

AsianInvestor

WWW.ASIANINVESTOR.NET

ANALEC

Research Enabling Solutions

Investment research: The hunt for a sustainable business model

Reprinted from AsianInvestor December 2012



Investment research: The hunt for a sustainable business model

A shrinking commission pie, unbundling commission rates and competitive pressures raises serious questions on long-term sustainability.

By Indy Sarker, CEO, ANALEC

The industry of sell-side and buy-side research faces headwinds like never before. In the past, managers at investment banks, brokerages and institutional money managers viewed problems in the research business model as cyclical rather than structural. However, over the last few years, there is growing realization amongst decision-makers that the problems are largely structural and deeply embedded in their respective business models.

A sell-side investment research industry where on average each analyst covers no more than 8 to 10 companies is increasingly unsustainable as a business model, given the costs of running a research operation and an external customer environment that is willing to pay less and less for investment research.

On the buy side, in-house research teams are generally the luxury of large active asset managers, with the bulk of the asset managers relying on their portfolio managers to research ideas with the help of sell-side analysts. Each time commercial sustainability issues have been raised within the research business, almost entirely the focus has been on costs – but doing something about them is difficult if the goal is to maintain coverage footprint and quality.

Offshoring of certain tasks delivers very limited opportunities to address long-run sustainability and brings with it its own set of challenges. From a buy-side perspective,



Indy Sarker

given the high costs of maintaining in-house research teams, it pushes many of money managers to operate less than optimal research processes and practices when it comes to investment due diligence.

The United States marketplace for investment research has seen unprecedented consolidation and reduction in the sell-side investment research capacity over the last three-to-five years, driven by cost pressures and a market environment that increasingly fails to justify marginal players. This resulting contraction in capacity is now raising concerns at the buy side – which consumes this research – that they are going to have to operate with less sell-side

output and related services. Such concerns show that fundamental research is not dead, but the industry’s inability to evolve puts many asset managers at a competitive disadvantage.

We believe the hunt for a sustainable business model within investment research has to increasingly focus on innovation via technology in order to dramatically alter not only the cost paradigm but also to address ambitious productivity needs of the industry. In addition to technology innovation, industry participants have to be open to considering “doing things differently”.

Good analysts will always be in demand. The costs of research professionals may be in decline, but not by 50% from present levels, the kind of radical change that would be required to make the business model work. How can research not only survive but return to profitability?

Sell-side research: The coming squeeze

The demands on sell-side research analysts have in no way diminished over the years, despite the recent perception of their reduced value in the marketplace. We estimate a median broker spends around \$50,000 per annum on each company under their coverage. If that same broker is not (on average) in the top five in the league table of their respective client’s broker panel, it becomes very difficult to sustain that business as a standalone offering.

Figure 1 – ANALEC ModelViewer value chain



ANALEC ModelViewer works across the value chain of fundamental investment research, delivering accuracy and speed in the decision-making process.

According to Greenwich Associates, the average number of brokers at an Asian money manager's broker list currently stands at around sixteen. There is enough noise in the marketplace that broker lists at most money managers is likely to shrink over the next few years, albeit gradually, with the use of commission sharing arrangements (CSAs) growing in significance. This does not bode well for full-service broker dealers that remain at the margin and therefore the most exposed.

We believe simply taking down costs without productivity tools or any process innovation in the business will only lead to reduced quality of the research service as well as adversely impact on the coverage footprint, raising questions on what constitutes a competitive critical mass.

The impending CSA challenge

The sell-side industry has seen the advent of CSAs in the UK and the US over the last five years, exerting further pressure on many of the sell-side players. CSAs allow institutional money managers to use the

‘there is enormous opportunity to reduce the tedium and resource intensity of many of the research processes’

commission dollars (on trades) to pay other service providers for their value-add in their investment decision-making process, without having to trade with such service providers.

This practice ensures “best execution” while utilising their commission dollars to source services and solutions that deliver the greatest value-add to investment process.

In the US, over the last five years, CSA as a payment channel has grown to a \$2 billion per annum industry and has contributed to the changing landscape of service providers, as well as creating a level playing field between full-service broker-dealers and independent service providers. In Asia, we believe the CSA threat to sell-side firms is likely to play itself out over the next few years, and will exert further pressure on the economics of many sell-side broker-dealers.

