



How is the sell-side research landscape changing?

Submission for CRISIL Young Thought Leader
2009

Gaurav Joshi

MBA, IIT Delhi

Email: gauravjoshi@dmsiitd.org

Phone Number: +91 9312525854

Total Word Count(Excluding Table of Contents and References) = 2457

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1. EXECUTIVE SUMMARY

Sell-side research business model has been in its present form for more than a decade with sell-side research provided to the client as part of the trading and other services. The bundled pricing model with sell-side research funded by trading commissions has outlived its time with serious challenges posed in the form of buy-side research capabilities, too many players leading to commoditization of sell-side research with little insights, possibility of regulatory unbundling and transparency requirements for trading fees, development and acceptance of Independent Equity Research (IER) and client's decreased perceived value of the research. The business model in its current form is not sustainable and warrants dramatic changes for survival. This dissertation is an attempt to study the current status of the sell-side research industry in India and the various challenges that the industry faces. It also studies the changes taking place in the developed world, including the US and Euro and its possible impact on the Indian scenario. The dissertation then delves into the recommendations and solutions to strengthen the sell-side research structure in India. It proposes a comprehensive 3 pronged approach comprising of Research Delivery model, Research Offer Design, Service Levels and Pricing models. The strategy identifies the root causes of the challenges in the business model and proposes innovative and novel solutions to convert the problem into an opportunity. The recommendations and changes suggested are feasible and implementable keeping in mind the Indian context. The paper concludes on a positive note highlighting the role of sell-side research and how the shake-up could lead to consolidation in the industry with fewer players and customized products, services and pricing models.

1. SELL-SIDE: INTRODUCTION

The retail brokers and research departments that sell securities and make recommendations for brokerage firms' customers are referred to as Sell-side. A sell-side research analyst typically works for a brokerage firm or an integrated Investment bank and is tasked with preparing equity research reports for client's recommendations.

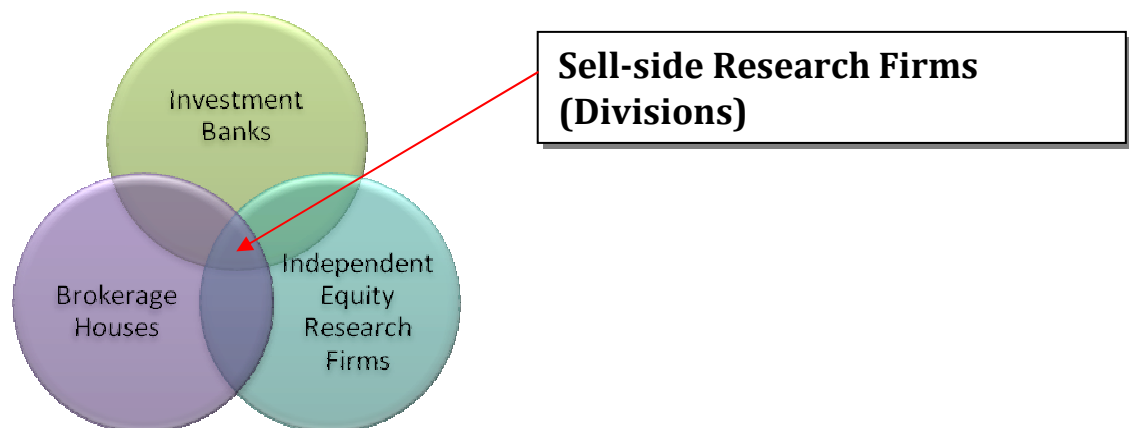
2.1 SELL-SIDE BUSINESS MODEL

Traditionally trading, research, and other services have been provided to clients as a bundle. Trading commissions were then allocated to other service lines through 'soft money' arrangements. Thus the research activities in a firm are subsidized by the trading commissions that might be generated by the trade that will result from the BUY or SELL recommendations. Thus the eventual cost of research services is passed-through to the investors.

A SWOT analysis of the current business model will help us in better analyzing the situation and work on the weaknesses and threats.



