

Hedge Fund Institutional Forum & Sheffield Haworth

# Hedge Fund/Fund of Hedge Funds

Sales and Client Service

Recruiting, Retention & Compensation

2009

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## EXECUTIVE SUMMARY



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## INTRODUCTION

The results from this iteration of our annual survey highlight the extreme market conditions faced by hedge funds and funds of hedge funds (FoHFs) in 2008. Having been hobbled by the credit crisis earlier than their counterparts at traditional asset management firms, many distribution professionals in the hedge fund world faced decreasing compensation for the second year in a row. Sales professionals were more likely to have experienced falling compensation than client service professionals. Senior professionals saw bigger drops than junior ones. And employees at direct hedge funds, who tend to earn more than their counterparts at FoHFs, experienced proportionally larger declines.

Due to the rebounding markets of 2009, most will be spared a three-peat. Compensation for sales and client service professionals is generally expected to rise in 2009, albeit modestly. More importantly, many hedge funds and FoHFs will be focused on coming to terms with a fundamentally changed dynamic between themselves and investors. Shaped by the scandals and shocks of recent months, investors are rewriting the rules of engagement, and savvy managers are moving to adapt appropriately. This next stage of evolution for hedge funds and FoHFs has significant implications for the sales and client service roles at these firms, including who is hired, what they do, and how they are compensated.

## HIGHLIGHTS

### Direct Hedge Fund Sales & Marketing

- ▶ While compensation levels for sales professionals have been trending down over the last two years of the survey, they are expected to climb an average of 8% across all experience cohorts for the 2009 performance cycle.
- ▶ Compensation declines in 2008 were more severe at the senior levels, and were felt particularly keenly by top quartile earners. Sales professionals at the more junior end of spectrum were more insulated from decreases.
- ▶ Heads of Sales were the hardest hit, with median total compensation falling to \$900k from \$2 million the prior year, and average compensation falling to \$1.5 million from \$4 million. The good news is that 70% of Heads of Sales expect to see an average 13% higher compensation in 2009.
- ▶ There was modest hiring in 2008, with most hiring front loaded in the first half of the year). Slightly more aggressive hiring activity is planned for 2009 and 2010.
- ▶ The use of cash guarantees fell for the third year in a row to an all time low 57% of firms using them in 2008.
- ▶ Pay practices became more opaque in a year when management focus was diverted almost entirely toward firm profitability and survival
- ▶ A growing minority of hedge funds are more aggressively employing product specialists to conduct what has become a more technical, sophisticated sales process and to help play defense to strategies that have been stress tested to the extreme.
- ▶ Sales activities shifted from more traditional business development such as final presentations and prospect meetings to more defensive activities like client service, conference attendance and consultant meetings.
- ▶ The use of 3rd party marketing virtually disappeared in 2008.

### Direct Hedge Fund Client Service

- ▶ The extraordinary events of 2008 provoked a major re-arrangement in activities: client service professionals were downshifted to more internally focused support activities in a year when business development evaporated and caused sales professionals to take on more externally focused client service activities.
- ▶ Despite the increased focus on more internal, support oriented functions, compensation for client service professionals did not fall as dramatically as sales professionals. In fact, compensation in some cases was actually higher than in the previous year for some experience cohorts due to a heightened emphasis on client management/communication/retention activities.
- ▶ Client service hiring and spending is expected to be down from the previous year. Firms that are hiring are doing so in order to expand current client service teams rather than replace headcount.
- ▶ Compensation structures were 100% discretionary, compared to previous years when commissions or other incentives were sometimes offered as part of the compensation structure for client service professionals.

## HIGHLIGHTS

### Fund of Hedge Funds Sales & Marketing

- ▶ Represented by a more experienced group of professionals than in previous years, compensation levels at FoHFs were mixed: While 50% of all sales professionals saw decreases in compensation levels, the median levels rose due to a more highly experienced group.
- ▶ Expectations for sales compensation in 2009 are not particularly optimistic. A broad range of projections mean that, on average, FoHF sales professionals are expected to experience little to no change in total compensation from the previous year.
- ▶ FoHFs intend to spend 10% more on hiring sales, marketing and client service in the coming year.
- ▶ Retention mechanisms are less cash-oriented in light of shrinking bonus pools. Some firms are offering investment product training as a way to retain sales talent.
- ▶ In a major shift from previous years, sales professionals shifted their focus from traditional direct selling activities to indirect sales and marketing activities (e.g. conferences, consultants, etc.)
- ▶ The prominence of product specialists continues to grow, particularly in the areas of thought leadership and other content-driven activities such as writing white papers and quarterly reviews.
- ▶ This year, compensation was 75% discretionary for FoHF sales professionals, signaling a decreased reliance on commissions and performance-based bonuses.
- ▶ Equity awards played a far more important role this year, with 43% of respondents saying they use them, compared to 28% the previous year.

