own attitudes onto a leader, coupled with how he responds back. Some of the responses of others are reality-based. Many are probably not.

Case Study in Transference and Countertransference

Listen in as one fund manager describes how he identifies and deals with these types of behavioral issues and how he battles his own.

Kiev: Do you have any sense of those times when people are projecting their own past experiences onto you and expecting things from you which are not consistent with your own concept of yourself as a leader? Can you give me an example?

Trent: We have a guy whom we hired from a big hedge fund where he was the number two guy in a sector. I am coming to understand that the problem he was trying to solve by coming to our firm was that he didn't have enough access to the guy in charge. He would always go through the number-one sector guy rather than get to the portfolio manager. There are definitely issues where he reacts if I am short with my time, my feedback, or too concise. It is as if he has attention-deficit disorder or is a child who lacks proper attention from a father. There are definitely times where I feel he has unreasonable expectations in the context of looking at what's best for the business. People like this have somehow convinced themselves that the next job is going to be the answer; it's going to be much better. The pendulum is going to swing from unfair to perfect.

Kiev: Is there a particular area where unreasonable expectations come into play?

Trent: On the compensation side. People who are not yet where they want to be financially have a hard time looking at things objectively. I am not sure whether they are transferring their issues on me or on the business or whether that is a natural tendency—to think that there is money everywhere. No matter how many times we say, "These are the skills that we need you to improve on," or "This is the output that we need you to do, and if you do that, there is reward," we have difficulty trying to get them to equate compensation with meeting those objectives. It does seem as if they have their own standards and have convinced themselves of something that was never discussed.

Kiev: Do you tell them this?

Trent: I think it's something that I need to get better at because I take it personally. This is a very reputation-based industry, and even though we are a business, it's a very personal business. There is an area of trust between an employer and employee that I take very personally. I get very invested in whether my employees succeed or fail. I care a lot—and my wife would say too much—as to whether I think that they view me as fair or not.

Kiev: Even if it's a distortion?

Trent: A guy can sit across the table and say, "What you paid me was unfair," and I can know that when I sat down in a quiet room, I gave the guy every benefit of the doubt and came up with what was a very fair number. If I told a hundred people, ninety of them would say that is a very fair number. But when the guy says, "That's not fair. You weren't fair," it bothers me more than it should. I can't let it go. I take it very personally. He might as well sit across the table and say, "You are a liar. You mislead me. You are a phony." That's not what he is saying, but it's what I am hearing.

Kiev: Sounds like you are uncomfortable with this?

Trent: I don't think anybody likes to be given that message. I will try to reason with the person. I will try to explain it to them as clearly as possible. Sometimes they get it; sometimes they leave because the working relationship becomes more difficult. As we become a bigger business, it's awkward to have the portfolio manager pay the analyst. If you had a CEO pay an analyst, that would be better because they don't have to work together every single day or have a compensation committee.

But in the hedge fund business, it's so strange. I work with these people every day. We make thousands of decisions together. Every time I see the guy, all I'm thinking about is that the guy called me a liar, and the guy (is thinking that I) screwed him on his paycheck. So, it's an unusual dynamic.

There is another unusual dynamic for us. A lot of the people that I have hired were my peers starting out where we worked in similar jobs together. We are similar ages; we have similar family experiences. I always think it would be easier if I were a generation ahead because if I am a sixty-year-old who has been in the business for thirty-five years, they would be more accepting of me as an authority, as having paid my dues. Instead, they think, "We used to have the same exact job thirteen years ago." It just takes the right type of person to be able to come in and accept that. One guy was sixty-one years old when he came to work here. We had worked for the same firm. Then he worked for another for five years, and it didn't work out. At a previous fund, I was helping do his models. Now he was coming in to work for me. These were unusual social dynamics, but he and I seemed fine with it. The bigger social dynamics occurred when he saw other guys who were thirty-three years old getting more responsibility than he was getting at sixty-one years old. The first nine months worked out great. The second nine months the guy kind of mentally broke down and ultimately left.

Kiev: Being appreciated or liked or looking at issues in terms of fair or unfair—those are life principles. Have you had any experience in transcending your life principle of wanting to be thought of as fair? Have you been able to act independently of those feelings?

Trent: It's a very big challenge for me. For example, take one of my key officers. Objectively looking at it, we should replace him with somebody more senior than him. If we look at what the business has become and at the skills on the page, if he interviewed for the job today, he wouldn't get to the second round. But there is a sense of loyalty and friendship, and he's a hard worker. So, there is a sense of respect for the guy. But there is a cold hard reality, which is that we are managing more money than we were when we started. We have more product diversity than we started. He has to manage people at this point, and we can't have a two-person staff in his area. We need five. That means he needs to manage four other people. He is not qualified or skilled at managing people. I haven't done anything about this yet, although I have known this for nine months.

Kiev: Do you have any mechanism for approaching him and revisiting the conversation about whether he now fits the new model?

Trent: Yeah, we do. But I don't know if it's working, because I don't want to confront him. But we took a big look at our business last year. We set out goals and objectives for the business. We started what I am calling BOB, for Best of Breed. The whole idea of BOB, really, is to benchmark ourselves to other organizations, such that then I can come to the guy and say, "Look, we're friends, but look at this realistically. We owe it to everybody to do what's right. You are a chief accounting officer, not a chief financial officer." We are going to go through this big whole exercise, which will take time and money, to get to the conclusion that I already know—which is, he's not the right guy for the job, and we've got to bring in somebody else. Would it be better if I could just directly walk into his office today and say, "You are not the right guy for the job, but

I need you to do another job within this firm?" I am a little bit scared that he would leave and that would be destabilizing.

Kiev: Has he given some thought to this?

Trent: We do reviews every six months. He knows those reviews are not the top. He knows that I have had issues. Do I think that he knows that he is deficient in some areas? Yes, I think he does. But from an ego perspective, this is tough. How do you enforce accountability without coming across like a nasty guy? Is it Colin Powell's answer—"Leadership isn't making friends; it's about getting things done?"

Kiev: You have to find the blend that works for you. To gain cooperation you need to be clear and discuss these issues. The more shared conversations you have about the process, the better you can figure out innovative ways of doing it. How you handle it today is different than how you handled it a year ago or two years ago. You don't have to be nasty about it. You have to give them the feedback. I think people are receptive to the opportunity to grow. But it takes a certain amount of coaching to get people past their fears. It all has to do with anxiety. It all has to do with people are afraid to do certain things. You are going to have to go where it's not necessarily comfortable for everyone to go. People have to learn to step into the ball and not hit it on the other side. That's new, and it's not comfortable.

It is evident from this dialogue that Trent is of two minds. He knows he must act decisively for the good of his firm. At the same time he doesn't want to lord it over people, to act as if he were a monarch. In this sense, he is a captive of his need to be a peer and a nice guy, feelings that clearly get in the way of the successful management of his firm. As I have said before, you don't have to use a top-down command-and-control method to lead. You can lead best by involving your team in the development of the procedures that they will be using. This can be done in a soft, rather than harsh, way. The important issue is that you cannot allow yourself to be held back by any fears that your recommendations to improve efficiency will be misconstrued by others as authoritarian or capricious.

As investors in your fund and as beneficiaries of your wisdom, the people who work for you will benefit from clear communication and your efforts to make necessary changes to promote efficiency. You are all in the enterprise together.

If you are a smart leader, you will learn to notice transference and countertransference so that you don't fall prey to the myths that are created as a result of these types of attitudes. We're all prisoners of our past, whether we're a leader or just a team member. Life principles tend to distort the way we see things so we don't get the full power of the opportunity available to us. Thus, good leaders need to be able to ferret out these attitudes, to work around negative attitudes, and to leverage the positive features of transference.

