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Leveraging Opportunities in the Current Economic Climate

Audio interview with Jeff Sprecher, ICE Chairman and Founder

Danielle L. Scott

Start

Danielle L. Scott: Good day. This is Danielle L. Scott, Associate Editor of the Graziadio Business Report, the online business journal of the Graziadio School of Business and Management at Pepperdine University. Today, Jeff Sprecher, founder of Intercontinental Exchange, or ICE, is here with us. Jeff has been serving as a Chairman of the Board for ICE since November 2002, and under his guidance, the company has expanded from energy commodities into outer-cultural and soft commodities, chemicals, credit default swaps, currencies, equity indexes and emissions across regulated futures and OTC markets globally in just eight years. Jeff was one of five finalists in the prestigious MarketWatch CEO of the Year program in 2006. Also in 2006, the Wall Street Journal named ICE the best one year performer of all public company stocks, based on its annual return of 196.8 percent. In 2008, Business Week named ICE in its 50 best performers list. A native of Wisconsin, Jeff earned a bachelor's degree in chemical engineering from the University of Wisconsin at Madison and an MBA from Pepperdine University. So Jeff, thank you so much for being here with us today and spending time with us. I wanted to start with asking a little bit more about ICE and its business model.

Jeff Sprecher: Sure, and thank you for having me Danielle. As you mentioned in your introduction, we're a commodities and derivative exchange and so we host the trading of a number of different commodities and derivatives in different asset classes, and basically we charge a commission on every trade. So maybe in layman's terms, you can think of us like an eBay where we match buyers and sellers and don't have a stake in the ultimate price, but we do charge a commission when the buyer and seller meet.

Danielle L. Scott: Now, also in my introduction I mentioned that you got a bachelor's degree in chemical engineering. So can you tell us more about your career path and what led you to ICE? How did you go from a chemical engineering major to the Chairman of a Board of a global exchange company?

Jeff Sprecher: Sure. Well, after graduating from the University of Wisconsin, I went to work for a Wisconsin-based company called Trane, T-R-A-N-E, an air-conditioning company, and became an industrial sales engineer. And one of the products that Trane sold were steam turbines that were used for the generation of electric power, and so I ultimately made my way to Los Angeles to open a sales office for Trane, and it just so happened that that was a moment in time when our country was deregulating the electric power markets. And so I was attending Pepperdine University at night while I was working during the day, and I met a couple of colleagues through Pepperdine who also were interested in the electric power market, and together we just decided to go ahead and start a company to build electric power plants and take advantage of the deregulating markets. Those markets were really being deregulated to foster the development of alternative power plants, and it's why California was in the lead, if you will, around the country in the deregulation efforts. And so my colleagues and I formed this company right at a moment in time when there was tremendous change going on and also it happened to be at a moment in time where Wall Street was very, very robust. And I happened to meet Michael Milken and the team from Drexel Burnham Lambert, who at the time were raising a lot of money for companies through junk barn offerings and other debt instruments, and we were able to raise significant amounts of money on Wall Street and beginning to build power plants. So we acted, in a way, like a typical real estate developers in that we would put together partnerships to own these power plants, and we became the general partners. And over a period of about 15 years, I ended up having ownership interests in various power plants around the U.S. And so again, California, in the 1990s, sought to further deregulate the power industry and one of the ideas that the state had was to create a power exchange where buyers and sellers could buy power at the wholesale level. And a number of us in the industry were very, very concerned about this exchange. We saw that it had some flawed business models around it, we felt that it could be manipulated and we ultimately felt that it could threaten the power industry, so I decided to create a power exchange as a foil to what was going on in California. And unfortunately the state actually passed a law that required everybody in California to use the government-run exchange, so I decided to set up a different exchange outside of California so that the rest of the country could have an alternative model. And that today is the company that I run, called Intercontinental Exchange. So my intent was actually never to work here or never to run a business; I was simply trying to do something to protect my power plant businesses. But I became so interested in the trading business and the revolution that's going on in the globalization of trading, the electronification of trading, that I actually left my power plant job, spent full-time working in the exchange business and basically have built this company, and ultimately taken it public, as you've mentioned.

Danielle L. Scott: Right. And that actually leads me to my next question, because you took ICE public after just five years of operations; was that your goal from the beginning? And what was the process leading up to that point?