2.2 OWNERSHIP OF SELL-SIDE RESEARCH FIRMS IN INDIA



2.3 CURRENT STATE OF SELL-SIDE RESEARCH

In recent times, the sell-side research industry is in a state of bother. The challenges are:

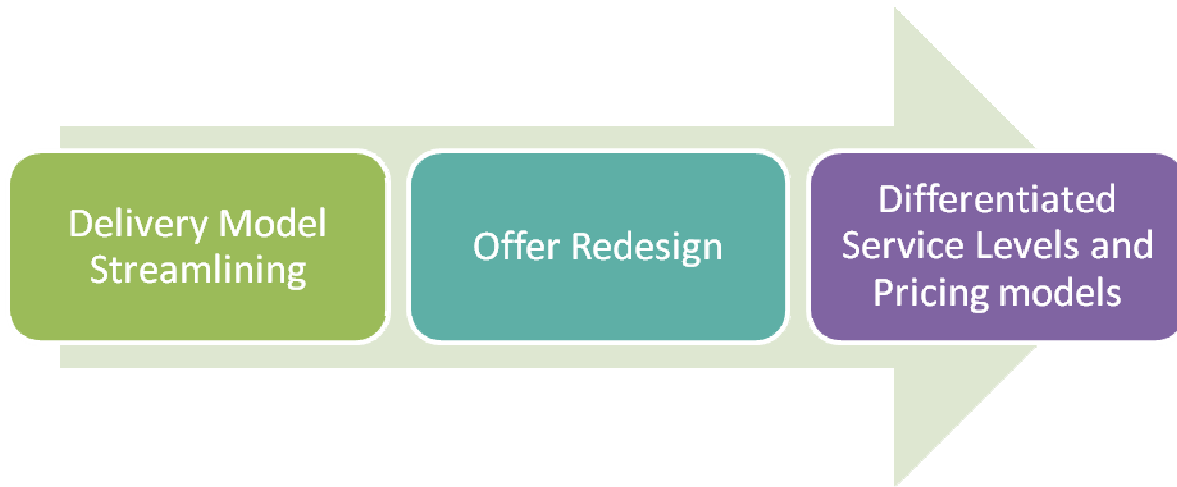
1. Sell-side research's investment banking linkage has been constrained as a result of the settlement with the global regulators (Spitzer Settlement, 2002)
2. The economics of the sell-side research is further depressed by decreasing trading commissions which have fallen by approximately 50% in the last 5 years.
3. Some large buy-side firms feel that they are over-paying for the research and are seeking unbundled trading from research
4. Regulatory pressures in terms of transparent reporting of commission-related services (Financial Services Authority [FSA], UK)
5. Increased buy-side interest and sell-side support for independent research

These changes in the scenario will completely alter the rules of the game. The research division will have to stand and sustain greater buy-side scrutiny. With revenues and fees at risk, the current cost structure can no longer be supported. Sell-side firms will face pressure on many fronts at once:

1. **Lower prices** – Prices will come down drastically due to unbundling. Customers will explore new options and the knee jerk reaction would be to use lower prices to protect business and increase profitability.
2. **Revenue Loss** – Mediocre research services will no longer be subsidized by strong deal execution commissions leading to a significant cost increased and decline in profitability.
3. **Margin Reduction** – Due to decrease in prices, the fixed costs will be shared over small number of businesses and the firms will have to shed expenses. During shedding, it is important to distinguish the fat from the muscle.

2. PROPOSED RECOMMENDATIONS

In the current crisis situation in the market, the paper suggests a three pronged approach to tide over the crisis and come out stronger. The strategy can be represented as below:



2.1 DELIVERY MODEL STREAMLINING

Understand the key process measures of the client and learn how the research report provided is used by the clients to benefit the processes. This includes increased collaboration with the clients to understand the areas of the research report which the client most focuses on and the areas that are ignored.

For example: A client may place significant emphasis on the financial analysis of the report, but may choose to ignore the future outlook section of the report. With this understanding, the research firm can choose to concentrate more on the financial analysis and valuations and might even skip the future outlook of the company.

A model may be developed which analyses the client behavior of the report and the offers can be connected with these processes and impacts. Once the various report sections are mapped to the decision making of the client, it is easy to identify the high impact sections of the report which can be further focused on. Meanwhile, the low impact sections can be trimmed off or completely abandoned. This will help in increasing the client's value perception of the research and also play a role in reducing the operating costs.

Report Section	Perceived Value to the Client	Impact on the decision	Total Impact on Decision Making
Research Highlights	High	Minimal	2.5%
Investment Summary	Very High	Significant	40%
Valuations	Very High	Overwhelming	50%
Business Description	Very Low	Minimal	0.5%
Industry Description (Sector Analysis)	High	Moderate	12%
Competitive Position	Low	Moderate	4%
Historical Performance	High	Significant	15%
Future Estimates	Very High	Overwhelming	70%
Management Policies	Low	Moderate	5%

Minimal – <10%, Moderate – 10-30%, Significant – 30-70%, Overwhelming - >70%

Very Low – <10%, Low – 10-30%, High – 30-70%, Very High - >70%

From the above illustration, it can be observed that sections on Business Description, Competitive position and Management policy play a miniscule role in the decision making of the client. On the other hand, financial valuations and future estimates play a very large role in influencing the decision of the client. In other words, these sections provide real value to the clients and must be focused upon by the researchers.