MAKING YOURSELF HUMAN

Once you have learned to relinquish the cover-up—the early-based defenses, which most of us have created as a result of our life principles—you will be in a far better position to handle whatever the world throws at you. You will be free to pay more attention to your work, your company, and your staff.

For example, when Jeffrey R. Immelt took over as CEO of General Electric, he faced truly tough battles. The company seemed invincible under the legendary Jack Welch; how could Immelt live up to such a titan? The economy headed south; how could he match GE's record of 10 percent gains quarterly? The answer was that he had to live with uncertain times and hard critics. But Immelt was prepared.

"I hate the criticism, but it's not a personal thing," he told *BusinessWeek*.[2] "I'd be lying if I didn't say I felt stress. But it's never about this company. It's about wanting the world to see and to touch and to feel how different we are."

Like Immelt, the most successful leaders are able to stand squarely and face their own emotions, their own demons, their own inner drives—and manage them. They don't have a need to mask their distress, covering it up with a false front of self-confidence. They don't hesitate to admit they are wrong or perplexed, and don't invest much energy in the high cost of maintaining a defensive posture. The best leaders are willing to tell the truth, to face up to their confusion, distress, anxiety, uncertainty, and errors, and move on from there. As a result, they are always ready to move forward, because they don't waste energy in denying their stress. They don't bother to dress up in a psychological costume of control.

If you want to be that type of leader, then you too must share your vulnerabilities and make yourself available to help and be helped. As you do this, you will begin to understand the needs of your team and create a learning organization characterized by open communication and creativity. In such a setting, you can tolerate expressions of complaint and turn them into opportunities for change and growth for everyone, defusing potential sources of friction or tension with the organization.

Having metaphorically taken your hands away from your ears, you will be available to listen to the market and to other opinions. The more you can take your ego and concern about your image out of the equation, the more flexible you will be in adapting to what goes on in the workplace. When you as the leader are unafraid of your feelings and refuse to put a negative interpretation on them, you will be in a better position to empower others to behave the same way—even during times of extreme stress.

COMBATING STRESS AND PANIC

Whether a disaster is real or imagined, your brain responds by delivering increased adrenaline, which increases alertness and visual acuity. More blood surges to your brain; you are thinking more quickly. You're more alert, and then there is that knot in your stomach. Beads of sweat gather on your brow; your breathing becomes shallow. We call the experience *stress*.

Whether we would like to admit it or not, many of us enjoy a certain amount of stress. That is why roller coaster rides are such popular theme park attractions. But at some point, the adrenaline rush can go beyond its optimum level and become counterproductive. Imagine a roller coaster ride that never came to an end.

This type of high anxiety results in more problems, because you are dealing not only with the unpredictable and random nature of events, but also with the distortions in perception and response associated with the increased levels of stress and the associated increases of adrenaline and other stress hormones.

If stress overwhelms you, you may even begin to experience panic. You start doubting yourself, and soon your thoughts start racing. The physical sensations become unpleasant: your heart beats too fast, you become short of breath, you get dizzy and confused. You become increasingly suggestible. You may start having trouble sleeping at night.

If the stress gets worse, your remarkable brain receives too many signals, and you may find yourself paralyzed and overwhelmed when you need to make decisions. At this point, there's a tendency to lose focus and to excessively worry about your own reactions. Under these circumstances you lose flexibility and have a tendency to make more mistakes.

For example, a manager in drawdown may, instead of reducing his risk, feel the inexplicable need to increase the size of his position, doubling up as things are going against him. He rationalizes this as an effort to get back what he's lost, but is instead putting himself at even greater risk of losing significant amounts of money and ultimately the ability to continue to trade.

Conversely, some traders become fearful and may avoid taking appropriate risk or using adequate amounts of capital. “I have a tendency to bale when certain things feel like they’re going out of control,” said one manager. “It’s almost like an emotional thing. But I found when I recognize it, and I remember what the feeling is, I can prevent myself from doing it. It’s no less painful, but I can at least figure out what I’m doing.”

In fact, it is the recognition of these maladaptive patterns and the ability to ride through them (and help others ride through them) that distinguishes the successful leaders from those who are less successful. As this manager noted, these patterns do tend to be repetitive, and the person inclined to double-down now will be habitually inclined to double-down in the future unless he makes a conscious effort to change his style.

No one is denying the causes of stress. Within the hedge fund world, where market fluctuations are a given, any discomfort may have a very real cause. But how that discomfort is handled is critical. If you panic, stress can cause you to make snap decisions that turn out badly. For instance, let’s say your fund is long XYZ stock, and it starts to lose money. You are nervous, so you sell it. Then it starts to gain again, and you jump back in. You repeatedly do that and find at the end of six months that you’ve left a tremendous amount on the table. Or it could be that you have wanted to get bigger, but you don’t. Then the position changes, and you lose an opportunity.

When you are under stress, your mind is not as flexible as it can be. You are not as mentally quick as you need to be. Under stress, you may not be able to execute. You may not be able to think a decision through as clearly as you did when you were calmer.

One hedge fund manager I knew accurately described the feeling in comparison to his sailing experiences.

“It’s similar to the feeling you have when you are first learning to sail,” explained Sam. “The boat starts to heel, and you think it’s going to go over. You really get scared, and you let go of the tiller, and the boat starts turning around in a circle. [A trader’s stress] feels the same way, because you feel like you don’t know how far that thing is going to tip.”

While stress will never disappear, especially in the hedge fund world, traders can successfully learn to manage their stress. There are tools that you can use to help manage stress and avoid the destructive forces of panic. One of those tools is experience itself.

“One of the problems that I had when I first got here was just a lack of experience,” says Sam. “There would be a terror alert, and the market would start selling off. We would be like, ‘Oh, there is a terror alert!’ We would start shorting, and then all of a sudden, the terror alert was false, and the stocks came ripping back and then you are like, 'Now what do I do? Do I cover the shorts that I just put on?' I went from shorting that on the fear to [noticing] when everyone is panicking and buying the dip. It is just being able to handle that stress. You learn over time. You become more comfortable. You have seen this happen in a recovery. You know you can bring the boat back."

While experience itself is a wonderful teacher, traders have to make an effort to remember those experiences so they can benefit from them. Sometimes the best way to do that is to actually record them.

"I have a plan," says Sam. "(Journaling) actually was what helped me to start seeing the pattern. It was like every month, 'Don't panic in the situation of terror alerts. Wait fifteen minutes, and if nothing is substantiated, buy that dip instead of selling.' Just going through and seeing it month after month—the first three months it was, 'Wow! Three times! At least now I can see that I am doing it.' What I did is, I started making plans for the next month. I would say, 'Ok what am I going to focus on this month?' I could go back and say, 'I panicked in this situation. I sold at the bottom here, and I did that. OK, this month don't panic, and don't short on terror rumors. Just come up with three short things I can try to improve on.' "

Knowing that he couldn't control the market itself, Sam learned to recognize the signs of panic when unexpected market changes occurred. Over time, he has developed a better, calmer response to these changes. Each panic situation becomes another learning experience. By keeping a journal, he can recall certain moments accurately.

By reviewing your past performance you too can learn to correct repetitive behavioral patterns likely to reoccur in the face of stress. Your journal can include trading charts, a diary of events, and emotional responses to them so that you can recreate your trades and plan new ways of handling similar situations in the future.

