

“What is needed is a way to mine the web to deliver relevant and differentiated intelligence”

The perfect storm buffets buy-side research

By Penny Herscher, president and CEO, firstRain

THREE MAJOR DEVELOPMENTS have stood out in the equity investment landscape in the past few years: Regulation Full Disclosure (Reg FD), preventing differentiated disclosure by companies; a steep decline in both the quantity and quality of sell-side research as a result of the mandated separation of research activities and investment banking, the downward pressure on research funding through commissions and the flight of key analyst talent to the buy side; and the explosion of the internet as a source of news, opinion, trend data and competitive intelligence not available through other channels.

These parallel developments have conspired to create a perfect storm. Buy-side firms have responded by significantly expanding their in-house research departments and hiring primary research firms, such as the Gerson Lehrman Group, which provide access to networks of experts, including employees of public companies. While this practice is under increased scrutiny by regulators for the potential use of non-public information to gain a trading edge, the pervasiveness

of such services and the level of attention they are receiving underscore just how critical alpha-generating insights remain to the research process.

Investment analysts largely recognise that the web can be a massive potential source of such insights for new idea generation, trend identification and questions on existing portfolio holdings, while also providing information that is sharply differentiated from mainstream news feeds and syndicated content.

It is also well recognised that extracting intelligence from the web for the purposes of investment decision-making is beyond the capabilities of consumer search engines that are geared towards providing information on all topics to all users at all times. What is needed is a way to mine the web in a manner that consistently delivers relevant and differentiated intelligence once the portfolio, investment theses and specific concerns of the investment analyst are known.

Such technologies and services have now emerged and are already in use by leading hedge funds and early-adopter mutual funds. This burgeoning category of search-driven research applications involves first investing in industry and equity research expertise to develop a thorough and current topic framework; then, driving only the most relevant content from across the far reaches of the web into this framework.

Professional investors usually have complex theses and ideas driving their decisions. To support this sophistication, the topic framework must capture the full richness of the complex ecosystem in which a company operates: its key competitors, principal suppliers, leading customers and distributors, as well as the broad industry themes that affect its prospects in the marketplace – all updated as market realities change.

Searching for relevance

In addition, investors need this topic framework populated with deep information, but delivered with precision and very high relevancy to give them the necessary insight, ideas and efficiency. To truly solve this challenge, the next generation of search-driven research technology requires critical innovations in the way data from the web is sourced, filtered and made available. These include, first, the automated monitoring of tens of thousands of sources – industry, corporate, governmental and regulatory web sites; national, international and local news sources; message boards, blogs and subscription sources – carefully researched and chosen by experts from the millions of available sources for their business value, credibility and importance.

Second, relevant information from these sources must be filtered into easy-to-navigate topic frameworks with a high degree of accuracy and redundancy removal, thereby making the information significantly more accessible for idea generation and trend identification.

Finally, the system must include a service-based business model, supported by software, that enables investment analysts to personalise each dimension of the application to match their specific needs and ensure only the most useful and interesting information is delivered for consideration.

New search-driven research technologies are rapidly maturing; initial deployments are already providing some first mover advantages to the institutions that have been the earliest to adopt them. Along with the vendors who are building these new applications, these institutions are showing us a way out of the perfect storm. ■



PENNY HERSCHER joined firstRain in late 2004 charged with solving the qualitative information overload problem of the institutional investor. She has developed firstRain from a cutting-edge technology provider to the leading search-driven research application provider to the financial services market. Prior to firstRain, Herscher was chairman and CEO of Simplex Solutions, an electronic design automation company serving the global semiconductor industry. She led the company to an IPO in 2001 and through the sale of the company to Cadence Design Systems in 2002. Herscher serves on the boards of firstRain, Rambus, the Anita Borg Institute and California Community Partners for Youth.