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Hedged Out

Inside the "Boys' Club" on Wall Street

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Abstract

Income inequality has skyrocketed in the U.S. Since 1980, the richest 1 percent doubled their share of the nation's earnings, and these high earners are concentrated in the financial services industry. Today, hedge fund managers earn an average annual income of $2.4 million, astronomical payouts that have mostly gone to elite white men. Using the U.S. hedge fund industry as a case study, I explain how an elite "boys' club" has become entrenched. From 2013 to 2017, I conducted in-depth interviews with 45 hedge fund workers and field observations at 12 workplaces and 34 industry events. I present an insider's look at the industry to explain why this industry has generated extreme wealth and why mostly white men benefit. In this paper, I identify the mechanisms generating social inequality in these firms and how this helps to explain the industry's high incomes. With less bureaucracy and hierarchy, I find that executives and employees called their firms "flat" recounting few mid-level managers and open communication. Despite this discourse, social inequalities were embedded in the organizational logic. This was evident in labour divisions, workplace culture, accountability structures, and compensation systems.

Keywords

Elites; inequality; gender; race; organizations

Bio

Megan Tobias Neely is a Postdoctoral Fellow in Sociology at Stanford University's Michelle R. Clayman Institute for Gender Research, and her research examines rising economic inequality in the United States through the lens of gender and race. Her current project is on the U.S. hedge fund industry, on which she recently published a paper, entitled "Fit to Be King: How Patrimonialism on Wall Street Leads to Inequality," in *Socio-Economic Review*.

Introduction

Income inequality in the U.S. has skyrocketed. Since 1980, the richest 1 percent doubled their share of the nation's earnings. Not by coincidence, that was the year Washington removed a cap on interest rates charged by banks – the first of many measures to deregulate Wall Street. Since then, the financial sector became riskier, more complex, and obscenely lucrative. Today, hedge fund managers earn an *average* annual income of $2.4 million. These astronomical payouts have mostly gone to elite white men (Harjani 2014; Lin and Neely 2017; Piketty, Saez, and Zucman 2018). This research presents an insider's look at the U.S. hedge fund industry to explain why this industry has generated extreme wealth and why mostly white men benefit.

The hedge fund industry drives the divide between the richest and the rest. Even entry-level positions in this industry earn on average $372,000, approaching the $390,000 threshold for the top 1 percent of household earnings. As in other high-paying sectors of the economy, women and minority men are drastically underrepresented. White men manage the vast majority – 97 percent – of hedge fund investments (Barclays Global 2011; Sommeiller et al. 2016). Women comprise only 17 percent of total industry employees and 11.2 percent of senior positions (Preqin 2017b).[1] I investigate the deep and often hidden mechanisms of inequality that prevent women and racial/ethnic minority men from having equal access in this industry that controls so much wealth in the U.S.

Few scholars have investigated the inner workings of this insular industry (Hardie and MacKenzie 2007; MacKenzie 2003; Riach and Cutcher 2014). From 2013 to 2017, I interviewed and observed people who worked at hedge funds. I realized that the industry's white male domination and extremely high earnings are deeply intertwined. Facing an unpredictable stock market – exacerbated by their own investments – elite white men protect their interests by building networks based on trust and loyalty.

Hedge funds make headlines, yet few people know what a hedge fund actually does. A hedge fund is a private financial firm that pools large sums of money from wealthy people and large institutions to invest in the stock market. The enormous scale of the investment enables firms with few employees to pocket vast profits. These small but powerful firms inflate bubbles in the stock market and played a major role in the 2008 financial crisis. The aftermath and Occupy Wall Street movement rallied political and public scrutiny of hedge funds. Despite scathing media portrayals, hedge funds remain popular with new money pouring in. Today, the global industry comprises 10,000 firms with $3.55 trillion in assets and 390,000 employees (Acton 2016; Preqin 2017a, 2017c).

Hedge funds are less regulated than other financial firms, because their investors are deemed to be sophisticated. The U.S. Securities and Exchange Commission requires each hedge fund investor to have a minimum net worth of $1 million (excluding a primary residence) and a minimum annual income of $200,000. Less than 10 percent of Americans qualify. Yet, the industry invests money for a wide segment of society. Pensions, governments, universities, and other non-profit endowments comprise nearly 60 percent of client investments (Preqin 2017a). Hedge fund investments impact states, businesses, and workers worldwide.

[1] Comparable demographics are unavailable for race and ethnicity.

The industry has broad implications for inequality throughout the workforce. Hedge funds buy large quantities of corporate stocks. The scale allows them to place pressure on executives to change management practices (Sitko 2016). Since hedge funds want to increase stock values, they advocate for restructuring and downsizing firms (Zorn et al. 2006).

This explains why, while hedge funds amass riches, most Americans compile debts. The U.S. has become an hourglass economy with fewer families in the shrinking middle class than in the lower and upper class combined (Pew Research Center 2015; Mishel et al. 2015).[2] Since the 1970s, the pay of top earners has skyrocketed at the expense of everyone else. Middle class wages have stagnated and working class's wages have declined by 5 percent (Mishel et al. 2015). These trends are the product of a whole host of government policies: tax cuts for the wealthy, deregulation of financial services, scaled-back protections for workers, and welfare reform for the poor (Collins and Mayer 2010; Galbraith 2000; Kalleberg 2011; Piketty 2014). The resulting inequality is a pressing social problem. Rising inequality undermines individual wellbeing, education rates, social unrest, and democracy (Costa and Kahn 2003; Hacker and Pierson 2010; Kang 2015; Mayer 2001; Subramanian and Kawachi 2006). Studying the "winners" of rising inequality sheds light on why inequality persists and grows.