"When I experience stress or disappointment, I lose my own sense of discipline," one trader said. "If I really journal the day's activity, and go back over it, reflectively, to learn from my mistakes, that helps me."

Whether you're on a hot streak or losing streak, experiencing stress or not, keep track in a notebook or on a tape recorder of your performance and of how you felt. This is a great way to keep reviewing what you've done and to see where there's room for improvement or where you need to develop more information to have more confidence in your decisions.

As Sam admitted, panic is the worst psychological experience you can encounter because "you feel like you have no control in that situation." But while it may feel like eternity, distress lasts only so long.

In addition to journaling, you can also reduce anxiety by timing the duration of the experience. This accomplishes two objectives. You develop some objectivity about the symptoms of stress, and you learn that it is a time-limited phenomenon that eventually passes.

Time your anxiety, and you'll see that the first time you measure its duration it may last as long as four hours. It isn't fun. In fact you might feel physically sick. But it is time-limited, and when you next experience similar discomfort, you will at least know that it won't last indefinitely. In fact, the next time you may discover that your anxiety may last only an hour. The time after that, it may last even a shorter time, and eventually, if you've done this timing exercise repeatedly, you will discover that even the most difficult circumstances prompt only a small pang of anxiety before the feeling passes. Again, the important point is to frame your stress so that it becomes a time-limited event. It is not as overwhelming as it feels when you're first experiencing it.

Ideally, you want to be in control of your emotions when things are not going the way you want them to go. The most successful people either know instinctively how to manage stress, or they learn how to keep it at its optimum level and continually review and practice their procedures just as the great tennis players continually practice their strokes. When you make a concerted effort to hold stress at bay, to tame your thoughts and think about your actions, you are taking back control and moving one step closer to mastery

USING IMAGERY AND VISUALIZATION

Dealing successfully with stress is crucial, because it is always present. As a leader, the more you find good solutions for your own stress, the more you will be able to help others deal with their distress. Fear takes you out of your game. Your mindset locks in on the negative. You feel awful. Your pulse races. You think: "I'm a lousy player. I picked the wrong profession."

Imagine what would happen if Todd Hays and Steve Mesler, the top U.S. two-man bobsled team in recent years, felt that way at the top of a course? They might crash at that first difficult turn. But world-class athletes manage the tremendous pressure they are feeling by rehearsing, in their minds, every nuance of the entire event or course they are about to attack. In the same way, traders can benefit from tapping into a previous triumph or success so as to develop a confident and winning mindset.

Visual imagery was among the first strategies that I taught Olympic athletes some years ago when I was on the United States Olympic Sports

Medicine Committee. Such techniques were especially critical for bobsledders, who had to learn to switch from all-out exertion in pushing the sled at the top of a course, to a calm, relaxed state while sitting in the sled as it streaked down the run. The athletes close their eyes at the top of the bob-run and imagine sliding perfectly at speeds of up to 90 miles an hour through each course turn. Similarly, biathletes had to learn to go in a few seconds from maximum skiing speed to a calm state with a markedly slowed heart rate so they could accurately fire their rifles at a target. These athletes learned to rehearse these difficult transitions through visualizing the entire sequence in their minds ahead of time, over and over.

Just as bobsledders can imagine their best run and biathletes can rehearse difficult transitions, the best traders can practice how to handle difficult trading situations and imagine successful outcomes in their minds before each day begins. Indeed, anyone can put themselves in a positive mindset through visual imagery so as to maximize performance in high stress situations.

One way is to consider the observation that the way you play losers and the way you play winners are not the same. Stated plainly, people are more inclined to get scared when they are losing than when they are winning, and as the actual losses pile up, they get even more scared and may become paralyzed and unable to take action, such as get out of a losing position. However, a trader can visually rehearse or imagine getting out of a losing trade over and over again and in this way prepare in advance how he will deal with a bad move in a stock. The better prepared he is, the more flexible he will be when the trading starts, thereby increasing his ability to make the right move and not be frozen by fear.

"I think that true learning is antagonistic," explained one trader who was battling with stress issues. "You have to experience a fair amount of stress in order to grow. It's what bodybuilders talk about when they say, 'No pain, no gain.' What is being challenged [by stress] is your belief in your own work, ideas, and your comfort for management and the fundamentals that you are investing."

Jim, another trader, told me that he has been able to reduce his stress through visualization techniques, which enabled him to become less attached to his positions than he had been previously. He began visualizing his trades beforehand, trading on paper before he actually executed the trades, and found that the technique eased his anxiety.

"With the paper trades, I felt like it was a game," he said. "It was fun—like a video game. I no longer had an emotional attachment to the money. I want to stay in this mindset."

Jim's experience reminds us of the amazing flexibility of the mind, which, with training, can enable you to handle more anxiety, more responsibility, more people, and more money than you might have thought possible. Recent research with magnetic resonance imaging and other technologies has revealed a pivotal idea—your brain has *plasticity*. It is capable of change—not just on a daily basis, but from minute to minute. You can train your brain through practice and repetition like you would train your other muscles, and thanks to its plasticity it can learn an infinite number of new things.

That's one of the points made by Dr. Richard Restak In his book *The New Brain*.[3] Studies of highly regarded music students showed that the superior students were those who had put in the most practice. But it was not boring, rote practice. The key to improvement among performers with expert ability, whether in music, athletics, or mathematics was "intense solitary, deliberate practice," and that for the highest-performing individuals, the goal "isn't just repeating the same thing again and again but achieving higher levels of control over every aspect of their performance."

For example, one concert pianist I know practices a few times a week while wearing tight leather gloves to ensure tighter finger control when performing under pressure. She also practices with the piano bench at different heights to prevent any surprises during a performance because of the stage crew's improper setting. One mezzo-soprano friend, by contrast, practices before a mirror while wearing a designated gown for the next solo performance to ensure comfort and professional appearance.

A great leader not only learns to do this sort of preparation for himself, he also learns how to guide his team through stressful periods by helping them recognize errors and prepare for future scenarios. He discovers new patterns that are discernible because of his experience, his mastery of his own experience, and his repeated review of the past.

The best leaders inspire their teams to function way beyond their limiting views as to what is possible. One manager I know encourages his traders to keep a journal log of their entry and exit points and then in quiet moments replay their trades so they can begin to prepare to do the best trades they can imagine in their mind's eye. This exercise is a very powerful way to break through limiting notions and give traders preparation in a variety of scenarios so that when they enter the markets, they are better prepared for a variety of contingencies.

I have watched basketball coach Bob Knight reviewing game films immediately after a game to see what went wrong. He concentrates on team errors and individual player errors so that he can coach them to correct for their mistakes. An extremely successful hedge fund manager I know does the same thing by reviewing charts and trades at the end of each trading day to see what worked and what didn't work.

Maybe you are dealing with a trader whose best trade was five years ago; maybe it was yesterday. You can hope that this trader remembers how terrific he felt during this trade and is able to recreate the emotional state associated with that experience. Tell him to recall that same state of mind when entering the trading room every day. You might suggest that he prepare himself mentally by thinking back to that moment and recording subsequent successful moments in a daily journal. Then he can begin each day with a greater degree of confidence about his ability to handle the markets and can better recover from the negative spiral of a drawdown when and if that happens.

Life principles and stress—the combination often serves to deter many traders from a successful path, and often their leaders feel powerless to identify, let alone help change, the negative patterns they see emerging as a result. But you can make a difference in your own trading and in the success of your team. You can recognize the power of long-standing beliefs, identify the actions that are resulting from those beliefs, and realize that while stress cannot be eliminated, it most certainly can be controlled. Through simple tools such as journaling, timing, and visual imagery, a great leader can transcend his own self-imposed limitations and help his team do the same.

