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THE UNIVERSITY OF CHICAGO

AMPLIFIED INTERFACES: ESSAYS ON ORGANIZATIONAL IDENTITY
AND THE SOCIOLOGY OF HEDGE FUNDS

ABSTRACT AND EXECUTIVE SUMMARY

A DISSERTATION SUBMITTED TO
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This dissertation combines sociological and behavioral perspectives to advance a single theoretical concept: organizational identity functions like a lens. As a metaphor, identity-as-a-lens is employed in varying ways in each of the three substantive chapters. First, the lens is with respect to the organization itself: How do organizations strategically manage and manipulate their identities to appear a certain way? Second, consumers utilize the lens: How does organizational identity affect the way audiences respond to new market information? In other words, what happens to information when it passes through the lens of organizational identity? Third, the lens is for the researcher: How can organizational researchers use constructs like identity to recognize and track macro-level changes in a market or industry?
1.1 Organizational Identity as a Lens

This dissertation is a collection of three substantive essays linked by a common empirical setting—the hedge fund industry—and an overarching interest in the construction and consequences of organizational identity in financial markets. The dissertation draws on sociological and behavior theories of organizations and markets to develop and evaluate new models of organizational and investor behavior.

More specifically, I aim to advance the following theoretical frame as it relates to the concept of identity: Organizational identity functions like a lens. As a metaphor, identity-as-a-lens is employed in varying ways in each of the three essays. First, the lens is with respect to the organization itself: How do organizations strategically manage and manipulate their identities (e.g., shape and contour the lens) in order to appear a certain way on the market? Second, consumers utilize the lens: How does organizational identity alter the way investors respond to emerging market information such as performance? In other words, what happens to market information when it passes through the lens of organizational identity? Third, the lens is for the researcher: How can we, as organizational scholars, use constructs such as identity to recognize and track macro-level changes in a market or industry?

Using the context of the hedge fund industry and advancing a measure of organizational identity as time-variant categorical conformity or “typicality”—that is, how similar a fund’s composition of trading strategies and asset focuses is to other funds in a specified reference group, at a given point in time—I investigate fund naming patterns, the performance-capital flow association, and fund birth and failure rates to address each of the three questions posed above. In doing so I advance three distinct, but conceptually intertwined theoretical models for
analyzing organizational identity and demonstrating its relevance for (1) organizational strategy, (2) investor behavior, and (3) market change.

1.2 What are Hedge Funds and Why Study Them?

Each of the substantive analyses in this dissertation utilizes a combination of qualitative and quantitative data on the hedge fund industry. Hedge funds are vehicles for “alternative” investing, where the designation “alternative” represents anything from traditional securities such as debt and equity to the more exotic; various forms of derivatives, futures contracts, and even art and real estate. Given this diversity in holdings, hedge funds may in fact be better characterized by what they are not than what they are. First, with few exceptions based on fund size and number of investors, hedge funds are not required to register with regulating bodies such as Securities and Exchange Commission (SEC). Second, hedge funds are not open to the general public, but rather a limited pool of “accredited investors.” Accredited investors are individuals who earn more than $200,000 per year or have a net worth over $1 million. Third, hedge funds are barred from advertising. Social networks thus play a major role in generating hedge fund clientele, as do more formal channels such as capital introduction services, commercial banks’ high-net-worth client lists, and hedge fund offering conferences. Fourth, hedge funds are not bound by the clauses of the Investment Advisers Act of 1940. This allows hedge fund managers to charge performance fees—typically 20 percent of profits—on top of the 1 to 3 percent standard management fee.

As private, relatively unregulated investment partnerships, hedge funds have far more flexibility when it comes to the types of securities they may legally trade and the ways in which they may trade them. Hedge funds commonly trade short- and long-term debt of both corporate
and government entities, engage in short selling,\(^1\) and use various derivative products (e.g., forward contracts) to actively hedge a portfolio’s risk profile. Hedge funds also typically place liquidity restrictions on invested capital in the form of lock-up periods—invested capital must stay in the fund for an agreed-upon amount of time—and redemption schedules—invested capital may only be removed from the fund at predetermined time points. Restrictions on the liquidity of invested capital provide some measure of insulation between the strategic goals of a fund manager and the potential for disruptive capital outflows.

Why study hedge funds? There is the issue of scope. Entering 2007 the hedge fund industry controlled approximately $1.4 trillion of capital and assets. Even more striking is that hedge funds are responsible for up to 60% of all trading in major global markets. There is also the issue of silence. Despite tackling matters in other capital markets, surprisingly few sociological studies of hedge funds exist (see Hardie and MacKenzie 2007 for an enjoyable, ethnographic exception to this).

