

Hedge Fund Value Chain

This article discusses the concept of the Hedge Fund Value Chain. There is a little more complexity to what is written below but in reality, not much, though the industry itself will strongly disagree. Hedge fund people are not rocket scientists – some class them as large children (which is closer to the truth).

The Investment Industry

The investment industry is as old as money (capital) itself. Ever since money has been around, there have been people (companies, corporations etc) trying to persuade you to give it to them for “safekeeping” and growth (investment). Various arguments are put forth to persuade you to pass on your money, some valid (inflation will eat it away etc) and others more dubious (we are better at capital allocation etc). If these people lose your money, they will say “opps, sorry, but you took a risk and it just didn’t work out” and go and find other clients.

What is an Investment Fund?

An investment fund is the pooling of all capital collected into a fund where, maybe but not necessarily, the benefits of scale and scope will allow greater growth. Remember, “investment” simply means that money managers will try a strategy, nothing more. There is a little bit of a science to this, but not much (see Risk Management, Equity Analysis, Macro Economics, Flow Opportunity etc; most decisions involve a high level of subjective assessment).

Differentiation

As with any range of products, differentiation appears. Two products may essentially be the same but one is called X and wrapped in green paper the other called Y and wrapped in red paper and suddenly you have two products and two prices etc. There may be real differences between the two products but there is usually much illusory difference as well. The art of creating identities is called branding.

What is a Hedge Fund?

So what is a Hedge Fund? Well, it is simply an investment fund wrapped up in its own paper and name and price tag (commonly 2 and 20 – two percent annual fee plus twenty percent of annual profit above a critical threshold). Hedge Fund managers will argue that they are better at allocating capital yada yada but lots of studies show that they actually are, on average, no better than any other money manager. There are some regulatory and legal and optional (the ability to perform certain transactions) advantages of being in the hedge fund class of investments but these are not necessarily related to superior performance.

Hedge Fund Value Chain

As with all value chains, there is:

- Input Logistics – the tangible raw material is money. The intangible raw material is the capacity to analyse markets and make money management decisions. The logistics of actually collecting the money is not very complicated in the modern, computer age –digital transactions).
- Operations – the tactics, strategies and management capacities etc. Reporting.
- Output Logistics - the logistics of actually returning money (again, simply digital transactions).
- Sales and Marketing – probably the most important aspect of a hedge fund. Appearance is everything; Trust Factors, Credibility Manipulation etc are all used to persuade people to part with their money.
- Service – there is not really much non-sales service involved, apart from reporting. Lunches with the most important clients when they are thinking of pulling money out etc. Plus other “entertainment services” where necessary.
- Margin Reporting - the critical skill of creative accounting required here.