CHAPTER 8

Empowering Others

The Gallup organization recently asked managers whether they provide employees with the same recognition for great work that the managers themselves would like to receive. Gallup, in surveying thousands of businesspeople, learned that being appreciated for specific accomplishments, on an individualized basis—and not just with money—was a critical element in keeping associates on board and committed over the long term. Sadly, only a handful of people said they received what they believed to be real recognition.[1]

Indeed, almost two out of three people received no workplace recognition in a given year. It might be because too many executives do not receive recognition themselves from those to whom they report or because they believe in the idea of tough love, which too often translates as criticism and sniping instead of praise or rewards.

The Gallup organization's current thinking holds that really listening to people and paying attention to their need for meaningful gestures of appreciation and approval for work well done are among the most important nonmonetary rewards you can bestow. Yet rewards beyond the expected bonuses or commissions are an often-neglected way of celebrating outstanding work in the hedge fund world, where so many firms are time-pressed or oriented only toward monetary goals. Indeed, even some of the best fund managers consciously choose a minimalist approach to celebration—limiting such occasions to annual Christmas or New Year's Eve parties. When asked about the need for more frequent celebrations, one manager said, “Generally, I don’t think there is a place for it. I think celebration is more of an ego thing.”

And this manager, like so many others, failed to see the problem with that attitude. In fact, he credited himself as believing that “recognition for doing a good job is of course very important.” While he believed in the power of a “positive environment,” he viewed celebrations as “popping champagne.”

“I think you can be objective and fair with people, can point out when they have done well only if you are balanced and pointing out when things aren’t going well. You don’t want to be too positive or too negative,” he said. “It should be balanced. If someone only hears the negative from you in public, and never hears the positive, it really hurts the relationship. For example, I sent the boss an e-mail at the end of the quarter, pointing out that things are going well and then moving on to the next project. I think people like to hear that a couple of times every few weeks, when someone is doing a good job, but not too frequently. The more you compliment someone, the more their ego expands. You don’t want to do it excessively.”

Other managers believe that while compensation, rewards, and recognition are important, they are better expressed privately.

“I have done things privately that the individual knows about, but I haven’t done it publicly because I didn’t want to send everybody else the message that they didn’t perform,” says one successful hedge fund manager named Leon. “I have rewarded people individually with cash. When someone went on vacation, I called down where he was going and upgraded him from the main lounge to a three-bedroom suite right on the beach, and said, ‘If anybody deserves this vacation, it is you. You have done a good job.’ I am not yet comfortable publicly rewarding people and having somebody else say, ‘Why not me?’ That may change over time.”

Leon believes that it is important not to overemphasize selected moments of success because it may promote “risk taking or concentration rather than a long, steady, or long-term performance.”

Different managers have varying approaches, and you may or may not agree with either of these two, but they are good examples of the opinions held by many in leadership, and they provide a baseline against which to measure your own views on acknowledging results.

Clearly, some people need more recognition than others, and your job as the leader is to know how to provide such support. If you truly want the best performance from your team, you will learn how to empower each individual to perform at his best and to continually seek to get better. Such a task is best not left to spontaneous actions of gratitude, but requires significant planning and creativity.

MONETARY INCENTIVES

There are many sources of stress in the hedge fund world over and above the stresses inherent in trading in an uncertain and unpredictable market. Perhaps the most common stresses relate to interpersonal issues and the most common among these relate to issues of compensation, which often create conflicts not always resolved to everyone's satisfaction.

While money is not the primary motivator, everyone has to admit that financial incentives are always welcome. In reality, monetary rewards are complex but necessary elements to help empower a team. The most beneficial incentives are a result of well-defined policies that encourage individuals to strive toward a team goal that will result in individual benefits. Compensation issues, unfortunately, are often a major source of stress because they are poorly planned and trigger competition.

An important task of leadership then, is to manage expectations in a realistic way and to develop a well-defined formula for determining compensation so that everyone can measure their performance against the specific criteria. But for managers, this is a difficult task. For example, one fund manager named Dennis felt trapped by his desire to make every employee "happy." In his mind happiness was equated with financial rewards and led to motivation. Unfortunately, his "pleaser" personality made him reluctant to lay down a firm incentive policy that would be in the best economic interests of the organization. In addition, he discovered that financial incentives often elicited more greed than motivation.

"I am feeling insecure about keeping people happy," he said. "All I hear about is the complaints. I never hear about how delighted everybody is. The biggest stress for me in managing my team is that I know better than they do how they are messing up; so that creates a natural tension between me and them, but I want people to be happy. I thought having happy employees is the right way to manage a business because it makes them more productive. In a hedge fund environment, there is always somebody who wants a gym membership paid for since other funds have done that. So, this makes it a less attractive place to work. Why is it that one guy has a massage therapist come to the office for his people, and we don't? This is what they say. Expectation goes two ways: One, what I expect of them, and two, what they expect of me, and expectations still get out of whack. So the question is, 'How often do we address the difference in expectations?' "

While every manager should take steps to handle personnel matters in a "nice" rather than "nasty" way, no manager should take on the load of constantly trying to "make" each employee happy. As a leader, the question to ask yourself is, "Are you providing an environment in which your team is able to perform?" not, "Are you making them happy?" The real issue is what work you, as the leader, need to do to get the team functioning in the most efficient manner so that everyone can have more conviction in ideas, take bigger positions with carefully managed risk, and presumably increase profitability.

Of course, clarity of objectives can reduce tension and create better alignments of interests. Therefore, a creative and effective compensation policy should be designed to motivate the team, boost their morale, and improve retention. It should be designed to align the firm's long-term objectives with the interest of those working in the fund.

Rather than try to compete with other shops that might offer huge payouts or bonuses to new hires, a smart leader will think about creating an investment banking type of program that offers eventual partnership interests, thereby discouraging too much turnover, a problem I discussed in the previous chapter.

In planning compensation issues at his fund, one highly successful hedge fund manager asks himself such questions as:

1. How many people should benefit from these profits?
2. How far down the organization should the incentives go?
3. Who has helped increase the funds under management?
4. Who has enhanced the reputation of the partnership?

But, as he said, "Those are very difficult decisions. There is no black and white. Reasonable people with the same reasonable set of facts come up with wildly different outcomes. To try and build consensus on that is a very stressful thing. One of the things that I have found is that it's very difficult to control the personal biases of people who tend to overvalue their own contribution. I think, in general, every person would say, 'Whatever I get paid this year, it would be more than my value in society.' [But] they also would say, 'But I don't want to get underpaid relative to other guys, because you know what? I did just as good, if not a better, job than they did.' The fact is that it's not quantitative or qualitative."

Specifically, how do you lay out a plan for financial compensation? First, try to outline what your team members expect and how their expectations differ from your perception of their contribution. Be prepared to face a difference of opinions about relative contributions and to ride through the stress that those conversations entail, all the while paying attention to each individual's need for recognition and appreciation. You also have to recognize that at some point you may lose a few people who are unwilling to accept your standards as fair and reasonable.

Second, make sure that procedures for financial compensation and incentives (including bonuses) are outlined at hire. If that has not been the case, then you may need to take the time to air out any misconceptions and set the boundaries now. And while the lines of communication need to remain open, there also needs to be an understanding that once a procedure is in place, it is not open for negotiation.

Last, and perhaps most important, remember that no one remains motivated by virtue of what *you* do or what you give them. Each person is motivated by his own values and perspectives. All you can do is provide an environment that fits the particular values that motivate them. That's all.

