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Where to Spend in a Time of Crisis

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According to Hedge Fund Research president Kenneth Heinz, 2008 was the worst year on record, with losses averaging 18.3 percent. Research firm Eurekahedge says assets under management fell from a peak of $1.9 trillion in 2007 to $1.5 trillion. But despite the financial damage, industry observers note that the buy side is still making select investments in technologies that can save time and money.

In speaking with analysts and executives from financial firms and technology companies, Securities Industry News identified ten areas that will remain a focus:

1. Offshoring. Whether it means using a third-party vendor or opening an office in a low-cost location, offshoring has become a common solution for saving money on salaries. Firms that had been on the fence-or merely experimenting with the lower wages in India and China-are expected to fully embrace the approach this year, due to economic necessity.

In a November survey conducted by Boston-based Aite Group, capital markets executives said they plan to offshore an average of 16 percent of their software development in 2009. Aite analyst Adam Honoré says that firms will bargain harder this year with their outsourcing providers to drive down costs, with chief information officers looking for quick returns on investment. "Overall, cost minimization is on top of the operational agenda," agrees Isabel Schauerte, a Celent analyst in London. However, according to Celent, many large capital markets firms have already taken full advantage of offshoring, making it difficult to eke out additional savings.

2. Automation. When times are good, it's easy to throw bodies at a problem. In a downturn, however, institutions face more acute pressure to rethink operations and find manual processes that can be automated or eliminated.

"We're always tweaking our compliance software to make the human component

less labor-intensive," says Greg Hold, CEO of Hold Brothers On-Line Investment Services, a direct-access trading firm in Jersey City, N.J. Two or three years ago, when Hold Brothers had 300 traders, it did closeouts by hand. Now that there are 1,200 traders worldwide, the firm uses software that "allows us to automate what used to be done manually. Traders now have certain stop-loss parameters that automatically get closed out."

3. Cloud computing. Software companies have long known that economies of scale can be gained by keeping all applications in one central place. While hedge fund administrators offer fund managers back-office services, other vendors, inspired by the success of companies such as Salesforce.com, are offering hosted, or cloud-based, versions of their software. "You don't pay for implementation-flip a switch and you're on," says Aite Group analyst Denise Valentine, adding that companies that provide complex applications can charge implementation fees that are as much as 80 percent of the licensing costs.

"We certainly see interest increasing," says Paul McTigue, senior business development manager at Calypso Technology, a trading systems company that offers its products on a hosted basis. The approach is especially appealing to smaller funds, adds McTigue.

4. Efficiency. Many buy-side firms have overlapping systems and underutilized technologies. Rather than purchasing new software, they can save money by combining platforms and leveraging functionality that is already available. For example, says Rajiv Krishna, global head of the securities practice at Bangalore-based Wipro Technologies, firms that use different systems in Europe, Asia and the U.S. are now considering retiring entire sets of applications in a particular geography and replacing them with, say, those used in the U.S.

Potential efficiencies are often overlooked. Although most companies run Microsoft Corp.'s productivity and communications applications, some don't fully utilize features that are built into the programs or can be customized quickly and cheaply. "Our customers already have these tools," says Colleen Healy, Microsoft's general manager for financial services. "All this software is already in-house. It may take only a partner to add the vertical functionality. And there is an ecosystem of partners who know these customers and solutions."

5. Virtualization. While storage and server virtualization usage is widespread on Wall Street, allowing firms to get the maximum use of those resources, the technology continues to evolve. Portland, Ore.-based start-up RNA Networks, for one, helps firms do the same with the memory chips in their servers. RNA adds a virtualization layer between the server and some or all of its on-board memory, enabling other servers to dip into it when necessary. As a result, a firm can improve speed, reduce costs, or both. "Saving money is definitely one of the value propositions," says Andy Mallinger, VP of marketing at RNA. "Most of the work we're doing now has to do with hedge funds, with arbitrage and with low-latency traders. The performance we're able to offer is better than

anything these folks have seen."

6. Service-oriented architecture. Also known as Web services, service-oriented architecture, or SOA, is a way to build applications in small, discrete pieces that can talk to one another using open standards. Theoretically, SOA is more flexible than the traditional approach: building large, monolithic systems that speak proprietary languages and require expensive middleware to make them work with other platforms. But it takes time and money to switch existing software over to the new architecture.

However, service-oriented architecture offers a sizable short-term benefit that can make it attractive even in stressful times, says Hub Vandervoort, chief technology officer of SOA infrastructure products at Progress Software Corp., a Bedford, Mass.-based provider of application infrastructure technology. SOA applications are easier to keep an eye on, he says-"You can inject probes. To the extent that the firm is already in an SOA posture, it makes new reports, new visibility, real-time surveillance much easier."

7. Business process management. Another advantage of SOA in today's climate is that it's a natural fit for business process modeling systems, which make it easier to set up new monitoring and reporting processes-a capability that could come in handy if much anticipated hedge fund regulations arrive.

Asset management firm Coris Capital of South Africa, for one, needed to reconcile assets and liabilities across different funds and three core systems-member administration, fund accounting and a product design and structuring solution from Microgen. Tom Crawford, managing director of London-based Microgen's financial systems division, says Coris opted for his company's SOA-based Aptitude business process management tools, which allowed the firm's staff to design new workflows via a graphical interface, significantly speeding up development time. It took about two months to establish the requirements and two more to build the system, a process that would have taken at least twice as long using traditional approaches, according to Crawford.

8. Open source. Adoption of the open-source Linux operating system is widespread on Wall Street, and the OpenOffice productivity suite is steadily catching up to Microsoft Office in functionality. Aite's Honoré says that more technology providers should consider offering their software at no cost-while charging for add-ons and advisory services-as a way to cope with a difficult sales cycle.

One vendor doing just that is San Francisco-based Marketcetera, which offers an open-source trading platform (SIN, Jan. 19). "Previously, organizations had to be willing to shell out a large purchase price in the expectation that six to nine months later, the implementation would do what they want," says CEO and co-founder Graham Miller. Firms using Marketcetera's trading platform avoid that initial cost-which could be around

$250,000-as well as ongoing licensing fees.

9. Better execution. With best-execution mandates in the U.S. and European Union, smart-order routing tools and platforms that accommodate multiple prime brokerages will remain a top spending priority for the buy side in 2009, says Celent's Schauerte.

Today, there are about 40 exchanges, dark pools and electronic communications networks providing liquidity in the U.S., according to Raj Mahajan, president of trading at SunGard Data Systems. It can be tricky for a buy-side firm to track down the venue with the best possible price-"Nightmare is a good word," says Mahajan. Following its October acquisition of Paris-based trading systems provider GL Trade-rebranded as SunGard Global Trading-the financial technology giant says it can help firms meet their best-execution requirements with offerings ranging from simple tools for small equities-based hedge funds to global, multi-asset-class, multibroker systems for the largest buy-side firms.

10. Risk management. With many hedge funds already having failed and the likelihood of worse to come, investors are demanding transparency and more attention to risk management (see page 7). In the regulatory arena, new Securities and Exchange Commission chairman Mary Schapiro, former CEO of the Financial Industry Regulatory Authority, supports registration of hedge funds and other initiatives such as tighter oversight of credit rating agencies.

"The regulator is likely to come up with much more stringent ways for things like, 'How do you assign a fair value to your portfolio?'" says Priya Bajoria, senior engagement manager for banking and capital markets at Bangalore-based IT services provider Infosys Technologies. The upshot, she says, is that "a lot of dollars have been set aside for risk management and compliance-related work."