The Changing Nature of the Firm

A phenomenon closely related to widening economic inequality, the U.S. firm has transformed over the past 40 years. Management theory has embraced a call to dismantle workplace bureaucracy in the name of efficiency. Investors, directors, and executives alike have redefined the firm's primary purpose as increasing prices for shareholders, rather than selling and investing in a product (Fligstein and Shin 2007). Facing pressures from investors to boost share prices, firms have since restructured, downsized, and outsourced to remove layers of management and bureaucracy (Davis 2009). In the late 20th century, the corporation changed from a social institution to a contractual one. Today, workers encounter the aftermath of this transformation.

Amid these changes, the "flat" firm has emerged as an ideal type, an abstraction rarely achieved in practice. A flat firm is defined as equal in that employees have no job titles or seniority and self-manage without managers, while a flatter firm removes layers of management to promote open communication between executives and workers (Anderson and Brown 2010). Hedge funds and information technology firms often strive to create a horizontal structure, yet they tend to more closely resemble the flatter firm type rather than that of a flat firm. Financial services and information technology lead the trend in flatter firms (Harrison 1997; Ho 2009). Despite the goal of making workers equal, both sectors feature striking gender and racial disparities (Catalyst 2018; U.S. Census Bureau 2013). How are social hierarchies constructed and legitimized in these new organizational forms? Why do some firms fall short of the goal to create a more equal workplace?

[2] In the U.S., the percentage of middle-income households decreased from 61% in 1971 to just under half in 2015 (Pew Research Center 2015). In 2015, 120.8 million U.S. adults were in middle-income households, while the combined number of lower- and upper-income households was 121.3 million. Middle-income is defined as an income that is two-thirds to double the median household income, adjusted for household size. The middle-income range was roughly $42,000 to $126,000 annually.

Financial services pioneered the “lean and mean” firm (Davis 2009; Ho 2009), making hedge funds ideal for studying flatter firms. Furthermore, the hedge fund industry captures an extreme case of high incomes and workplace inequality, which can make visible processes obscured in other settings (Katz 1997). The industry captures the flat firm type with a start-up culture and less regulation than other financial firms. On average, hedge funds survive only 5 years (Lanchester 2014). While hedge funds may have anywhere from 1 to 1700 employees, the average employs 20 people (Preqin 2017b). Founders intentionally created alternatives to the pyramid structures of bureaucratic investment banks with the goal of fostering autonomy, trust, and ownership among employees.

Organization Forms and Workplace Inequality

Business management research suggests that removing mid-level managers and outsourcing jobs will empower the remaining employees to better contribute, innovate, adapt, and communicate (Anderson and Brown 2010; Hamel et al. 2012). What has come to be called “flat” within the business sector most closely resembles what sociologists call network forms of organization. Walter Powell (1990) defines network forms as reciprocal patterns of exchange among interrelated parties bound by contracts, in contrast to hierarchy forms which organize exchange internally through employment relations. Network forms are characterized by enduring patterns of trust and reciprocity, structures without formal hierarchy, norms for transparency and flexibility, and cultures of shared ownership and benefits (Podolny and Page 1998; Powell 1990). Examples include business franchises, joint ventures, strategic alliances, outsourcing contracts, and research consortia.

In a seemingly unrelated line of research, feminist scholars have theorized how organizational bureaucracy operates as a tool of male domination (Ferguson 1984). Rosabeth Moss Kanter (1977) identified how work organizations sort men and women into different jobs and departments with unequal status and pay. Joan Acker (1990:147) later demonstrated how gender is embedded within the organization’s logic. Organizational logic refers to the established rules, job descriptions, performance evaluations, and compensation systems organizing a workplace. Organizational logic constructs and legitimizes hierarchies within a bureaucracy, which makes inequality endure over time. Gender interacts with race and social class, among other systems of inequality, to form workplace hierarchies (Wingfield and Alston 2014). Feminist organizations have strived to dismantle these hierarchies and create egalitarian alternatives (Ferree and Martin 1995; Rothschild-Whitt 1979).

While considerable research has studied cooperatives and other alternative organizations (Meyers 2018; Sobering 2016), less is known about how profit-driven network forms may produce or alleviate inequality. By fostering openness and collaboration, network-based firms could better integrate women and racial/ethnic minority men, or more informality and flexibility may lead people to rely on status hierarchies, preferential treatment, and trust-based authority (Powell 1990). In general, the absence of formalization has been found to create ambiguity, a condition that amplifies implicit bias through mechanisms such as designating a higher bar, extra scrutiny, shifting criteria, or double standards (Correll 2017). Shelley Correll (2017:231) identifies how bias emerges “when decision-making contexts are ambiguous, lacking clear criteria for making decisions or sufficient performance information about the people being evaluated.”

A network form with striking disparities provides an opportune case for examining how informality and ambiguity impact workplace inequality. While some technology firms have had better equality outcomes than hierarchy organizations in related sectors (Smith-Doerr 2004), financial firms with similar structures do not have the same outcomes. Overall, research has contradictory findings on whether inequality is reduced by the features distinguishing network from hierarchical firms: labour divisions, workplace culture, and authority structures (Dobbin, Schrage, and Kalev 2015; Dobbin et al. 2015; Roth 2006; Turco 2010; Williams, Muller, and Kilanski 2012).

The relationship between trust, uncertainty, and exchange may help to explain why some network-based firms promote inequality, while others may exacerbate it. Gail McGuire and Will Bielby (2016) identify how trust reduces ambiguity in high-risk workplaces by building strong support networks. Moreover, tight-knit networks lead to redundant information flows that can replicate explicit rules and provide procedural clarity. In investment banking, when market uncertainty is high, organizations restrict their networks to those with similar status and a history of exchange (Podolny 1994). Overall, uncertainty leads people to restrict access to their networks and place their trust in close social ties (Tilly 2001).