A CONFRONTATIONAL ENVIRONMENT

"If you want to get the most out of people, you have to apply pressure—that's the only thing that any of us really respond to," wrote Bill Parcells, the legendary professional football coach who turned four losing football teams into winners.

"As a coach, I've always tried to turn up the heat under my people, to constantly push them to perform at a high level. Creating pressure in an organization requires confrontation, and it can get very intense, very emotional."

Parcells did not apologize for his confrontational style. "I've actually come to relish confrontation, not because it makes me feel powerful, but because it provides an opportunity to get things straight with people. It's not until you look people right in the eye that you get to the sources of their behavior and motivation. Without confrontation, you're not going to change the way they think and act."

Parcells attributes his success in part to this strategy. "I laid it on the line: I told everyone that losing would no longer be tolerated." In frank, one-on-one conversations, he asked each player for his support in helping the team achieve its goals. "This," he wrote, "allows me to explain exactly what I expect from him."

"In the end, I've found people like the direct approach. It's much more valuable to them to have a leader who's absolutely clear and open than to have one who soft-soaps or talks in circles. I've had many players come back to me ten years later and thank me for putting the pressure on them. They say what they remember most about me is one line: 'I think you're better than you think you are.' "

What speaks volumes about Parcells' standing as a motivator is that this article appeared not in a sports magazine but in the *Harvard Business Review*.[2]

The difference between Parcells' confrontational style and the more negative intimidation style discussed in Chapter 1 lies in his efforts to consciously challenge his players to get better by focusing on their hidden potential and their capabilities. Parcells encourages his team to play up to their potential. He is also very cognizant of the need to balance demands with praise and always to encourage people to perform up to, if not beyond, their self-imposed limitations about their own abilities. Sometimes Parcells' confrontational approach looks intimidating, but as with other successful coaches, it is a balanced approach that recognizes the individual nature of his players and how best to tap into their talents.

Parcells' style of leadership has value in getting the attention of his players, something you must do as a leader in the process of empowering others to align with the larger vision of your fund. Whether you do it forcefully or gently, your challenge is to tap the emotional wellspring of motivation to embrace the promise of the future. By declaring a vision and encouraging your team to enter into the zone of learning, you create a new realm of possibility that will enable them to do extraordinary things. At the heart of such emotion-driven communication is the ability to get people to focus on the present moment, free of the limiting notions of the past and future. When you are able to do this, you create a state of *satori* or clear-mindedness, free of the domination of memory, ego, or neurotic concerns motivated by negative emotion.

In tennis, this is about keeping your eye on the ball; in sailing, it's about watching the telltales on the mainsail to see which way the wind is blowing and making the appropriate adjustments. In football, it's about moving the ball up the field. In all areas of life and business, it is about banishing fearful thoughts of catastrophes, what has been called impossibility thinking, and focusing only on critical steps related to your larger vision. This kind of reframing is a critical component of leadership. You create a vision and then act in the next moment in ways that are consistent with it, gradually moving toward the realization of the vision. Each step of the way becomes part of the building process toward the end result.

So, what's involved? While confrontation may be the initiator, to be successful, it must be part of a larger, well-thought-out policy of empowerment. Parcells' policy was to pick the right team, make sure the players were committed, motivate them to win, confront them, tell them that they can do better, and keep pushing them to do so. If they couldn't take it, he replaced them with those who were meant to be on the team. He discovered that this was the way to turn ordinary teams into Super Bowl contenders.

I have seen various kinds of morale boosting in the best sports coaches, even those who are thought to be tough and crusty. It is said about legendary basketball coach Red Auerbach that although he seemed intimidating, he listened during timeouts when he demanded that players tell him what should be done, and at other times turned to his team for suggestions about players he might want to acquire. He gave everyone a sense of being an integral part of the team.

I observed another legend, Bob Knight, hammer home the teamwork lesson while visiting him at Texas Tech in February of 2004. A player of his, N.J. Emmet, broke the Big 12 Conference lifetime scoring record during one game, and Coach Knight was asked during the press conference why no announcement was made to celebrate this event.

His reply was that if it had been an individual achievement like a 100-yard dash, he would have done so. But Emmet's scoring record was the product of a team effort—the guys who threw the passes to him, the guys who screened for him and others in specialized roles all contributed to his record. It was not an individual achievement, as much as it would appear that way in the record book. In fact, that day Emmet hadn't been playing defense and was taken out of the starting lineup to shake things up and to give everyone on the team the knowledge that they too would get a chance to play if they were willing to be team players and that just scoring big was not going to be rewarded.

This is an important lesson for potential leaders at hedge funds to learn as well. Unless there are clear directives, people sometimes tend to follow their own lights and are not as team oriented as they ought to be, oftentimes doing whatever will get them praise.

The leader must define the values he holds dearly and keep relating everything back to these values. The more this is done, the more likely it is that over time, behavior will correspond to the values that have been emphasized.

MEASURING EMOTIONAL SUCCESS

Of course, not everyone seeks to motivate through confrontation. In the best of the best, there is an increasingly conscious effort to build a structure of open communication to foster teamwork, as the following dialogue so clearly demonstrates. James is a hedge fund manager who believes that motivation comes naturally when his team members are "feeling good about themselves." He firmly believes that all those who come to work at his shop are much better as people after they have been at his shop for a while than when they first arrived.

Case Study on Teamwork

In this dialogue, James and his senior analyst talk about creating a culture of teamwork in their particular fund by consciously devising a values-oriented vision and recruiting for values and character as well as earning capability.

Kiev: How much do you consciously eschew creating adversarial relationships between you and the trading staff, a type of relationship that is not uncommon in the hedge fund industry?

James: That's exactly the distinction I've been trying to make. I know of one traditionally run fund which has had a lot of people leave even though they have had pretty good performance. It's all because of the competitive mentality. Three senior guys started it and then what happens is, they not only pit us versus them, they then pit the analysts against each other. They are now a very large fund. They hire three summer associates and tell them at the beginning of the summer one of you will get the job, so work your butts off. So immediately there is an intense competition.

Daniel: It's a very "eat what you kill" environment.

Kiev: What happens long term in those kinds of funds?

James: They can't retain people. They stay for a while because they feel like they're part of it. They have adversarial relationships with analysts. They keep hiring people. I mean you can hire people into it, but can you retain them? Can you develop that?

Kiev: They don't create the right incentives for their analysts?

James: That's the point. You see all these people leave. You wonder, should I spend some time developing them?

Kiev: Develop them and they'll leave after two to three years.

James: We have lost very few analysts in all our years because of the way we select them.

Kiev: Do you hire specific kinds of people that you know will fit in well in this firm?

James: They have to be honest, good people first, and then they've got to be smart. They have to love to learn and be interested in teamwork.

Kiev: Can you be more explicit about your concept of teamwork?

James: Working with other people to make overall profits. I am interested in finding people who are team oriented, who are willing to work to maximize profit by working together rather than working independently or competitively with others.

Daniel: You told me five years ago when I joined the firm that investment returns were important but that equally important was whether or not a person adds to the culture of the firm. You know what's critical for James is to have a lifestyle and an environment that was positive.

Kiev: I had lunch recently with a top sports executive who told me that his key to picking people is to tell people what he wants and only hire people who are willing to commit to his particular work and behavior ethic. He is really big about guys working, not partying late into the night, not missing practice. He wants people who are really willing to commit to being on the team. He also supports the notion of the team self-policing itself, and leaves a lot of things up to the players to maintain team morale.