Jeff Sprecher: Sure. It was a goal. I was the 100 percent owner of the company when I started it, and one of the things that I realized about an exchange is that it's only as valuable as the number of buyers and the number of sellers that show up at the exact same moment in time. So it's a complicated business to start, because not only do you have to go out and get new customers; they all have to come at exactly the same moment for it to be effective. In other words, think of logging into a website where you want to buy something and there are no sellers, and later a seller comes in and there are no buyers, so the commerce can't start until people arrive together. So in trying to solve this problem, what I ultimately did was approached 13 very large energy trading companies around the world, and I offered to give them a stake in the business, so I basically just gave them equity in the company in exchange for commitment that they would come at a moment in time and commit to buy and sell through the platform. And we needed a way of getting those people to exit the business at some point in time and so we started to contemplate the idea that we would need to do a public offering, and that was important in the sense that we built the business from the beginning to be a public company. We were able to put systems and recruitment people from the beginning that had a goal towards being a public company.

Danielle L. Scott: So can you tell me, in general, what should management teams always keep top of mind to help make this private to public transition go as smoothly as possible? What kind of lessons did you learn?

Jeff Sprecher: It is quite a different phenomenon, running a public company then a private company. And so as I mentioned, we were fortunate to have that as a goal because one of the big issues that we all face as public companies is the ability to be transparent, the ability to communicate the financial performance of the company, and to be able to help others predict the future financial performance. And that means that internally, you really have to have some very good people and systems that understand the business, that are accounting for the business in real time, and that are providing senior management that are externally-facing with a lot of information so that you can be accurately communicating to the investing public. I happen to be talking to you today from New York where I'm here, frankly, because I'm having investor meetings, and one of the big parts of my job, and probably occupies at least a third of my job now, is simply talking to shareholders and potential shareholders about the company. And so, you know, part of my own career growth has been learning to delegate the operation of the business to others so that I can be out talking to people, and that was a difficult lesson for me to learn as a small business entrepreneur; to let others take control of things so that you can free yourself up.

Danielle L. Scott: I can imagine that one of the things that you need to talk to potential shareholders to quite a bit is ICE's growth and acquisition strategy, and you seem to have gone through quite a few acquisitions in the past couple of years. So can you tell me more of what your growth vision is and what the rationale is for the acquisitions that you've made?

Jeff Sprecher: Sure. Well, first of all, one of the great benefits of being a public company is that you do end up with acquisition currency in the form of your own stock, and you do have the ability to access capital markets in a much more convenient way as a public company. And so I've taken advantage of that, as you've mentioned, to do a number of acquisitions. What's happening in the trading world are a number of trends that are intersecting, and I've simply tried to acquire companies that move quickly as opposed to trying to organically build against the changes that are happening. So exchanges in commodities used to be open outcry trading venues; they were places where guys in funny jackets stood around in a big room and flashed hand signals at each other. And in fact, if you watch CNBC or Bloomberg Television during the day, you'll see that there are still some vestiges of that, and they make good backdrops for television. But the reality is that the bulk of trading that is done today is done electronically, and what electronic trading has allowed to happen is that people around the world can simultaneously put price signals and do commerce across computer networks, and so I've been buying businesses that help get us more global, or help move us into new asset classes that are on the cusp of moving from essentially analog to digital trading. And we've done a series of acquisitions, and one of the things that we acquired that some of your listeners will certainly be aware of is a company called the New York Board of Trade, which is the world's leading coffee, cocoa, cotton and orange juice exchange, and the reason that a lot of people are aware of that company is that it was the backdrop for the movie "Trading Places" with Eddie Murphy. And so if you watch that old movie, you'll see that they're in a big room flashing hand signals; today, the bulk of that business is done globally, electronically, by people with mice on computers and also by computers that are trading against other computers. So that's an example of the kind of business that we've wanted to acquire to take advantage of the changing landscape that we're facing in globalized trading.

Danielle L. Scott: So through all of these seemingly rapid fire developments, you've talked to me—personally, one of the lessons that you've learnt was kind of letting go of operations so that you can take a more high level approach to getting shareholders. But as a business, as a whole, what are some of the other lessons that you've learnt? In the operations, for example, what lessons did you have to learn?