A reliance on trust may generate inequality by preventing inclusion and equitable access to information, resources, and support. Trust-based relationship in networks firms can breed favoritism, exclusion, and bias (Powell 1990). Moreover, gender and race influence perceptions of trustworthiness (Simpson et al. 2007; Smith 2010). People hold deeply-ingrained beliefs that gender and race reflect inherent characteristics, qualities, and tendencies (Ridgeway 2011). Since exchange is cultural not rational, actors may not designate value and distribute rewards fairly. Relationships may digress into particularism and dependency, which promote homophily and exclusion (Powell 1990).

Both management theory and sociological research suggests that fewer managers, informality, and flexibility will better integrate workers (Smith-Doerr 2004; Whittington and Smith-Doerr 2008). Feminist theory also suggests flatter organizations have potential to be more inclusive. Yet, the industries pioneering these types are starkly unequal. Research on the flexibility and formality of organizations has contradictory findings on inequality. I investigate how and why one case of flatter, network-based firms features deep social inequalities. I identify mechanisms creating inequality in firms purporting to lack hierarchical authority and formalized bureaucracy – two primary mechanisms understood to generate workplace inequality.

Methods

I first acquired experience with hedge funds working in the industry from 2007 to 2010. I investigated hedge funds and their personnel in the hedge fund division of a large investment firm. I reviewed regulatory filings, financial statements, civil ligation, news coverage, legal agreements, and background checks of over 200 firms. I acquired a nuanced understanding of this social world, allowing me to contextualize data from interviews and fieldwork. Returning to the field with a sociologist's perspective yielded fresh insights on a rapidly changing industry.

I collected qualitative data on hedge funds to identity mechanisms producing inequality. To gain insight into the social world of hedge funds, I conducted in-depth interviews with 45 hedge fund workers. Interview questions covered firm culture, labour divisions, evaluations, compensation, and demographics. I recruited interviewees through mailing lists, events, LinkedIn forums of professional associations, as well as through snowball sampling, which helps to reach hard-to-access populations who may not respond to other recruiting strategies (Lofland et al. 2005). I used theoretical sampling by recruiting a sample more diverse than the industry to maximize variation, which establishes representativeness in ethnographic research (Burawoy 1998). Interviewees reflect a balanced number of men (n=23) and women (n=22). I oversampled for people of color (n=18) and first- or second-generation immigrants (n=11). I ensured confidentiality by assigning pseudonyms to interviewees and removed any personal or organizational identifiers.

[See Annex, Table 1]

I supplemented interviews with field observations, which revealed the industry's informal norms and practices. I collected data at 34 industry events such as conferences, investor panels, and networking events. I attended events in Texas and New York. Over one-third of all global industry assets are managed in New York. For geographic variation, I selected Texas, a major industry hub with over 200 firms. Opportunities for fieldwork arose during 12 interviews held in workplaces. During and immediately after leaving the field, I wrote ethnographic field notes to record, interpret, and reflect on social processes and meanings (Emerson et al. 2011).

Findings

Interviewees called their firms "lean" and "flat," reflecting shared values for efficiency, inclusion, and openness. "Flat" was defined relative to investment banks, which have hierarchical, pyramid structures and formalized bureaucracy. The discourse of flatness obscured social hierarchies embedded within hedge funds. Consistent with the industry demographics, hedge funds are not necessary equal, fair, or empowering for workers. In what follows, I identify how these flatter firms construct social inequalities in labour divisions, workplace culture, accountability structures, and compensation systems.

Division of Labour: Specialized, Interdependent, and Contract-Based

Countering the "flat" discourse, operating agreements written for investors outlined a division of labour concentrating power among executives. Agreements highlighted the top executive's central role as chief investment officer. A section on "key personnel" featured chief investment, portfolio, executive, operations, and compliance officers, detailing each by name with short biographies. Executive officers often held multiple roles.

The label "key" signalled they were crucial to the firm's viability. A separate section stated the firm's ability to retain key personnel to signal firm stability – a necessity in an industry where firms often turnover. Key personnel disclosed their personal investments in the fund to demonstrate commitment. A "key man" clause often allowed client investors to redeem their money if key personnel exited the firm or became incapacitated. The gender specific "key man" clause reflected a firm dependent on one or two executives – assumed men – without whom the firm may fail to operate.

Organization charts featured varying layers of hierarchy. Figure 1 captures a hedge fund hierarchy continuum, from single-person to hierarchy forms. Smaller firms usually had a two-tiered hierarchy of executives and staff, while larger firms had additional layers. Figure 2 features a sample organization chart of an average hedge fund. For reference, Figure 3 compares flatter and hierarchy forms, which are relationally defined. Interviewees worked in a range of firm structures, from single-person to multi-layered firms with over 1,000 employees.

[See Annex, Figures 1, 2, and 3]

An implicit hierarchy existed in how labour was divided between “front” and “back” offices. Front office personnel either raised or invested money, while back office personnel had support positions such as operations and compliance. The front and back office did not describe the firm’s physical layout, usually an open-plan office. The front office referred to market-oriented and client-facing jobs deemed of higher value to the firm. Interviewees reported higher pay in the front office than the back office. Within front offices, investment teams earned more than client services. Each division organized work around specialized portfolio managers and their support staff. Specializations such as investment strategies, risk analysis, and trading were independent and complimentary.

Front office jobs were gender-typed, making it difficult for women to advance. Interviewees described firms mostly comprised of men on the high-status and high-paying investment team. Women were concentrated in client-facing positions called investor relations or client services. Consequently, men held a majority of executive positions. These factors indicated firms were male-dominated in numbers, status, and authority.

This was evident in a multi-tiered hierarchy, described by Margaret as “flat.” Margaret, a 20-something East Asian American research analyst, said, “[O]ne of the beautiful things about hedge funds is they are small and they are flat.” When asked to explain “flat,” Margaret recounted a three-tiered hierarchy on the investment team – executives, portfolio managers, and analysts – of which she was the only woman. Altogether, her firm employed five women: Margaret, three administrative assistants, and an office manager.