2.2 OFFER RE-DESIGN

3.2.1 INCREASE COVERAGE OF STOCKS

According to *Bloomberg* data, only 170 firms, or 6% of some 3,000 stocks traded on the exchanges, are covered adequately by research analysts, while another 435 firm are tracked but by less than 10 analysts covering each of them. The rest, 2,395 firms, are not studied at all.

A sell-side research firm can increase client value by identifying stocks with limited coverage. It helps to draw attention of the client towards growth stocks which might be under-valued. This would fulfill the basic function of sell-side research by opening novel opportunities to invest for

the client. Also, the brokerage commissions would also be boosted by enhanced trading activities at the bourses on the undervalued stocks.

3.2.2 RE-ENGINEER THE CURRENT PRODUCTS OR DELIVER NEW TYPES OF PRODUCTS

3.2.2.1 RISK PROFILE OF THE CLIENT

Typically, most of the investment research reports are generic with a BUY/HOLD/SELL recommendation on the stock and cover the overall investment attractiveness of the stock (or a particular sector) in the medium to long run. However, clients do not have high value add with generic reports. In terms of investments for clients, returns are always mapped to risk levels. Thus, a stock with a 20% return in a one year time-frame will also have some risk levels associated with it. Different clients have varied risk appetite and will approve of stocks with different risk complexions. Thus, it would be worthy if the investment returns are supplemented with a risk profile of the stock to help the clients better understand the risk associated with their portfolios.

Scrip/Sector	Avg. Return	Risk Measure (Deviation)	Timeframe
Reliance Industries	23%	10%	18 months
Infosys	35%	19%	42 months
Power Sector	-15%	4%	6 months

3.2.2.2 TIMEFRAME OF THE CLIENT

Most of the sell-side researches have a fixed time horizon of 1 year. The targets are usually valid for a period of 1 year and there are no research reports available for extremely short term investments (3-9 months) or for considerably long periods (growth companies for a period of 3-5 years). Researchers can accomplish tremendous differentiation in the marketplace by providing stock picks for extremely short timeframes (for speculators, etc) and recommendations of very long periods for financial institutions (Mutual Funds, Insurance Companies, etc)

Speculators	Volatile Stocks	Extremely Short timeframes (3-9 months)
Mutual Funds, Insurance Companies	Growth Stocks	Very Long time periods (24-60 months)

3.2.3 DETAILED PERFORMANCE MATRIX TO THE CLIENT

In order to establish the validity of the research and to increase the client's perceived value, the sell-side firm must publish a periodic performance review of the companies that it tracks and the recommendations vis-à-vis the actual market figures. This will improve the credibility of the research and help in gaining the buy-side trust. A competitor analysis can also be carried out wherein the sell-side firm's superior performance in terms of correct predictions may be highlighted compared to its competitors.

3.2.4 CLIENT EXCLUSIVITY

Sell-side reports have been commoditized due to over-supply leading to dilution of the value-add it brings to the client. The sell-side firm may adopt a distribution strategy where some amount of client exclusivity is maintained as too many reports kill the value of any single research insight. A revenue stream can also be developed by generating income through sale of exclusive content.

Example: Some sections of the report (valuations, operational performance) may be made public while some sections (recommendation, future projections) can be kept exclusive only for the sell-side clients.

3.3 DIFFERENTIATED SERVICE LEVELS AND PRICING

3.3.1 MODULAR ARCHITECTURE

The research market in its current state is not segmented with a 1 size fits all model. A new modular architecture needs to be developed by identifying the different needs of the customers and satisfying the needs through numerous products. Large Funds, Small and mid-size funds have different needs and 1 product cannot satisfy all their needs. Thus, innovative products need to be developed in the form of specialized research reports for small firms, comprehensive research modules for large firms and sector specific research for sector funds.