James: Totally would happen here. The reason it would, is because if somebody was acting in a way that was more self-interested than team oriented, someone on the team would point it out by saying, "Hey, I am sure you made a mistake."

Kiev: Does the team know it's empowered to do that?

James: I don't know.

Kiev: Have you ever told them that?

James: I told them in the sense that Daniel and Paul sometimes share and organize these staff meetings. I have sat down with analysts at year-end reviews. I said: "Listen, you can't necessarily control how your stocks are going to do next year, but one thing you can control much more is how you add to the culture and environment of the firm. So you pick these stocks, and they're great picks, and I agree with them. You're making big positions and they all stink. Maybe the year after that they will go up. The next year they stink. So we're sitting here next year—that part you have some control over them." We talk about that. Let's talk about the other part of it. You can find good people to bring to the firm. You can train the younger people at the firm. You can bring in really interesting speakers, which we do. You can form all sorts of relationships.

Kiev: Can you give me an example?

James: Daniel has formed a lot of relationships with outside speakers and consultants and we have both benefited from it. Those are things that people can control and should be rewarded for doing so. Do you see my point? It began to lessen some burden. Analysts go through bad periods in their stocks. It doesn't make them happy. They are very hard on themselves. At the same time, the other activities give them an outlet for something they can spend pure time and energy on, right? When your stocks are stinking, you can think, "It would be really great if James met Peter Bernstein or some other interesting author. They can help with the recruiting and help with the class."

Kiev: How much of this approach is managed or is it simply approached in a laissez faire way?

James: It's managed insofar as I tell people what is possible here.

Kiev: It sounds like you are encouraging people to take the lead in these activities. Is that a decision that you have taken that people do better when they know the direction but are left to their own devices to make things happen?

James: You have got to hire people who can do that, and are motivated to do it. There is some formality. I mean, we have a weekly staff meeting, but it's never on the same day. We just figure out the day at the beginning of the week. Sometimes I think it should be earlier. I really run it in the sense of I tell people what I am thinking about. Now at the meeting today, I am going to talk about some marketing type issues and some cultural things. I am going to explain what I heard yesterday about a multibillion-dollar fund and I would be pointing out all the problems. By doing that, I am reinforcing our values.

Daniel: That would be the meeting also where I might say, "Let's bring in some speakers over the next few months." James will never follow up with us and say, "Where are we on this?"

Kiev: You use some energy thinking about, "How do we move this forward in a way that makes this a learning organization, where people are going to get something and add something and they grow in the process?"

James: I think people look forward to the staff meetings. Nobody ever misses one. No matter where they are, they always call in because to miss one you really feel like you miss one.

Kiev: Do you think a lot of guys now running hedge funds think this way?

James: No, and I think the reason they don't is because a lot of them are preoccupied with performance all the time. They are so focused on the performance that a lot of this other stuff gets lost. At the end of the day, if you do all this stuff right, at least you start the adrenaline flowing. That's what I tell people. When we started, we just had a few analysts. I said, "We are going to do it the way we think we should do. We will have the integrity of doing what we said we were going to do. Then work it out where at least we do things with integrity and we will have some fun."

Kiev: That's great. So you laid out a philosophy with a set of values and principles which have guided a lot of issues over the years.

James: Absolutely. We recognized that we have to focus on things we can control and also recognize what we can't control. I spend as much time with people who have an enjoyable time and those who don't. It's kind of a unique aspect of the culture here. There is really no micromanagement at all. I mean you are totally left here on your own on the court.

Daniel: There is no adversarial system here. If there is a hole in your thesis or your work, John will mention it. But the fact is that no one is watching over your shoulder, as opposed to some other firms that were successful in the past, which would pit people against each other and tear apart each other's ideas. You would be challenged in these other firms. You are never challenged here. So what I think is critical is, you have people who have this self motivation. We have people who probably put too much pressure on themselves and it does create emotional baggage so they can't tap into that creativity, but no one is micromanaged or humiliated.

Kiev: How do you handle the guys who put too much pressure on themselves?

James: I think the culture is a buffer. They just have to feed off the other people to get their perspective back, but in the end you really have to be self-motivated here.

Kiev: You have to know how to be an analyst before you come here.

Daniel: No. All of us, especially James, are able to teach and coach. That is one of the unique aspects of our culture.

Kiev: Are you consciously thinking about creating a learning organization?

James: I try to help them, and they come to see me. Most people who start their own hedge funds call on me. I say, "Here is the most important thing—number one, think about how you want to live your life as you're starting your fund. You need the opportunity to create an environment *and* culture where you could live the life that you want to live. Unless you think about it, you're going to allow the business to dictate the life you want to live. You may end up being a financial success and a personal failure." Then I say, "Think about it right. The decisions you're making now are going to dictate so much about what you're going to create and the kind of people you hire, and even the kinds of investors you want as limited partners."

Kiev: What questions do they ask about starting a fund?

James: They often come to me with a shallow question. "How much do you pay a starting analyst?" That's not the question. The question is, "What kind of person do you want to hire that is going to fit into your culture? Who will allow you to create the culture you want to create, allow you to live the life you want?" Then we talk about limited partners, because they all get inundated, particularly if they come from successful firms.

Kiev: What else do you say about investors?

James: They get calls; everyone wants to meet them. We talk about what kind of limited partner you want in your fund. If they don't care, I ask, "Are you going to care if they call you every day? Are they going to call if you're down five percent in a month, which you will be at some point, if you manage money the way I manage money? Most investors get panicky. Are you able to describe to potential investors what you're trying to create? Not just your investment thoughts, but the culture of your firm?"

Kiev: What reaction do you get when you raise these issues?

James: It's very eye-opening. A lot of them are so anxious to raise money that they don't give a lot of thought to what kind of limited partner they want. They are so anxious to hire the right person, the big name, the profitable guy or gal that they don't think about the impact of the person on their culture. The things that I put down in my original vision document are things that I explicitly share with other people. Particularly those who are starting firms. I really try and get them to focus on starting out with a strong perception of how they want to live their lives and the culture they want to create. If they don't think about this, more often than not I say these people end up, whether they are successful or not, average successful, meaning successful performance-wise or not, there is something that does not make them happy.

James has one of the more enlightened leadership philosophies I have encountered in the hedge fund world. This incisive dialogue underscores a broader vision or mission statement, which serves as a guiding set of values and principles for creating a positive culture. Obviously he has spent a great deal of time thinking about what kind of team he wants and how he expects that team to be productive. He takes into consideration not just what kind of traders and analysts he wants, but what kind of people will be most comfortable in the environment he wants to build. He is ready to cede some control over to people when they can make a difference, not just by picking or trading certain stocks, but by doing other things, such as recruiting and mentoring fresh team members, bringing in guest speakers, and doing other things to add to the firm culture over and above picking stocks. Clearly, this is one of the more enlightened types of approaches to building a firm culture as well as putting a lot of emphasis on the types of investors you are looking for.

"I think investment success begins with what I call emotional success," he said. "I think our emotions are always springing traps for our reasoning powers and because of that there is a lot of emotional clutter. This clutter gets in the way of doing what is a reasonably simple and straightforward task of managing money. In my seventeen years, the best ideas have always been simple and straightforward. Decisions have been somewhat obvious when all of the stuff has been removed from it . . . attachments to the stocks, feelings of inadequacy and fear, feelings of envy of another analyst having the stock that is going up while yours is going down, feelings of 'Oh my goodness, am I going to lose my job?,' feelings of 'He looked at me really weird today, and I am feeling terrible guilt.' "

This extremely successful manager was able to look at his career and to comment, "My passion for the business increases because I enjoy being around the people and watching them develop and learn. It's an emotional clearing mechanism for me to separate out the stuff from analysis. It's relieving stress from someone's shoulders. Leadership is helping people to work through emotional clutter."