Margaret preferred hedge funds to investment banks, where she started her career, which she considered “very hierarchical” and “very large.” There, however, her department was more gender balanced than at her hedge fund employers. She said, “It’s not until you start talking to very senior people that there became an odd dynamic, a tangible difference in being a woman versus being not.” She found this “gender dynamic” more apparent in hedge funds where she first starting noticing how it affected her own career. She said, “I never really thought about it until after I left investment banking.” When asked about the biggest challenges in her career, she said the “gender ones” citing how her approach to communication and risk differed from her male colleagues, which prevented her from contributing to team decisions.

The 2-tiered hierarchy of flatter firms also featured gender stratification. Scott, a white executive in his 40s, described his average-sized firm with 14 employees organized into two tiers: “Our firm structure is very flat and lean. We have 14. It’s a small team and it’s very flat. Everyone collaborates at one level. There are a few of us elevated above that level, myself, [men’s name], and [men’s name].” The executives were all men.

Margaret’s and Scott’s firms were the norm, as women hold only 11 percent of leadership positions (Preqin 2017b). I found only two exceptions: two firms with women who were the primary decision-maker. Although women comprise only 17 percent of the industry, 12 of

Deborah’s 20 employees are women. This was so unusual colleagues call her firm the “chick fund.” Employing 60 percent women – in an industry of 83 percent men – was such an anomaly it earned a nickname. Diane also employed a greater proportion of women, including her chief financial officer, on her 10-person team. These outlying cases highlight the norm for male-dominated firms.

In addition to gender sorting, assignments were often patterned by race, ethnicity, and nationality. This occurred on the investment and client services teams. People of colour were assigned to clients perceived a racial or ethnic match. On investment teams, white women recounted gendered assignments, i.e., retail. White men usually began their careers as “generalists” and then later specialized. Meanwhile, racial/ethnic minorities often specialized in a geographic area specific to their race, ethnicity, and/or nationality. Jerry, who is Latino, attributed his advancement to his access to wealthy families in Mexico. Born in East Asia, Lisa was a portfolio manager who specialized in emerging markets, including Korea, Taiwan, and Vietnam. These specializations type-casted their expertise as niche and afforded fewer opportunities to advance. Leadership positions often favoured employees with experience perceived as general (i.e. U.S. and European-focused), rather than region specific. These distinctions shaped how firms distributed pay, status, and authority.

The third firm-type on the continuum, partnerships with shared ownership, appeared more equitable but generated inequality based on how men and women were sorted into different specializations. When asked about the firm structure, Farrah, a white woman in her 40s, replied: “We were all equal partners. So it really didn’t feel [hierarchical]. We got along really well and everybody knew what they liked to do. So there wasn’t really, you know [a hierarchy].” While equal partners on paper, one was the primary decision-maker. Farrah said, “We leaned on one partner who sort of took on a lot of the running of the [investment] business. I did everything client related and he did everything more related to the business, and the other two guys were happy to let him.” The operating agreement identified four equal partners, but each had distinct pay, status, and authority. The lead portfolio manager, the key investment decision-maker, effectively ran the business. He had assembled a loyal following of client investors while managing a portfolio at a previous firm. Partner titles made the firm appear flat, but specializations created a hierarchy among partners.

Farrah’s firm later went under, leading her to embark on a series of short tenures at three struggling firms. Because Farrah specialized in client relations, her options were limited relative to her male colleagues on the investment side, who lived off their own investments when I interviewed Farrah a decade later. Farrah said, “My partners still basically just work for themselves running their own money.” She found this option unavailable to her. Farrah faced fewer opportunities for upward mobility relative to her male colleagues, reflecting an industry trend in resources and status. With women concentrated in client services and men in investment teams, men and women often had different statuses in leadership roles, which impacted their careers when firms failed.

Operating agreements concentrated executive power, using explicitly gendered terminology, and designated hierarchies of specialized executives and support staff. Jobs and assignments were both gender- and racially-typed. Although depicted as equal on organization charts, the differential status and rewards designated to these roles made colleagues, even partners, unequal in practice.

Workplace Culture: Flexible, Autonomous, and Adaptive

Executives thought fewer mid-level managers and flexible advancement criteria promoted meritocracy, so they often held multiple roles and did not hire mid-level supervisors – perhaps also to cut costs. Interviewees reported being expected to self-manage with little oversight and without standardized evaluations. Performance was usually discussed while negotiating annual bonuses. Consequently, executives had considerable discretion in training, compensating, and promoting employees.

The executives I interviewed expressed pride in establishing a collaborative workplace. Diane, a white woman in her 50s, was one of six women executives I interviewed. She attributed her firm's success to it being "flat" and her employee's ability to self-manage: "Everybody here is an adult, so they require very little supervision." Diane recounted her approach, "I'm hands off but I'm not hands off. So, the research process, I'm very hands off. I'm the one who comes up with the big picture, sometimes a crazy idea, and then I want the team to go out and create the models that either support or refute my idea." Regardless of whether the models supported or bellied her thesis, Diane was the sole decision-maker: "When it comes to the actual direction I want the portfolio to go, I've already decided how that is going to occur, but I want them to do the analysis to support my thesis."

Diane called her firm's culture "organized chaos" to capture how her team developed investment ideas. Diane avoided a standardized process believing it stymied ingenuity. She thought informality allowed more room for creativity. When asked about her firm's culture, Diane replied, "It's entrepreneurial chaos," and then elaborated:

> *One of the reasons why we've been successful for so long is that we think outside the box. No idea will be knocked down because it doesn't fit into our box. Our box is thinking about where the opportunities are at and how we monetize them. So, I would say "organized chaos."*

Countering Diane's account, employees thought informality created ambiguity in job roles and conflict among teammates. Amanda, a white client services professional in her 30s, said the founder at her 100-person firm believed non-standardized evaluations and promotions fostered meritocracy. Amanda called her firm "flat" because it had no titles or formal hierarchy: "We don't have titles, so no promotions. The only way you feel like you are getting promoted is through comp[ensation]." Amanda questioned this practice: "It's supposed to promote a meritocracy, but I think sometimes people need those milestones to feel like they are progressing in their career." With minimal feedback, Amanda gauged her performance by compensation; however, her supervisors gave little insight into how they calculated her bonus and pay.