The scarcity of sociological research on hedge funds is surprising because hedge funds, compared to many other types of organizations, are decidedly social things. Restrictions on direct marketing mean that managers often identify investors through networks of social ties. Managing trust and reputation in the resulting relationships is paramount given the likely embeddedness of such ties. Besides investors, the relationships among hedge fund managers themselves are a major determinant of information flow in the industry. Funds share information on trading opportunities in real time via every available method of electronic communication. In

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\(^1\) Short selling is the process of selling securities that one does not own. When an investor feels that a security is overvalued, he may borrow that security (typically for a fee) from a willing party and sell it to a third party. The revenues the sale generates will be realized as profits if and when the investor is able to buy the security back at a lower future price, at which point he will return it to the original lender.
other words, social structure is not simply a plausible explanation of performance; it is an inherent one.

One of the reasons hedge funds are so seldom studied may be because hedge fund data are difficult to obtain. Even the largest commercial databases—like the TASS database used for much of the quantitative analyses presented here—suffer from systematic biases, are incomplete in one way or another, and, being meant primarily for the investor segment, are expensive to obtain. Furthermore, hedge fund personnel and fund managers are known to maintain low profiles. They have economically rational reasons to stay out of sight. Provided one is headed in the right direction, moving before the market has significant advantages.

1.3 Data: Quantitative and Qualitative

In each of the substantive chapters I discuss the specific data utilized in that chapter. There is some overlap from chapter to chapter and, unless otherwise noted, the quantitative data used throughout the dissertation comes from one source, the Tremont Advisors Statistical Services (TASS) hedge fund database. To avoid redundancy, here I include only a brief description of the TASS data.

The TASS database contains monthly, self-reported, fund-level data on returns and assets under management for approximately 12,000 unique hedge funds (as of the end of 2009). From this, capital flows—capital movement into and out of a fund on behalf of investors—may be calculated. In addition to this time-series data, the database includes information on a number of fund characteristics. Characteristics include things like fees, capital restriction terms (i.e., lockup periods, redemption notice periods), and information regarding a fund’s portfolio and strategy at both a coarse (i.e., primary style) and finer grain (i.e, trading strategies, types of assets held, investment targets, countries invested in, etc). Characteristics do not change over time. This data
feature precludes the potential for change on behalf of individual hedge funds (in the data, though perhaps not in reality). It is widely accepted, however, that this stasis reflects the true nature of the industry as fund characteristics at this meta-level—for example, types of assets held as opposed to the actual securities bought and sold—are unlikely to change over the course of a fund’s life. Agarwal, Daniel, and Naik (2007) and Klebanov (2008) support this claim and note that a fund manager is more likely to open a new fund than change the underlying features of an existing one.

I complement much of the quantitative analysis with qualitative data drawn from more than three dozen interviews with key industry personnel in the United States, Europe, and Asia. The majority of the interviewees fell into one of three roles: fund managers, fund of funds managers, or hedge fund consultants. The remaining interviews were conducted with lower-level hedge fund personnel, such as traders, analysts, or investor-relations managers, the alternative investment managers from a small sample of U.S. university endowments, and academics, mostly in finance. All of the direct quotes in this dissertation are those of fund managers, unless otherwise noted. The funds of the managers I interviewed ranged in size from $10 million to over $10 billion and tenure from not yet launched to going on three decades.

1.4 Introduction of Chapters

Each of the substantive essays included in this dissertation are complete with their own theoretical and literature review sections. For that reason, I again forego redundancy in this introductory chapter. Below I provide short synopses of each essay. Furthermore, each of the essays includes its own discussion section that highlights the contributions and limitations of the study. These contributions are briefly revisited in the concluding chapter of the dissertation.
More time is spent in the final chapter discussing related future research both planned and already underway.

1.4.1 Overcoming Ambiguity

The chapter, “When a Rose by Another Name Smells Sweeter: Do Deliberate Names Mitigate the Consequences of Organizational Ambiguity?” examines a need faced by some organizations: the need to look like something that they are not. Using as a backdrop existing research on the “imperative” of categorical conformity (Zuckerman 1999), this chapter attends to one of the ways organizations may attempt to overcome ambiguity in their categorical identities. Namely, they hijack the authenticity of an existing market category by including that category’s moniker directly in their organizational name.

In other words, I propose that organizational names serve important identity functions. One such function is to reduce ambiguity. Organizations may try to do this by choosing a deliberate name that includes a product (e.g., “Tire”) or market (e.g., “Automotive”) identifier in the organizational name itself (e.g., “XYZ Automotive and Tire Repair”). Using data from the hedge fund industry, this chapter addresses questions related to the strategic use of deliberate fund names. Results indicate that atypical (i.e., ambiguous) members of a fund style category are in fact more likely to choose deliberate names than typical ones. Furthermore, the strategy appears to be successful. Whereas atypicality lowers a fund’s probability of survival, having a deliberate name offsets this effect. For the high-liquidation rate years of 2008 and 2009, atypical funds with deliberate names had a lower liquidation rate than atypical funds with non-deliberate names. Implications for theories relating to authenticity, identity work, and deception in organizational settings are discussed.
A number of characteristics specific to the hedge fund industry render it an idyllic setting in which to base this study. First, hedge funds are forced to identify with one of only about a dozen style categories at the time of entry. In contrast to organizations in other settings, atypical funds do not have the option to claim a new categorical (style) label. Nevertheless, styles amount to identity claims that investors evaluate in the course of deciding whether to allocate capital to a given fund manager.