Jeff Sprecher: You know, I believe that companies are simply collections of people and so the most important asset that a company has is its employees. And so I've gone from being a small business entrepreneur; I mean, the sole owner of this company that I was starting, to today having a global enterprise that has billions of dollars of net worth and people working all around the world. And so what I really have learnt is that hiring quality people is the most important thing that a company can do, and then giving those people the freedom and the flexibility to take risks and to correct their mistakes before mistakes fester and become too bad, is really the culture that we've tried to achieve, and it's obviously the most complicated part of running a business. One of the things I actually learnt at Pepperdine, in an organization behavior class that I took there, was trying to manage conflict resolution. And companies that have good conflict resolution tend to actually have good managements and good operations. So we set up meetings specifically to allow people to comment on parts of the business where they don't have operating responsibility; in other words, I like to put a meeting together where you bring talent from all over and you talk about the entire company and you let everybody criticize other parts of the company and make those people that run those businesses defend their decisions. You do that in a closed environment where people can feel that they can talk freely, and then you don't leave until there's been resolution on these issues. And by instilling that, I really think that we've been able to grow our business very, very quickly and to minimize the kinds of mistakes that we've made, and actually bond the management team together in a sense of camaraderie and empowerment that has helped make my company grow so fast.

Danielle L. Scott: One of the things that you just said, when the first criteria is hiring quality people, so can you tell me a little bit more about what criteria you use in building your management team?

Jeff Sprecher: I'm not probably a good textbook example, because I really do believe that first impressions matter. I've hired people that have no experience in the area that we have tasked them for, but have been impressed by their leadership skills or their contributions that they've made in completely unrelated areas. So I tend to think that it's much easier to train somebody about the business than it is to find good people, so better to find people and then train them, as opposed to simply narrowing your search focus to people that have, you know, specific domain. I'll give you an example; we had a very, very complicated operation and we really needed somebody to come in and help organize our technology. I approached and hired the guy who was the president of my condominium association who was running our condo board, because I went to one of those meetings, I watched him manage that meeting, and I could see that he was a natural leader and that he was very, very good at driving consensus. And today, he's a senior officer in the company, has, you know, really grown with the company and it's been a tremendous hire. Also, I bought a small technology company that had 22 computer programmers that were working there, and as soon as I went in to introduce myself, one of the computer programmers asked me if he could talk to me privately. And he came in and he told me all of the problems that this group was having and basically said, "If you don't fix these problems, everybody here is going to quit." And I said to him, "Okay, you go fix those problems," and he said, "What do you mean, me?" And I said, "Look, somehow that group of 22 people through that you were the appropriate guy to come in here and deliver that message to me, so I'm assuming that when you go back and deliver the message that it's going to be fixed, they will equally take that direction and message from you," so I promoted him; today he's our Chief Technology Officer. And so those are examples of very, I guess, unconventional hiring techniques, but they've worked well for our company because part of what we're trying to do is look for new opportunities and so, you know, there aren't really skill sets that are around for something that's news or something that hasn't been invented yet, and you're better off to just have a high quality person that can problem solve and help lead people and drive consensus.

Danielle L. Scott: So my next question was going to be about the top three drivers of ICE's unprecedented growth and success. I would imagine one of those, from your previous answers, would be the people that work there. What other two drivers would you say have really driven ICE's success?

Jeff Sprecher: We've positioned ourselves in a number of intersecting trends that have just-- you know, we can't take any credit for, but what we can take credit for is seeing those trends and basically, you know, putting our sail into that wind. And one of the biggest trends that's going on is really the flattening of the Earth and the fact that business is being done globally. And we've all read about and heard about the growth of China, for example, and the tremendous imports and exports that are going on in that country. Well, in my business, which is helping buyers and sellers meet to trade commodities, it was very, very important to have a global reach. And that trend of true globalization, of commerce, is something that played into my company's ability as we were taking regional businesses and putting them online and taking them global. Another thing that has happened, and particularly students at Pepperdine I'm sure are aware of this, is the world is going more and more electronic. Information that you and I are consuming and reacted to and the way we're reacting to it is increasingly being done across computer networks, and communication and commerce is increasingly electronic. And companies want to take costs out of their businesses by having more straight-through processing and less friction in transaction costs, so that trend has also played into the use of electronic trading around the world. So I think, you know, you sort of led me into the answer, which is if you have very good people and then you can identify some macro economic trends that you can position yourself in, it's relatively easy then to grow a business.

Danielle L. Scott: Now, one of the overwhelming macro economic trends right now is the economic downturn. So how is ICE faring in this new economic reality and how has it changed, or has it changed, the company's sort and long term strategies?