The lack of formalized evaluations and job responsibilities created role ambiguity and organization chaos. Amanda recounted jockeying for an account with a teammate who had no title yet was in practice her supervisor acting akin to "head of marketing." He deleted her name from meeting notes and took sole credit for an investor account, preventing her from being recognized for her achievement. Amanda thought they should have not been in competition, as her successes bolstered his performance as the lead.

Some interviewees perceived executives as poorly equipped to provide training and mentoring, which they attributed to insufficient managers and informal procedures. William, a white man in his 40s, advised hedge funds. While executives recounted intentional informality, William attributed informality to how founders lacked prior management experience:

> *You're asking people to run businesses and they're trained stock pickers, so it's almost a joke, and so a lot of times the organizational and leadership issues, there's a level of dysfunctionality and communication is often not very good because these are, you know, finance guys. Guys mostly, I mean, are not great communicators, obviously this is a generalization.*

William then identified the difference at hierarchy forms: "When people rise up the ranks in traditional corporations, they have certain skills they evolve at low-management, mid-management, and upper-management levels. In a lot of the finance world, it doesn't happen that way at all."

Executives believed eschewing titles and evaluations fostered meritocracy and autonomy among employees. Employees, however, recounted how procedural ambiguity led to dysfunction, competition, and bias, which created inequality I identify later. Instead of creating flexibility in job roles, informality exacerbated uncertainty.

Accountability Structures: Transparency, Reciprocity, and Openness

Executives thought flatter organizations fostered openness, transparency, and accountability. In lieu of separate human resources departments and other accountability structures, executives encouraged employees to communicate openly. Yet, not all employees felt comfortable speaking up and those who reported issues recounted unwelcoming, even retaliatory, responses. Vincent, a white man in his 40s, described his firm as "very flat" and "quick to decisions." He endeavoured to make himself accessible to his employees by encouraging a sense of teamwork and collaboration. He said, "[the employee] would just walk in the room and ask a question. On very rare occasions, if it was for odd specific reasons, I would overrule [ideas], but that was very rare."

Some executives called for "radical transparency," a term used to capture openness in organizational process and data, in employment relations. These executives encouraged all employees to give direct, candid feedback. One firm's recruiting materials detailed explicit expectations for transparency. A letter from the founder called for being truthful with colleagues and open to feedback. He discouraged secrets and rumors, requiring supervisors to include employees in every meeting concerning them. One firm had a library with audio-recordings of meetings, specifically to allow employees to hear what colleagues said about them.

To promote openness, the firms I observed removed physical barriers between executives and staff. In open-plan offices, colleagues worked side-by-side on trading desks, which are long shared desks often organized in two rows facing one another. I conducted on-site interviews in conference rooms, because workspaces were open. Executives reserved private offices for private calls and meetings, opting to sit on trading desks alongside their team.

Efforts to promote open communication made some people feel excluded. As the only woman, Lisa, introduced before, said, "It felt a little bit like a frat[ernity] house." She said the firm organized events without women to promote male bonding: "They can talk about, you know, sports, and they can talk about many other different things they won't feel comfortable talking about around women. It's the same thing as why golf clubs don't want that many women members." However, the men also exchanged investment information. Similarly, Gita, another East Asian-born portfolio manager, discovered her male colleagues posted tips on their fantasy football website.

Several people recounted penalties for accepting the invitation for openness. I first met Sasha, who is black, at a conference, and then six times over the next year. Sasha first described her firm as collegial and supportive. She later became frustrated with her teammate and supervisor, both white women. Sasha learned her white teammate earned three times her pay, despite being less qualified in credentials and tenure. Stressing her labour market value, Sasha requested a raise commensurate with her training and experience: "I should get paid market and market is x y z." Sasha said her supervisor refused and told Sasha to be grateful for the job: "She might as well called me the N-word. That's what it felt like."

While always conscious of her token status as a woman of colour, this moment was the first time in Sasha's career when she felt "put in her place." Sasha said her supervisor commended her work until she demanded equal pay, "the things she said to me really showed her true colours, her real feelings. I've always been the one [black person], but I've never been so directly spoken to, put into place – like 'know your role' – as I was at that moment."

Human resources then contacted Sasha to discuss what had transpired. I was surprised when Sasha said this. I specifically asked about human resources in each interview, and interviewees usually recounted no personnel designated exclusively for this function, which was the norm at small and mid-sized firms. Some paid psychologists – "corporate shrink" – to mediate disputes. "Human resources" was the chief investment officer (CIO) – the top executive at Sasha's firm. This appeared to be common practice among executives who "wear multiple hats." Sasha expressed concern about the CIO's motives because he asked if she would press charges for racial discrimination. She understood the meeting as solely an attempt to prevent legal action. He acted to protect the firm, rather than her rights. Sasha did not pursue legal recourse, and tensions escalated until she quit.

Sasha's case appeared standard for handling discrimination or harassment. Several people said seeking internal or external recourse was futile or exacerbated problems. Pressing charges was called a "career-ender," because it tarnished the person's reputation. They thought firms would reject employees and candidates known to have filed a discrimination lawsuit. Instead, those facing discrimination sought employment elsewhere, which interviewees identified as the only feasible option.