Second, regulations against direct marketing by hedge funds elevate the importance of naming as central component of a fund’s identity. Should an atypical hedge fund feel a need to appear differently, its avenues for engaging in strategic identity work (Ibarra and Barbulescu 2010) are severely limited. Lengthy narratives of the marketing campaign sort are not possible. Still, identity work may be import in spite of this constraint. Strategic naming offers one available avenue.

1.4.2 Amplified Interfaces

Whereas the prior chapter only theorizes at the level of the fund-investor interface, Chapter 3, “Amplified Interfaces: How Organizational Identity Affects Investor Reaction to Market Performance,” investigates this interface more directly. My route in is via the performance-flow (i.e., fund returns/losses beget investor capital inflows/outflows) association. In contrast to existing studies on this association, however, I examine how it is affected and moderated by organizational identities. What this means in terms of a research question is the following; “How does organizational identity alter the way market evaluators react to objective market information?”

From the point of view of categories research in economic and organizational sociology, the angle taken in this chapter breaks with the way scholars have been treating identity and
examining its place in markets. Whereas much of the existing work focuses on how organizational identities themselves are interpreted and responded to, this chapter examines how organizational evaluators use identity to process and evaluate object performance information as it becomes available in the market. I argue that this is important because markets are punctuated by streams of constantly updated information related to things such as price, performance, strategic changes, employment turnover, and strategic affiliations. And yet, despite knowing quite a bit about organizational identity, research has told us much less about how such suddenly available information is interpreted through identities.

In other words, although prior work has demonstrated that economic actors who fail to conform to prevailing logics—such as the categorical structure of markets—garner less attention and perform poorly, evidence also suggests that some non-conforming actors can elicit considerable attention and thrive. In this chapter, I propose a model for better understanding when conformity and non-conformity have favorable effects on certain economic outcomes. Analyzing the association between organizational conformity, returns, and capital flows in the hedge fund industry, I find that investors allocate capital more readily into non-conforming hedge funds following periods of short-term positive performance. Non-conforming funds are also less severely penalized for recent poor performance. Both effects persist despite strong steady-state normative pressures towards conformity. Deciphering this outcome and exploring what it means for theories relating to organizational identity, legitimacy, and isomorphism in markets, are the ultimate aims of this chapter.

1.4.3 Structure, Expectations, and Market Change

The final substantive chapter, “Intermediaries, Mediators, and Market Change in the Hedge Fund Industry,” shifts levels of analysis from individual funds to fund styles or fund
categories. Here I develop a method for quantitatively assessing the “shape” of a hedge fund style category and track changes to that shape overtime. The method is built using logic similar to the measure of organizational atypicality discussed above but is extrapolated to the group level. Homogeneous styles are characterized by significant overlap of funds in terms of their trading strategies and asset focuses. Heterogeneous styles include funds that are significantly varied in their compositions. Results highlight an interesting pattern that is consistent across all hedge fund styles: the universe of funds was strikingly homogenous throughout most of the 1990s. In 1999, this pattern changed dramatically.

I frame this final chapter around the importance of expectations in markets. One of the core features of organizational and economic sociology is the belief that social expectations shape market behavior. Because this normative effect is generally thought to apply universally across organizations in a given environment, variations in outcomes that cannot be explained by forces of competition alone—for example, the instance or proliferation of organizational heterogeneity—are typically attributed to one of two causes: a fundamental change in expectations, or organization-specific differences relating to tenure, status, or strategy (not unlike the naming strategy discussed in Chapter 2). I explore an alternative mechanism: Expectations are applied differentially as a function of the way they are circulated through the market. The diversification of market practices may, in turn, be possible in spite of continued skepticism about such practices so long as the process that brings them about veils their illegitimacy.

Central to the proposed framework is a distinction between two types of brokers: the intermediary and the mediator. Both types help facilitate markets by transferring material resources like products and capital from one party to another. Where the two differ is in their capacity to transmit expectations or “codes of conduct” between transacting parties. Having
limited power relative to one or both parties in a transaction, intermediaries are forced to transfer expectations intact from one party to the other or else forego the transaction. Having more power, mediators may opt not to.

Applying this framework to the hedge fund industry offers an explanation of increasing fund heterogeneity that both precedes and complements technology- and resource-based accounts. The rapid shift from increasing homogeneity to large-scale heterogeneity among fund products was facilitated in part by a contemporaneous role-shift of a set of market brokers—funds of funds—from intermediaries to mediators. The August 1998 failure of the hedge fund, Long Term Capital Management, and ensuing unwinding of much of the hedge fund industry made this role shift possible. In their new role as mediators, funds of funds were effective in attenuating the constraining effects posed by investor expectations and, in turn, enhanced the agency of individual fund managers.