Jeff Sprecher: I think it's a mixed bag for us. We all are, I think, sensitive to the price of oil and are aware that last summer, oil approached $145.00 a barrel and today, it's closer to $45.00 a barrel, and my company hosts the trading for about half of the world's crude oil trading. And so the trading volume in crude oil, we're up around 25 percent over a year. In other words, all of that price volatility has led to tremendous emphasis being placed by integrated oil companies and refiners and others to lock in low prices or exit positions that they had where they had locked in high prices. And so there's been a big volume there. We also, as I mentioned, host a number of agricultural markets for trading. The world's sugar market is, for example, traded on our platform. Sugar is one of those commodities that is really consumed by the global population during times of prosperity. We all, as we have more money, consume more desserts, eat more high value foods that may have sugars in input, and sugar is also used in Brazil to make ethanol, so it has a component of it that's sensitive to the price of oil. And when you look at the sugar market today, because of the problems accessing capital, particularly for emerging markets, you can see there's been a big downturn in the trading of sugar. So I would say across our businesses is a bit of a mixed bag. Probably the most exciting thing that we're working on right now is to create a clearing house for credit default swaps. Clearing house is simply an institution that would become the buyer for every seller and the seller for every buyer, so it guarantees the price and performance and takes away your counter-party risk. And the world desperately needs to get some of these exotic derivative contracts off of the books of the banking community and put into a venue where there can be price transparency, where the true value can be discovered, and where people will not be afraid of the collapse of their counter-party. So we've been working with the New York Fed, with Tim Gitner who was, until a few days ago, the head of the New York Fed on developing a clearing infrastructure that we hope that we'll be able to launch within the next few weeks. So we are trying to be opportunistic and look for areas where the global downturn has created new opportunities and position ourselves in those as well.

Danielle L. Scott: Now, every day in the news, it's doom and gloom about the economy, but I'm not hearing doom and gloom at all from you, so what are your predictions for 2009 and moving on with ICE? It seems like you're optimistic that there are a lot of new opportunities that are coming that you can take advantage of.

Jeff Sprecher: Yeah, I think part of it is my nature as a small business entrepreneur. First of all, I do agree with most of the pundits that the financial community is pretty bad, and in my position as the head of an exchange, I have an opportunity to get to know a lot of the senior executives around Wall Street, and certainly they are concerned about cascading problems moving out of mortgages into credit cards, into commercial real estate, and it's very hard to see an end to the credit contraction right now. But in terms of me as a business manager, all that represents a changing environment, and whenever there is change, there are opportunities. And what we've been focusing on is letting go of those things that we can't control and focusing on the areas that we can control and try to position the business in areas of change and for companies that can do that, you can really accelerate yourself against your competition. For some reason, all of us as humans sort of resist change, but when you think of the most important times of your life, the most memorable times of your life, like the birth of a child or a marriage or the loss of somebody that you cared about, it is extreme change that provides, you know, the things that build your character and your memory. And so trying to comfort my staff and get them to focus on the fact that these are amazing times for us to advance our business against our entrenched competition is really part of my job, and it's something that we actually are quite excited about because these are almost unprecedented times in the global economy.

Danielle L. Scott: One of the exciting new developments with ICE, it seems to me, it looks like ICE Millions. You were on the cover of the October 2008 "Profit and Loss", and they talked quite a bit about ICE Millions within the article, so can you tell us a little bit more about that and why it's an exciting development?

Jeff Sprecher: ICE Millions is a new product that we're launching. It's basically foreign exchange, so the dollar versus the yen, or the dollar versus the euro. And foreign exchange trades has pairs, and typically the foreign exchange market is traded through banks and is physically delivered, so if you and I were to trade the dollar versus the yen in T plus two days, we actually end up with yen in our bank account. Well, in these chaotic times right now, there's a lot of people that want to hedge or speculate in the currency fluctuations that are going on, whereas the economies are trying to deal with their own economies through their Treasuries and banking systems. And so there's a lot of fluctuation in currency right now, and a lot of people don't want to end up with yen in their bank account in two days; they simply want to trade the value of the dollar against the yen and have the cash settled. And secondly, there's a lot of people that don't want to have even a two day credit exposure to a bank, so we came up with the idea of trading cash settled currency pairs that would be cleared in a clearing house where we would become the buyer to every seller and the seller to every buyer, and we'd collect the collateral on people's behalf. So to a certain degree, if you think of PayPal and eBay, we'll stand in the middle and guarantee performance and we will not convert you to the opposite currency, but simply pay you the economic value of that currency. So this is again one of those things where we're looking at the landscape, we see problems in trading, we see problems in counter-party risk with banks, and we're hoping to take advantage of those opportunities to put a product out into the world that we think people will really be interested in.