At a networking event, one woman confided how during layoffs at her previous employer, 60 percent of women on the investment team were laid off, but no men. Pregnant at the time, she contacted an attorney to "look into her options," although she did not intend to press charges. She accepted the severance package, had her baby, and then started applying for jobs. She later learned from a potential employer that when they called her previous employer for a background check, the firm told them to watch out because she had pressed charges against them. “Which wasn’t even true!” she exclaimed. Unable to find a job, she finally did pursue legal action and settled out of court with the former employer. No longer able to find employment in the industry, she used the settlement money to start a consulting firm. The settlement forbade her from sharing additional detail, which may explain why her lawsuit was the only one I encountered.

Matthew experienced racism during his 20-year career in trading. He upheld the norms for masculinity in financial services, attended elite boarding schools, and graduated with an Ivy League degree, but his colleagues treated him differently as a black man. Several white women reported him for being “arrogant” and “threatening.” I asked if he filed a complaint at a larger firm with human resources. He said, “Never on the complaint side, because these HR [human resources] departments are designed to actually support management full stop.” Matthew identified racism at the firm level, leading him to distrust human resources.

Instead, Matthew embraced a neoliberal ideology of individual responsibility to protect his own interests. He said, “My mentality is always I am responsible for my own career. Now there is something very powerful about that if you take that on.” Matthew then continued, “If you are responsible for your own career, and . . . you’re not getting paid what you think you should be getting paid, whose fault is that?” Matthew did not expect others to take responsibility, saying, “If you accept responsibility, you will stop waiting for someone to hand you something.”

This led Matthew to identify the labour market as the only viable solution to interpersonal and institutional racism. He would take his talent elsewhere: “The improvement on the situation is not going to be somebody waking up one day and being like, ‘Holy shit, I have perception bias.’ It’s going to be people gravitating to places where they can be seen for who they really are and those places would benefit from the type of talent they attract.” In a context lacking worker protections, Matthew attributed neoliberal logic to labour markets, consistent with how interviewees understood stock markets. This logic assumes the market will match like-minded employers and employees, and discriminating employers will lose valuable talent. I call this market-mediated recourse for workplace discrimination or harassment.

Executives encouraged openness, except when it challenged executive authority. A small, reputation-based industry comprised of network-based firms foreclosed internal (HR) and external (legal) options for discrimination recourse. The labour market was understood as the only solution, and the burden fell the individual being targeted, with detrimental effects on their careers. This solution reflected and reinforced the power imbalance between executives and employees.

Compensation Systems: Ownership Culture and Shared Benefits

Hedge funds determined compensation based on employees’ perceived contribution to the firm’s profits. Executives thought this incentivized employee performance and promoted meritocracy, but some employees expressed reservations about whether it was meritocratic, because individual contribution is difficult to measure on teams.

Compensation practices stemmed from the management and performance fees charged to client investors. While management fees of 1-2 percent covered operating costs, performance fees conferred a percentage of investment returns, usually 20 percent, as motivation (McDonald and

Karsh 2017). Performance fees served as bonuses for the firm, so executives compensated employees based on each person's perceived contribution to performance.

Some executives created a shared ownership structure. Scott, introduced earlier, said his firm had an "ownership culture" reflected in pay: "Everyone here will share the profits of this firm when it's profitable and everyone will not be compensated as well when the firm is not profitable so we're all pulling for the same thing." Scott distributed the fund's profits among the team. At hedge funds, this may occur through an annual bonus, paid out from the performance fee, to give employees a sense of ownership. Other firms shared partnership interest, a percentage of profits and losses, among employees. The latter, like Scott's firm, actually shared ownership to give each employee a stake. Diane, introduced earlier, also valued teamwork and collaboration, yet determined individual pay based on the team's performance. Diane thought her firm's flatness allowed her to do this: "It's really flat. It's really flat. I measure our success by our performance."

Several people believed numeric metrics reduced racial and ethnic biases. Fernando, a Latino man in his 30s, thought the stock market provided an objective measure of performance and the balance sheet reflected individual merit. Fernando cited this as evidence of meritocracy:

> *What I have found is ethnicity is a non-factor. Ethnicity – people don't care. And it's because these funds are very PNL [profit and loss] oriented. They are there to make money. . . it's a function of meritocracy. If you're from India, from Asia, if you're black or white, it really doesn't matter, as long as that person can produce.*

From this view, the stock market levels the playing field.

A belief in a meritocratic stock market concealed how favouritism and bias influenced how executives evaluated employee's performance, value, and compensation. Justin, a white executive in his 50s, questioned the practice of determining compensation based on an ambiguous perception of how the employee contributed to the firm's performance: "Since it's quantitative, your numbers are your numbers. But this is only when you have your own firm, which is late in your career." Until then, Justin said, individual effort is hard to evaluate because it contributes to the firm's performance. He then explained, "A lot of this is gut instinct. You can't tell if it's implicit biases. You like 'em and you enjoy their company." When asked if implicit bias influenced perceptions of contribution, he said, "100 percent. Oh, yeah."

Like Sasha, other people I encountered expressed an awareness of gender- and race-based pay discrepancies. At a women's networking event, women shared strategies for negotiating bonuses. Two women wrote unsolicited reports to demonstrate their value. One trader, a South Asian American woman in her early 20s, recounted the first time her supervisor negotiated her annual bonus. She silently and abruptly left the room when he presented a number. She had no benchmark, but she anticipated he would underpay her as a younger woman of colour. Afterwards, her supervisor proposed a substantially higher amount, large enough to confirm her suspicion. Interviewees confirmed that earnings were negotiated case-by-case.

Albert, a white executive in his 50s, and his partner paid their employees equally. He said: "We basically decided to pay everyone the same." Because the partners held equity, they earned less than employees while the firm became established. He continued, "In terms of my partner and I getting to be paid less, hopefully that's just a period of transition we're in." Albert then acknowledged an exception to equal pay. Two employees received higher salaries to accommodate expenses associated with a family. Albert said:

> *We made some modest changes frankly only for two people because they had families and personal situations and came to us and said, "Listen, I've got this – this is going on, these are the realities." And it was to the tune of a couple of tens of thousands of dollars a year rather than anything over and above that . . . We've only done it twice and both of them were associated with, let's call it, as opposed to an individual, it was associated with raising a family in New York.*

Albert employed only one woman who was not a parent. Two men received a "daddy bonus" to support a family. Albert's account reveals why executives may think fathers deserve more compensation. Other interviewees confirmed this male-breadwinner advantage happened at their firms, but did not extend to women breadwinners.