From a buy-side research perspective, the advent of CSAs will no doubt help them source value-added services and innovation to feed their pre-trade analytics process, without impacting their cost of business.

Sell-side research: Strong need for innovation

Full service broker-dealers need a strategic rethink of their business processes and to

Figure 2 – ModelViewer: Innovation for the Investment Research industry

ModelViewer – For the Sell Side	ModelViewer – For the Buy Side
Significantly enhance analyst coverage capacity	Significantly increase bandwidth to process ideas
Reduce lead times on coverage initiation	Fractional cost model, delivers enormous benefits
Achieve transparency and high quality research	Enhance agility in your coverage
Focus on balance sheet and refinancing risks like never before	Increased granularity and transparency in analyses and investment conclusions
Dramatically alter your cost of research operations	A trade identification tool built around fundamental parameters

push the boundaries of innovation when it comes to their investment research operations. The cost paradigm of the business needs to change dramatically, if one has to fight the impending challenges successfully. We believe there is enormous opportunity to reduce the tedium and resource intensity of many of the research processes, especially when it comes to financial data compilation and building out financial forecasting models and creation of ‘maintenance research’.

reliance on the sell-side in many ways has not materially diminished, although the nature of the reliance may have changed over the last 10 years. Consequently, the buy side's need for in-depth due diligence and research, along with trade identification tools to facilitate the investment process, goes a long way to help their outperformance objectives.

ANALEC ModelViewer seeks to fill that need in order to ensure the buy side remains cost competitive while successfully outperforming its benchmarks. To fundamental investors, ANALEC ModelViewer delivers the power of a research department on their desktops, without the costs or management challenge of the same. It empowers small research teams (at the buy side) like never before when it comes to agility, and speed of decision-making and feeding their investment due diligence process.

Investment research: Where does one go from here?

It is becoming increasingly clear that whether you are a sell-side or buy-side research provider, your businesses are in dire need of innovation. We believe harnessing software-enabled solutions goes a long way to realise those ambitious productivity and performance targets. In a world where the forces of creative destruction are at play, embracing innovative technology solutions in the research department would go a long way to ensure long-run viability and success. ■

Contact

To harness the power of ANALEC ModelViewer (www.model-viewer.com) for your research needs, please contact the team at ANALEC at sales@model-viewer.com or +1 (646) 810 6462

Buy-side research: Embracing innovation

Active money managers are increasingly under pressure to outperform market benchmarks and thereby justify their fees to their clients. In that context their needs and demands (from the sell-side) have only grown over the years. Financially many buy-side firms have failed to commercially justify large research departments for their in-house consumption; consequently

ANALEC

Research Enabling Solutions

ResearchWise



ANALEC
RESEARCHWISE™

ANALEC ResearchWise is a complete business process automation platform, specifically addressing the needs of an investment research organization. ANALEC ResearchWise helps in quality controlling the research product across offices and bringing together under one electronic umbrella all aspects of the research organization – centralization of financial content; report authoring, compliance and workflow, investment screening tools for client servicing, bespoke technology enabled product creation and content distribution. It helps to minimize the resource intensity of maintenance research as well as raises the visibility of the research product via electronic means across a spectrum of marketing channels.

ClientManager



ANALEC
CLIENTMANAGER™

ANALEC ClientManager is a client servicing accountability platform geared specifically to address the “new realities” and impending challenges at full-service stock brokers and investment banks. It allows each stock broker/investment bank to scientifically quantify and compare the cost-of-service to a particular client organization versus the revenue generation from the client organization. ANALEC ClientManager allows the capture of each touch-point of the client service in an electronic form, across the client service organization, and helps business managers to make intelligent and proactive resource allocation decisions with a view to maximize revenue generation and minimize cost of service.

ModelViewer



ANALEC
MODELVIEWER®

ANALEC ModelViewer is a versatile software enabled research platform that delivers to the buy-side and sell-side investment research industry, ready-to-use financial forecast models on a range of globally listed companies. These integrated financial forecasts models and associated content have been created and are maintained by a team of investment analyst that are organized along industry lines, feeding off publicly available information sources and delivering speed and transparency in the investment decision-making process.

It allows each user of the platform the ability to drive their estimates and forecasts on the future financial performance of the companies, by tweaking the assumptions driving the future forecasts. The resulting estimates can then be used for investment screening purposes on the platform.