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Published on FINalternatives (<http://www.finalternatives.com>)

Offshore Research Gains Momentum With Hedge Funds



By GV Mani -- As the world of alternative investments gets turned on its head this year, the industry is facing pressures it hasn't experienced in years. Hedge fund managers are looking at ways to continue evaluating opportunities and launch products within the constraints of lower revenues and severe cost pressures.

One strategy alternative funds are turning to is outsourcing investment research processes, including equity, fixed income and derivatives research and analysis, which is gaining increased acceptance with fund managers.

The number of hedge funds shrank in 2008 and overall performance is down 18% year-to-date, according to published reports. Many funds are lowering fees, halting redemptions, and some are cutting staff. For funds to manage costs going forward, all options are on the table.

Likewise, private equity funds have seen deal flow halt, the value of their holdings plummet, and acquisition prowess diminish due to the credit crunch. And although revenues are down, there are likely to be plenty of investment opportunities ahead. Taking advantage of those opportunities will require private equity funds to proceed carefully, but forcefully.

Offshoring Gains Acceptance

Some segments of the alternative investment industry have turned to offshore research firms over the past several years, but with the current historic market conditions, research outsourcing is likely to gain momentum and move to the mainstream.

For alternative investment funds, offshore research services essentially perform analytical tasks that require highly skilled analysts. Offshore research services can provide financial modeling, quantitative analysis, program trading software services, high levels of detailed analysis and even analysis of investment ideas.

In such a competitive environment, the exploration and development of ideas is the most important capital that funds possess. Freeing up in-house managers and analysts to focus on strategies and new approaches is one of the essential roles of outsourcing firms.

The Value Of Flexibility

The recent volatility in the markets means that funds will need more support than ever. Offshore services offer teams of analysts that can help ramp up coverage when it's needed, and can be scaled down when it's not, without human resources or hiring concerns. This flexibility to turn on or turn off experienced and highly qualified offshore research teams can help funds exploit opportunities that emerge quickly, which is an extremely important competitive edge.

For example, a number of new funds are being launched to take advantage of distressed debt situations. In order to exploit the market climate and avoid delays, several of these funds have used offshore service teams to quickly get the funds to market and take advantage of rapidly closing windows of opportunity. The teams are already mobilized, there's no hiring process, and the coordination is very efficient.

Offshoring firms with geographically dispersed delivery centers in complementary time zones offer two advantages—seamless overnight transition and real-time research support. A research model requested by a client analyst in New York before he or she goes home for the night is prepared in India and ready when the analyst is back in the office the next morning. And if an analyst in New York or London has an immediate need,

it can be fulfilled by the team's Latin America or Eastern Europe delivery centers, providing additional flexibility.

Beyond Cost Savings

Though 40% to 60% cost savings were the original appeal of financial research outsourcing, the scale outsourced research teams provide has become an even stronger argument for their use. In view of the deep concerns in the credit markets about the details of loan portfolios, financial institutions want to examine those portfolios on a much more exhaustive basis. But the lack of manpower among banks and funds presents difficulties in drilling down the analysis to the loan level of detail, which is something that analysts have been increasingly doing for clients recently.

In another example of value beyond cost savings, an investment fund raised several billion dollars and wanted a detailed report on the global infrastructure sector to guide it in its quick deployment of the funds. An offshoring firm developed the report, identifying investment themes and regions where the themes were likely to find resonance, and zeroed in on listed investment plays.

In Confidence

Security of information is one of the main reasons that funds have been slow to adopt outsourced research as a component of their business model. The concern that sensitive information could be lost or compromised looms over the potential for funds to maximize efficiency with offshore services.

To ensure no breach takes place, analysts are housed in client-dedicated firewalled space and work for specific clients to assure maximum confidentiality and protect the security and safety of each client's intellectual capital. Offshoring firms do not manage any money of their own and individuals are subject to comprehensive personal trading policy restrictions, thus there's no possibility of anyone trading on information received from a client. Offshoring firms also subject themselves to security audits to reassure clients that there's no place in the process where a leak could occur.

Go to Trial

From a fund's perspective, to get started in an outsourcing relationship there should always be a trial and evaluation period, usually several months. The criteria by which offshore providers are judged should include ease of process and quality of communication; rising beyond the basics and meeting a very high standard in its deliverables; and adding significant value to the fund's investment decision-making process.

The global market offers a lot of talent to those willing to take advantage of it. Outsourcing investment research is no longer simply a matter of cutting costs, but of adding value that can provide a competitive edge. In a global financial market that brings new developments every day, alternative investment funds are increasingly finding that offshore partners can provide the research scale and quality necessary to help them compete more efficiently and intelligently in this challenging environment.

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