"Of course, we want to continue to be profitable, but that isn't all," he said. "We want to create a culture of teamwork and cooperation that is profitable, but more importantly, a culture that is the kind of place you want to spend your entire professional career."

James holds a somewhat original view in the hedge fund community—that self-fulfillment is found in teamwork and integrity. Ultimately, these lead to uncommon and sustained success over the long haul. While I haven't too often encountered this focus on the goal of character development as the source of self-confidence and self-esteem, I heartily endorse it as a vital ingredient to creating a long-term and sustainable hedge fund.

Another facet of empowerment deals with compensation issues and the clear definition of career paths. This is very well explored in the following dialogue with Randy, one of three partners in a $1 billion hedge fund.

Case Study on Empowerment

Successful fund managers employ a variety of strategies to make sure each portfolio manager, each trader, and each analyst is empowered to do his best work. In addition to finding someone's strengths and pairing that person with someone who has complementary strengths, it is also useful to consider creating a compensation structure that aligns everyone's interests with those of the firm and builds up a chance for retention. In the following conversation, I talked with Randy, one of several principals of a billion-dollar event-driven hedge fund, about this.

Kiev: How are you organized?

Randy: The first thing to understand about our culture is that it came about from three partners who were equals. The idea was one of decentralizing and empowering people while at the same time putting a framework around us—but it's a prestated and explicit framework. We all know the rules. We all know what the violations of the rules are. The result is in that four years we have never had a partner raise his voice at another partner. We never frankly had any real advanced disagreements.

Kiev: Did you have a lot of good discussions before you started your firm?

Randy: Yes, we worked together before. I said just personally, "I think this will work. We seem to get along well. We are not yellers. We are pretty cool and calm. Why don't you set up the structure so if you had a yeller." As long as we all sign up to the rules and you don't have anyone who breaks that compact, meaning, "Forget this; I am going to do what I want," we all win or we all lose.

Kiev: Did you build in any kind of fail-safe mechanisms for resolving conflict?

Randy: Basically, we negotiated an operating agreement between the partners. It's pretty simple. We operate very similar to what the traditional investment bank partnerships did, which is ultimately, majority rules. It's the vote. So if a partner wants to go above a certain amount of a position and he can't get two partners on board, then we don't do it. If he wants to go past even a certain other level, you need three partners on board. For whatever reason, we bought into the system and co-created the rules.

Kiev: Would this system work with three other guys randomly picked?

Randy: I don't know whether we got lucky or if it's a good system. I think it is probably a combination of both. It all comes down to ego, and do you have people that say, "I understand that sometimes this won't go my way, but at the end of the day, the system works, and therefore I am going to subsume my ego." We never came at it and said this is a fund or this is a product or a personal vehicle, which has probably hurt us at times. We said, "We are in the asset management business."

Kiev: Tell me how you arrived at a structure that would be fair to everyone.

Randy: We said, "It's an Italian restaurant." One example I like to use is, there is very little differentiator in Italian food. There are a lot of good Italian chefs. Somehow, there are Italian restaurants that do real well and there are ones that do real poorly. The difference, frankly, just comes down to management, where they understand their human resources, their taxation, and real estate. We gear ourselves toward being a really well-run Italian restaurant. Our cooking might not always be as good as some of the famous fund managers and I recognize that, but I am not a master chef but our cooking is hopefully good enough and we can build a sustainable business. So we try to adapt and evolve.

Kiev: What do you believe are the keys to your success?

Randy: Where there is a competitive advantage, number one is understanding control in trading psychology. Number two is understanding what you are good and bad at and having a plan. It has to be adaptable, but never go into a situation and throw your arms up and go, "I don't know what the market is doing."

There is always some process in there and having a plan to understand that. Then number three is focusing on having a good business. You don't wake up and become a stupid analyst. It doesn't make any sense. What happens is, you fail to manage your own psychology. It changes. You then become a bad trader and the market changes and you're not set up for it. Either you don't have a plan for the evolution of the markets or the change, or your business falls apart because you didn't focus on that.

Kiev: How well are you adhering to these three principles?

Randy: I know we can have a plan. I know I can understand where our psychology gets better. To me, that's a little bit more about the success. Then when you talk about waiting internally, I think people respond to that.

Kiev: How has this worked over the past four years for you?

Randy: Think about an Italian restaurant. One day you talk to all your employees and you yelled at them or you didn't do anything. The third day you didn't talk to them at all. Then imagine one day you decide to pay the guy ten bucks an hour and the next week you decide to pay them five bucks an hour. Let's say every fourth week you fired one of his colleagues. Then let's say you are changing your mind constantly about the menu. So people don't know where they stand. Then you take your senior chefs and you are always belittling them or correcting what they are doing. You would have a pretty bad Italian restaurant with high turnover that ultimately is going to have problems with being successful.

Kiev: How does this relate specifically to your firm?

Randy: I think ultimately it comes down to a couple of paradigms where we are different. People like stability. They don't like the rules of the game to change. They don't like uncertainty. While they say they want to make a ton of money, at the end of the day, especially as they get older, they have kids and they have houses. If I do my job and I do it right and I don't completely mess up, I will continue to go further and further. I can do pretty well. I think some major managers have to deal with the "eat what you kill" method. It is very good in the short term if you can keep the fuel coming into the engine.

Kiev: But you don't think it is good for the long term?

Randy: The problem is one third of your guys you burn out because they don't belong in the industry. One third of your guys become brilliant and if you can keep on getting there, maybe it's one tenth.

Kiev: The middle guy you have to nurture and the ten percent you let go?

Randy: Given unlimited assets or unlimited resources of people then maybe you can burn through everyone and you can get the twenty percent. We don't have that, so what happens is we try to draft. We try to bring people in. Each of the teams hires a little bit differently.

Kiev: How many people do you have?

Randy: We have about fourteen people in research, which is relatively high for our asset base. That's the analyst pool. There are three senior PMs who are the partners. There is one PM who is going to be made a partner in January, then four or five senior analysts and then maybe three junior analysts.

Kiev: Has your retention rate been pretty good?

Randy: We lost one person in four years. We let someone go last year.

Kiev: Do you think this reflects the philosophy of the firm?

Randy: The main one is, you imagine you were working for someone and how you would want to be treated. You would want to be treated with respect, honestly and consistently. You would want to be treated fairly. If you can get yourself to do those things, the only people you are going to lose are either people who aren't working or people who are overambitious and want to run their own firm.

Kiev: On what basis do you recruit new people?

Randy: We don't go out and say, "Who is the guy at the top fund who is running their consumer book?" We don't have the resources to do that. We instead say, "Where can we find good people?" I don't want necessarily twenty-three- or twenty-four-year-olds. They show up hung over a lot. They don't have their work ethic down.

Kiev: Paint me a picture of your best hires.

Randy: In this environment, we were able to go out and find a lot of people who were twenty-seven to thirty. By that time you got your stuff together. You are not crazy and know you've got your stuff done. You probably have some knowledge of your industry. You may or may not be married but you haven't made a ton of money. We have hired mostly from the sell side. These people have everything in front of them. Most of them are laid off. They are young enough that they are going to work hard. They are old enough that we don't have to do a ton of trading. They are very hungry and we don't have to deal with the ego issue of "I worked at Maverick or Pequod and this is what we did there." That's great and you might be able to add value to that, but I think it can be difficult.

