



RESEARCHFOCUS®

EXPERT NETWORKS

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## EXECUTIVE SUMMARY

Expert networks are one of the most dynamic sectors of investment research generally, and alternative research especially. Initially embraced by hedge funds, expert networks, which assist primary research by facilitating consultations with industry experts, are now widely used by a broad cross-section of investors, from hedge funds to mutual funds, investment advisors, pension funds and private equity investors. Our most recent survey of expert network users, conducted during the third quarter of 2009, suggests that *36% of investment management firms are users of expert networks.*

The recent financial crisis has not dampened demand for expert networks services, despite attrition in the number of hedge funds and layoffs in buy-side staff. Expert networks have become firmly embedded in the investment process. Although the crisis caused a hiatus in investment activity, it did not alter the trend toward increased primary research by investors, nor expert networks' status as the tool of choice. *Over 40% of expert network users rated expert networks either 'extremely' or 'very' important to their investment process.* For hedge funds, expert networks are even more critical, with *over 60% of hedge fund respondents rating expert networks as 'extremely' or 'very' important to their process.*

Nevertheless, the last twelve to eighteen months have been a turbulent period for expert networks, as for all forms of investment research. *We estimate that overall spending on expert networks will decline by 16% in 2009 to \$364 million from \$433 million in 2008.* This reduction is not so much the result of reduced usage, although some expert network clients were obliterated or merged during the crisis, but more from price competition. Some expert networks used the crisis as an opportunity to increase market share with more aggressive pricing, and some clients, looking for opportunities to reduce spending, forced unilateral fee reductions.

Amazingly, expert networks continue to proliferate. This Integrity **ResearchFocus**<sup>®</sup> report covers 38 expert networks, up from 25 firms covered in our last report in February 2008. Within the last 12 months, 6 new expert networks launched. In addition, existing research firms are adding expert network capabilities. Barriers to entry remain relatively low, and the attractiveness of the sector continues to draw new entrants.

The Pequot and Galleon insider trading scandals appear to have similarly left expert networks unscathed, so far. The scandals underline the importance of expert networks' investments in compliance policies and procedures. We have even heard murmurs from regulators that the scandals will end up driving more primary research activity toward expert networks, since they provide a compliant framework for regulating interactions with company insiders.

Not all expert networks are equally convinced of the importance of robust compliance capabilities. For this report, we queried each firm about their compliance capabilities. A number of expert networks refused to discuss their compliance capabilities with us, in many cases because they are minimal. *Our survey of expert network users showed clearly that, for buy-side analysts and portfolio managers at least, compliance is not a major consideration.*

We believe that it is a mistake for any expert network to de-emphasize compliance. Compliance systems and processes of the type outlined by our recommended best practices are essential to gain business from the larger expert network users, whether hedge funds or long only asset managers.

For this report, Integrity surveyed 301 hedge fund and long only investors, including 120 users of expert network systems, to better understand how they use expert networks, which networks they prefer, and why. We asked users which factors they use in selecting expert networks. There are nine major factors: the skill with which they match the appropriate experts with client requests, cost effectiveness, uniqueness of the experts provided, the firm's compliance capabilities, depth of coverage, customer support, speed of the match process, survey capabilities and additional services such as conferences.

We asked expert network users to rank the factors by importance. The most important factor, by far, is the skill with which expert networks source experts based on client requests. To evaluate match quality we asked users to tell us the percentage of successful expert matches generated by their expert networks. Cost effectiveness was the second most important factor among users, reflecting the extreme cost consciousness in the wake of the financial crisis.

Based on the survey results, we ranked expert networks reviewed in this Integrity **ResearchFocus**<sup>®</sup> report on the nine metrics users cited for selecting expert networks. Each factor was weighted based on the importance given to the metric by users, with one exception - compliance. Expert network users give compliance little consideration, deferring in many cases to dedicated compliance personnel or senior management. For our rankings we gave compliance capabilities a significantly higher weight than the user survey suggested.

Based on the resulting rankings, we selected 4 firms as *2009 Top Picks for Expert Networks*. Each Top Pick is chosen from a specific category of expert networks: Global Generalists, Healthcare Specialists, Technology Specialists, and European Specialists. We did not receive enough survey responses to choose a top pick for Asian Specialists.

This edition of Integrity **ResearchFocus**<sup>®</sup> reports begins with an overview of the expert network segment which discusses the expert network sector generally, how investors use expert networks, and why investors value them, incorporating results from our user survey. We then analyze the expert networks' compliance programs. We review "best practices" for the policies, procedures, and compliance tools, and we evaluate the compliance programs for specific expert networks based on how well they match the best practices standard. We then provide a comparative analysis of the different expert networks based on feedback received from the user survey. From this analysis, we select the *2009 Top Picks for Expert Networks*, with the *Runner-Up* firms and *Honorable Mentions*. We also include other notable firms to consider, based on their technology, business model or other factors. We conclude with our analysis of the future of the expert network industry. Profiles of each of the 38 expert networks identified in this review are included in the final section.