### Fund of Hedge Funds Client Service

- ▶ Limited data suggests that compensation for client service professionals at FoHFs is significantly lower than that for client service professionals at direct hedge funds .
- ▶ Compensation for client service professionals was muddled by the myriad of new hires that occurred in early 2008, causing a mixed - and less predictable - compensation picture.
- ▶ Heads of Client Service expect average compensation to increase by as much as 20% in 2009.
- ▶ Compensation for client service professionals at all other levels is expected to improve by at least 10% in 2009 as reported by 70% of responding FoHFs.
- ▶ For the first time in years, spending on the client service function has slowed in acknowledgement that it places more pressure on revenues and margins at this particularly sensitive time.
- ▶ 100% of responding FoHFs require all new client service recruits to sign either non-solicit or non-compete agreements.
- ▶ There is a widespread move toward pure functional client servicing focused on responsibilities such as responding to client inquiries and ramping up client communications with more frequent written and oral communication. External marketing activities are almost nonexistent.

## CONCLUSIONS

There was no shortage of bad news in 2008. Many sales and client service professionals saw their compensation fall for a second straight year as the markets went into a free fall. This surprised no one, given the severely eroded asset bases and greatly diminished fee income in a market almost devoid of opportunity.

Recruiting efforts slowed down but never came to a halt, especially because a variety of developments in the marketplace spurred growing demand for expanded client service roles to more aggressively manage client communication and reporting. A clamp down on new distribution initiatives, whether via third-party or direct channels, followed as attention and resources were instead directed toward retaining increasingly restless and worried clients.

The shrinking bonus pools affected almost everybody, but not equally. Sales professionals were more likely to have experienced falling compensation than client service professionals. Senior professionals saw bigger drops than junior ones. Employees at direct hedge funds, who tend to earn more than their counterparts at FoHFs, experienced proportionally larger declines.

It now appears that 2008 represented the bottom. Most sales and client service professionals are not likely to see further declines in compensation this year, and many will actually see increases. Rebounding markets in late 2009 pave the way for more optimistic hiring plans in 2010, but not yet at the pace seen before the market downturn. Given the extreme conditions of 2008, many Heads of Sales/Investor Relations are now better positioned to argue for the expansion of either sales or client service teams in order to more effectively retain clients as well as develop new ones.

The coming year is not likely to be a return to business as usual. Selling hedge funds and servicing investors will become (and in some cases already is) a very different sort of activity in the wake of 2008. New entrants and re-potted ones will continue to vie for assets, but there appears to be a growing rift between a select group of top hedge funds and the rest. This is in part because of investor reactions to recent scandals, which immediately raised standards and expectations. Addressing heightened concerns over transparency and liquidity places significantly more pressure on managers who until recently were not equipped or inclined to do so. Compounding this is the growing need to make solutions-oriented sales to multiple constituencies, namely gatekeepers, investment professionals, and Boards. As a result, hedge funds and FoHFs will be raising the bar, looking for the highly trained, highly skilled sales and client service professionals required to succeed and sustain a profitable business in a changing environment.

## **ABOUT THE SPONSORS**

### **Institutional Investor Institute**

The Institutional Investor Institute, founded in 1970, is a private membership organization of 100 institutional investment management firms. This group represents the major players and innovators in investment management which exercise discretionary investment authority for more than US \$5 trillion in assets. Iii provides its members with research, data and information regarding institutional investors and asset management firms.

### **Sheffield Haworth**

Sheffield Haworth is a leading global financial services executive search consultancy, with offices in Boston, New York, London, Dubai, Mumbai, Delhi, and Hong Kong. We employ over 100 professionals and have a client list that includes leading global financial services companies, asset managers, hedge funds, law firms and corporations.

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