Kiev: So the ones you have found are relatively young, but not swaggering?

Randy: We have been more successful in taking our young people and growing them. The issue then is, you don't know what you've got. You have to learn the people and I think it's very similar to a soccer team. With soccer, ultimately you need eleven people out there. So if you stack yourself with strikers, then you don't really have much chemistry. Every person I hire I want to be a portfolio manager. I recognize that not everyone will be and then you figure out whether they can add value and if they can't, then you remove them. Again, most of the people we have hired we have known for years. We have never used a headhunter for research.

Kiev: Do you have very explicit goals? Are they transparent—"This is what we want to produce by the end of the year?"

Randy: Yeah. We target double-digit returns. We target four to eight percent standard deviation. We really try to keep the capital preservation very high. We have been in business four years. The core fund has done an eleven percent return with a four percent standard deviation. The biggest drawdown peak to trough hasn't been greater than a percent and a half on any given day for the year.

Kiev: Do you have your PMs set goals that are aligned with a larger target?

Randy: Each team is different. What we do is our compensation system. We sit there and say, basically, here is what it is. Here are two aspects to it. One is qualitative and stable and one is quantitative with some upside. If you work here and you know what level you're at—whether you are an analyst, senior analyst, or portfolio manager, and you continue to grow, work hard, and are diligent—we see a future for you.

Kiev: Can you give me an example?

Randy: I will have a guy come in and say: "I think I really want to buy Sprint. I know the score. I have been following this group for years." I will say, "OK. Tell me how much and what you do."

Kiev: It forces them to explain how much conviction they have.

Randy: To have conviction, take ownership and have responsibility.

Kiev: The analysts are expected to size it up.

Randy: I rely very heavily on what they want to do. If we should have done it, you should have convinced me. You know you have got responsibility.

Kiev: Is there a willingness to have these conversations?

Randy: Yes, absolutely! There has never been a lie told between any partner here. Our conflict resolution is identify the problem, put all the information out there, and figure out what to do and move on. Where you start running into problems, are the guys who are not sure about these numbers. I think ultimately everyone knows if you are wrong too long, you are fired. I think in this environment so far, we have done a good job of maintaining safety and consistency while maintaining aggression and competitiveness, but time will tell. I think we are growing a couple of people.

Randy's method of organizing his firm and creating career paths for all involved is a model worth noting. The structure creates a sense of security so that people can take appropriate risks in line with their own and the firm's objectives. There is great transparency about what is going on and a high level of accountability expected from everyone. Beyond that, compensation is clearly defined and the potential for friction and disappointment minimized, resulting ultimately in high morale and retention.

Unfortunately, not all firms follow the policies adopted by James and Randy. Many of their contemporaries need help moving in this direction. For example, at one firm, I observed a videoconference of a manager whose aggressive style was smothering some of the enthusiasm of his people. I urged him to make a few simple changes in his approach so as to boost their confidence.

I also urged him to encourage people to tell him what they hold back on out of the natural reluctance to sound like they were complaining. I suggested that he needed to notice his own tendency to jump in as the savior who would make sure everything happens.

About a week later, I observed another videoconference. The manager definitely listened more and strengthened morale. I saw more ownership of process by participants, more awareness of bottlenecks and willingness to find solutions, and less apparent resistance. I heard the CEO ask questions that were very encouraging, instead of demeaning or sarcastic. I watched as he gave clear directions. He gave team members more responsibility for their assignments. He did not jump into the discussion as much.

This manager still had more changes to put in place and more morale-boosting to do, but his progress was unmistakable.

As a leader, you are in the position to empower your team. You set the stage for them, but it will be up to them to perform and not hide behind excuses such as "I'm new" or "I'm young." To the extent that you can pick up on someone's hesitancy or discomfort, you can open the space wider for him and then enquire what steps might be taken to remedy the roadblocks.

LEAVING A LEGACY

We are in a rapidly changing period; hedge funds are flourishing. Many leaders are beginning to consider the possibility of leaving a legacy—that is, building a first rate, long-lasting investment organization. This is perhaps why there is more interest today than ever before in the concept of leadership. I talked to David, a hedge fund manager who started in the business in the 1990s and had a unique perspective on the industry. He was able to comment on the distinctions between the hedge fund giants of the 1990s and the fund managers of the twenty-first century like himself, who are more interested in issues of leadership. His comments point to an ever-increasing need for more leadership, more professional management, and greater awareness of building for the future. I asked him what it takes to be a successful leader of a hedge fund today. What are the tasks and skills that are needed?

"At least from our perspective it's much more about people management and HR, not necessarily just portfolio management," said David. "The people who are building good hedge fund businesses are doing a better job of paying attention to people, HR, recruiting, and screening people. They are trying to set direction and vision of the firm so that when somebody joins, they know exactly what the next three to five years look like. The model from the late '90s was the sole proprietor—Robertson, Steinhardt, Cooperman, and Soros, to name the biggest ones. Of those, only Cooperman is still in business. From the perspective of an employee joining them, they were only trying to figure out how much capital they could deploy and how much they could get paid for it. That was really about it. In the process of business-building, it wasn't collaborative. It wasn't building a partnership. People who are successful today are looking not only to budget financial risk but to budget for business risk. They are interested in protecting, preserving, and growing their franchise. They are choosing multiple products. They care about the brand name, and they care about retaining talent. You may not make as much money as the CEO in any one year, but over ten years or over five years you are going to make a lot more. So, ultimately it is incumbent upon you to become a more effective leader and a real CEO building a real business and a legacy."

"People are reinvesting rather than just taking the money out of the business and stuffing it under a mattress," he continued. "Today, people are making real reinvestments in hiring and training a bunch of junior people, opening offices in London or in Asia. They are expanding the business that way, by bringing in professional business managers, professional HR people, and leadership consultants. So, people are making discretionary investments that you normally find other businesses doing. A good leader in a hedge fund today thinks about it as a business in much the same way that we expect our portfolio managers to think about their stock investments. We have free cash flow. Do we reinvest ourselves, or do we share a purchase? There is a lot more reinvestment today."

David's insightful comments point to the naturalistic way in which the leadership process evolves. Most firms simply evolve organically. Few fund managers initially pursue long-range objectives. Concepts such as harmony, wealth, longevity, and ownership are broader themes that are not articulated initially. The fund manager starts off hoping just to get through the year; he's not thinking about the billion-dollar fund he may be running in a couple of years. Then, all of a sudden, running so much more money is a problem because the markets are getting tougher, and leadership and management issues are more than he ever imagined they would be.

Building a legacy can mean many different things. It can mean building a firm with longevity so that it continues even after you, the founder, have retired or gone on to other things. Or, it can mean inspiring and teaching your principles and your style to legions of young Turks who do not stay with your firm but who make your name legendary by founding a dozen new and successful firms of their own. Or it can mean providing capital for the best and brightest on your team so that under the broad umbrella of your operation they make huge gains for increasing numbers of clients. Whatever the direction your leadership takes, it is clear that a good leader must find a way to empower his team. He must provide individuals with enough room to keep tapping into their own immense, limitless reserves of potential.

There is no one best leadership style. The best style for you is probably the one that works for the objectives you choose. That is the beauty of the hedge fund model. As hedge funds expand and multiply, as the game gets more crowded and comes under increasing regulatory and media scrutiny, a new generation of nimble, smart leaders is emerging, eager to face the altered hedge fund universe and be psychologically strong enough to attempt to master the new challenges. You are a member of that generation, and you too can become a leader worth remembering.

Notes

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