Danielle L. Scott: And one of the things that you talked about was the price of oil last year this time, as opposed to right now. In your opinion, for someone who's mired in the energy markets, what are the factors affecting the deflation in energy commodities?

Jeff Sprecher: I think one of the things that's misunderstood by a lot of people is how quickly prices can move in commodities, particularly critical commodities like oil. And for those in your audience that are in California, we witnessed something similar in the energy problems in California about 10 years ago, and it's a phenomenon that I guess I could best explain by using an example, and that is that if you were to go into a hospital for an operation and that hospital had 10 bottles of oxygen that they could use during operations and you were the eleventh patient, how much would you pay for a bottle of oxygen? Well, knowing that that may be there to save your life, it would be very, very important for you to make sure that you paid enough to be one of the lucky people to get a bottle of oxygen. If you turn it around and think about the hospital that has 10 bottles of oxygen and you're only the ninth patient, the bottle of oxygen is probably going to be priced at whatever the cost of oxygen is. So what you see in that example is that once you get to a tipping point where supply and demand are at the margin, prices can expand very, very quickly and they can also collapse very, very quickly, and that's largely what we see that's happened in the oil business. We were at a point this summer when the world was still going through tremendous growth, there was tremendous sense that business was going to keep going and that we did not have enough crude oil to satisfy the world demand. As soon as we started the recession, consumption dropped down a little bit. In fact, it actually started when Westernized countries started using less petroleum just by driving less miles. We got underneath that tipping point, and the prices collapsed back down to the cost of production. So frankly, very little has changed in the world in the oil supply and demand equation, other than the fact that right now, we're below this tipping point. But it doesn't take much global demand to push us back over that, and so I'm hoping that, just as a citizen of the United States and watching our Congress grapple with energy policy, that we're not lulled into this sense of very, very low prices, because it is amazing how quickly they can ramp up.

Danielle L. Scott: Jeff, I think you've given us a great overview of ICE and how you've been able to take advantage of the opportunities that were presented in front of you and kind of see a couple of steps into the future as to what will be the opportunities, so I think you would be a great person to ask for advice. What advice do you have for current and recently graduated MBA students? What do you wish you knew then that you know now?

Jeff Sprecher: Well, first of all, you know, I don't want to sound too clichéd, but really, I think success comes by doing things that you love with people that you enjoy being with. And I remember when I was in college; at the time, a lot of people wanted to become doctors because at that time, doctors were a notable profession, they made a lot of money, there was a lot of status affiliated with being a doctor. Today, if you go talk to your average doctor, they'll tell you how hard that job is, how difficult it is to make money in that environment and how the risk and rewards of being in the medical profession today have really dramatically changed. I point that out just because, you know, you would hope the people that are in the medical profession just enjoy care-giving and being doctors, because the economy and what people are paid and how people earn status can change so much over time. So the best thing you can do is just something that makes you happy. Do it well, and all the other accolades that one may have in terms of earning respect and earning a living and taking care of the people that you take care of will flow out of that. And I suspect there's a lot of graduates coming out of Pepperdine and other schools today that had hoped for Wall Street careers, and today, you know, thousands of people are leaving Wall Street. Sort of, there's a mass disenchantment right now with being affiliated with Wall Street, and look how quickly that changed; really, just in 18 months. So don't think about, you know, finding a career based on status or economics or what have you; think about what you enjoy doing and give yourself permission to fail and give yourself permission to try to do the things that you love.

Danielle L. Scott: I think that's a great answer. Thank you so much. That's pretty much all the questions that I have for you today, unless there's anything else that you would like to add, something that I haven't brought up.

Jeff Sprecher: No, I think that's nice. Thank you very much.

Danielle L. Scott: Well, great. Okay, so I think that's it. Jeff, thank you so much for your time today. This is Danielle Scott from the Graziadio Business Report. Again, you can find us online at gdr.pepperdine.edu. Thank you.

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