A dominant belief held that stock markets promoted meritocracy by providing an unbiased measure of individual contribution. Yet, measurements of contributions on teams were often ambiguous, and executives negotiated compensation ad hoc, creating opportunities for bias and discrimination.

Conclusion

Hedge funds provide a cautionary tale of network-based firms' potential to create more inclusive and equal workplaces. Delayering a firm did not necessarily promote equality and, at times, worsened the problem. Informality created ambiguity and exacerbated a sense of insecurity in a context with high firm and employee turnover. The "flat" discourse obscured the implicit social hierarchies creating inequality in these organizations. Achieving the goal of including and empowering workers requires firms to implement mechanisms to improve the status and authority of women and racial/ethnic minority men (Correll 2017; Dobbin et al. 2015; Kalev, Dobbin, and Kelly 2006).

Many empirical findings presented here are consistent with research on hierarchical companies. Flatter organizations, however, were designed to reduce hierarchy and therefore the status differences within hierarchies. The hedge fund case shows why this does not always happen and how social inequalities remain embedded in the firm logic. The formal structures detailed an explicit hierarchy, gender and race interacted as organizing factors in labour divisions, self-management created dysfunction, openness afforded few employment protections, and shared ownership cultures concealed unequal compensation. Persistent inequalities find new ways of emerging in these flatter structures, and perhaps in more insidious ways, since hierarchy is more visible and salient in hierarchy forms.

While these findings may only pertain to elite finance workers, this research has important implications for the growing sector of technology start-ups seeking to disrupt how business is done. Research should continue studying other high-earning and male-dominated industries. Low-wage workers may have different experiences at flatter organizations, which warrants additional study. Furthermore, more research should investigate efforts to revolutionize work and mechanisms to combat workplace inequality.

Why should we care about social inequality at hedge funds? What does society gain by making financial elites more inclusive and diverse? Hedge funds matter because the processes creating social inequality in this industry directly relate to the high earnings responsible for widening income inequality. Social hierarchies in flatter firms facilitate and legitimize exceedingly high pay. This helps to explain current inequality trends and why white men are overrepresented among top earners.

Hedge funds have few checks and balances to executive authority. This allows patronage to flourish, as I show in a related article (Neely 2018). Patronage refers to a gendered and racialized organization of authority based on trust, loyalty, and tradition. Patronage allows a select group of white men to groom and transfer capital to one another. This system of white male privilege is not only self-sustaining; it can speed up over time, as the beneficiaries concentrate their power and resources. Each generation becomes wealthier and wealthier.

Furthermore, the industry's distribution of resources not only consolidates resources among elite, white men. It also allows them to influence conditions for workers throughout the labour market. A growing trend is hedge funds expanding their reach into corporate governance. These "activist" investors pressure executives to delayer, automate, and outsource workers to increase shareholder dividends. Thus, we can expect to see flatter firms proliferate.

Hedge funds shed light on what is at stake in these new organizational forms. Hidden beneath a discourse of empowerment and inclusion is a steep social hierarchy. This hierarchy consolidates authority, status, and resources into the hands of a select few and enables executives to demand high compensations. The entrenched social hierarchies at hedge funds and the high earnings garnered by executives are interrelated symptoms of the industry's social organization – one that reinforces the status, authority, and resources of financial elites.

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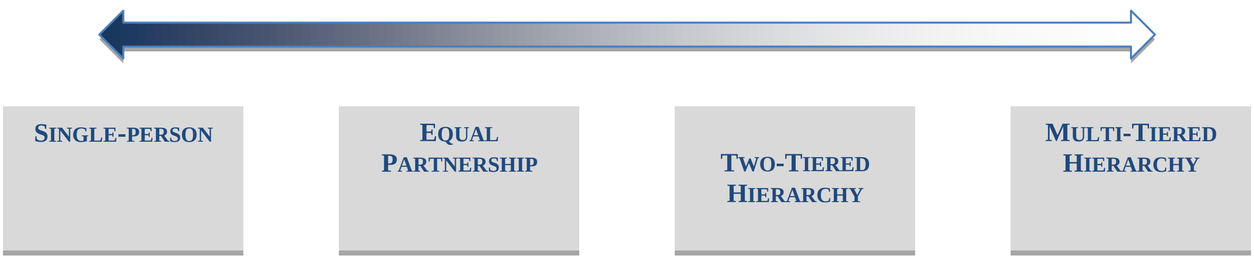
Annex

Table 1: Interviewees' Characteristics

Characteristic	**Number**
Age	
20-29	6
30-39	15
40-49	16
50-59	7
60-69	1
Education	
Doctorate	9
Masters	13
Bachelors	23
Gender	
Women	22
Men	23
Race/Ethnicity	
Other/Multiracial	1
Middle Eastern American	2
Black/African American	2
Hispanic/Latina/o	4
Asian American	5
White	31
Role	
Investments	24
Sales	15
Support	6
Tenure	
Less than 10 years	12
11-20 years	19
More than 20 years	14

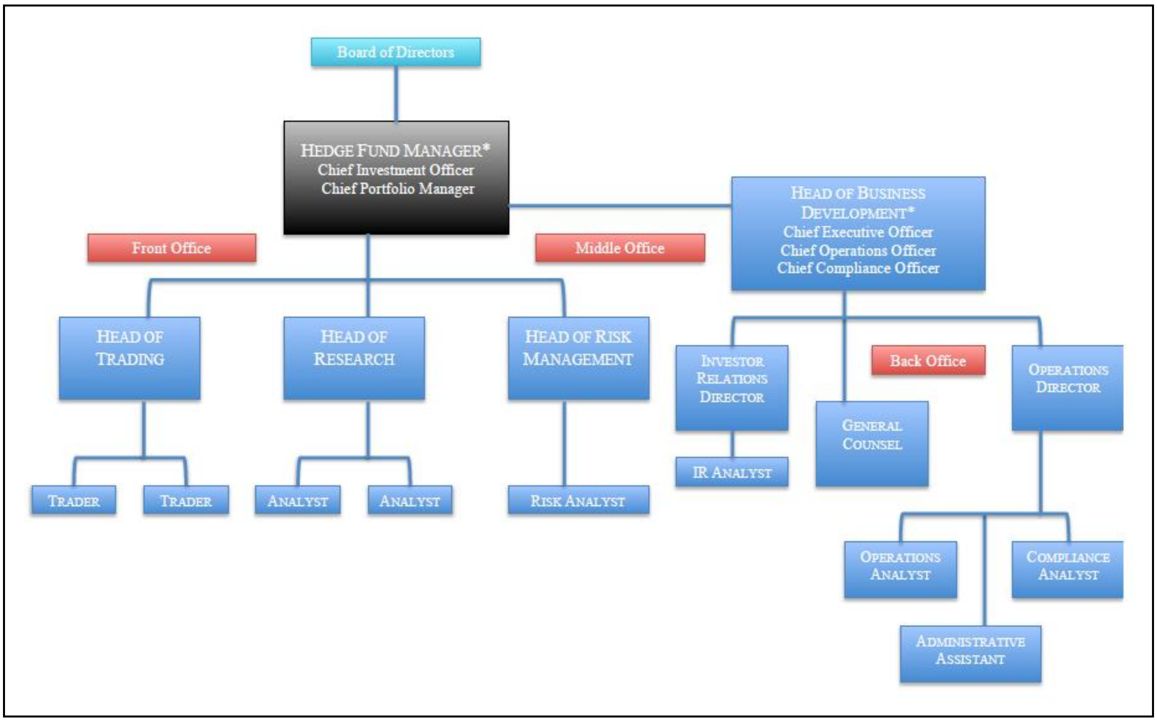
Source: Author

Figure 1: Hierarchy Continuum in the Division of Labor



Source: Author

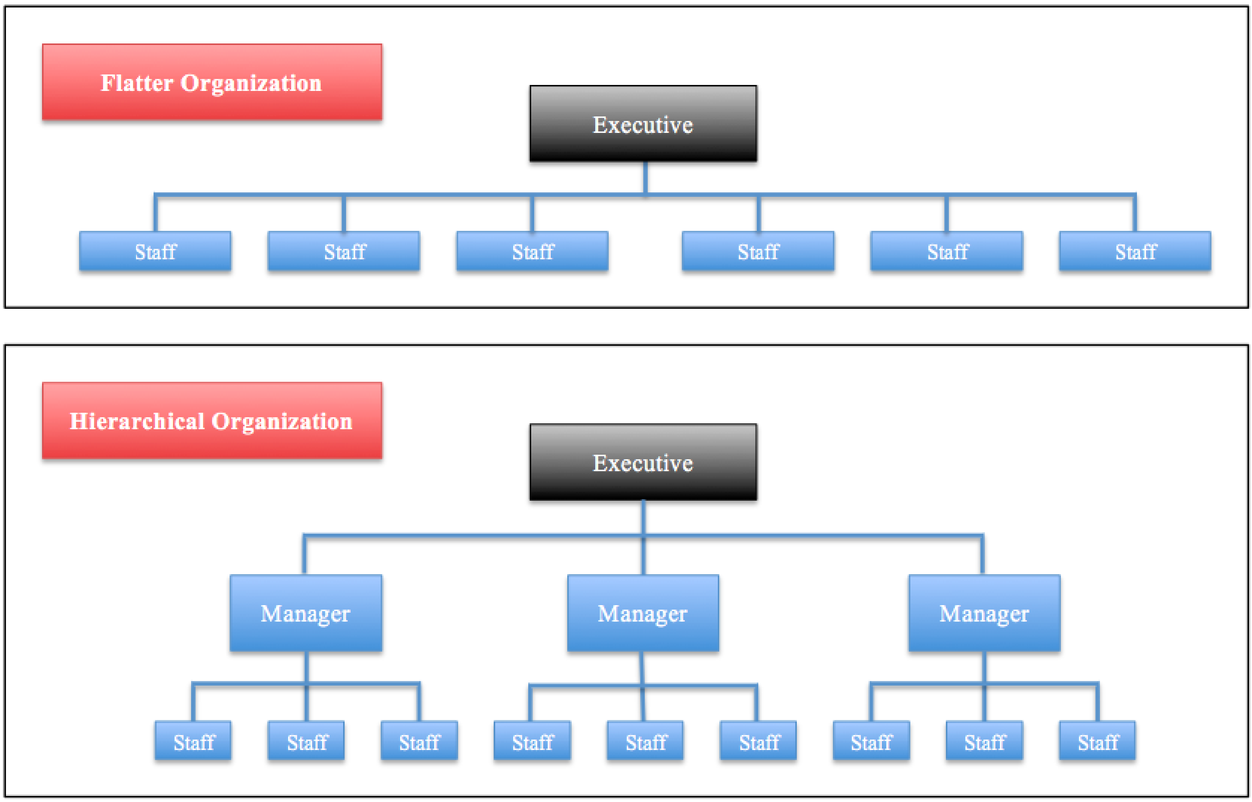
Figure 2: Mid-Size Hedge Fund Organizational Chart



* The hedge fund manager generally holds more decision-making authority than the head of business development, although each firm varies with respect to the status hierarchy among the executives.

Source: Author

Figure 3: Flatter vs. Hierarchical Forms of Organization



Source: Author