Client Type	Research Need	Innovative Product	No. of Stocks Covered	Price
Large Funds and Institutions	Supplement in-house research	Focus on major insights and management policies	On request of Client	Premium price (contract

				basis)
Medium Funds and NBFCs	Identify growth stocks and detailed coverage	Research report with comprehensive analysis and valuations	BSE-200 and Growth stocks	Moderately priced based on trading volumes
Small Firms and Individual Investors	Basic Investment research and recommendation	Research report with limited information and technicalities.	NIFTY stocks and high volume stocks	Free

3.3.2 DIFFERENT PRICING MODELS

Although unbundling may not be imminent, the dependence of sell-side research on trading commissions needs to be reduced for the industry to become self-sustainable. For this purpose, different pricing models will need to be developed against client needs. Different appetites for unbundling will result in payments for research through payment models ranging from bundled commissions, CSAs to hard cash.

Also, different sections of the report can be priced differently based on the decision making impact on the client. Sections which provide significant value to the client can be priced higher than those with lower influencing power.

3.3.3 THE WAY FORWARD

The current industry problems should be looked as an opportunity to streamline the existing business model and innovate a robust model for sell-side research. Firms will have to build a business case for their continued existence in the research business. For some firms, the best option might to exit the business altogether by spinning-off the division to another company. Others who decide to continue with the business will have to commit to either emerging as broad-based high-quality research providers or becoming niche providers of quality research. In both the options, the key word is 'quality'. The quality of the research will be increasingly put to test and will have to stand the rigorous scrutiny from various stakeholders.

4. CONCLUSION

Although it is a tough medicine, the current challenges will make the sell-side research business model stronger and healthier. The market will reward those firms that innovate and adapt and punish the laggards. Firms that strive to do more to establish value to their clients will win regardless of the regulatory policies and buy-side research capabilities. Rational clients and a better understanding of their value will enable all the players in the industry to make better decisions. It enables buy-side institutions to gain further insight into with which firms they should do business with and under what conditions. It also enables sell-side institutions to become more relevant through a focus on delivering real value to clients — and to get paid fairly for that value.

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GAURAV JOSHI

MALE, 25 YRS



PHONE : +91-9312525854 • EMAIL : GAURAVJOSHI@DMSIITD.ORG
ROOM-A59, ARAVALI HOSTEL, INDIAN INSTITUTE OF TECHNOLOGY DELHI - 110016

EDUCATION

MBA	2008-2010	Department of Management Studies, IIT-Delhi	9.25 (CGPA)	2nd Rank in Class
B.E (Info. Tech)	2006	Veer mata Jijabai Technological Institute (VJTI)	70.02%	Distinction in Mumbai University
HSC (Science)	2002	Ruparel College	89.50%	(98% in PCM)
SSC	2000	D'silva's High School	89.06%	2nd rank at City Level

WORK EXPERIENCE

Assistant Manager at Wipro Technology Services Domain: Financial Services Profile: In-charge of business operations & offering solutions for Derivative and Portfolio Products	Dec 2007–Jul 2008
Subject Matter Expert at Amdocs Development Ltd, Cyprus Domain: Telecommunication Services Profile: Software Development and Delivery, Quality Assurance	Jul 2006–Nov 2007

PROJECT WORK/INTERNSHIP

Summer Internship at ICICI Bank Analysis and Recommendation on the Payment Systems: Study of the existing models of payment mechanism in India and analyze the impact of Cheque Truncation System (CTS) on bank's operations	May–July 2009
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RESEARCH PAPERS AUTHORED AND ARTICLES PUBLISHED

- **Has M&A benefitted the Indian Companies?** published at a **National Conference** at Jain University, Bangalore
- **Operational Excellence and Risk Management in times of Recession** published in 'Ashwamedh', management **research journal** of XIMB
- **A new business paradigm in the telecom industry** – Central piece for 'The India Economy Review' on the changing trends and business models in the Indian telecom sector.

CERTIFICATIONS

- **Global certification on Investment Planning** conducted by the Financial Planning Standards Board (FPSB), India

ACADEMIC ACHIEVEMENTS

- **Winner of Bharti Foundation Merit Award and Scholarship** for securing second position in MBA
- Recipient of **JRD Tata Scholarships** for **2 years** for excellent performance in **Engineering** education
- Received '**Scholar of Scholars Award**' for outstanding academic performance at inter-school competition

EXTRA-CURRICULAR ACTIVITIES AND ACHIEVEMENTS

- **Coordinator** of the **Media and Public Relations** Committee at DMS, IIT Delhi
- Event **Head** of 'Enter the Matrix' team at 'Technovanza', National Level inter-collegiate Technical festival of VJTI
- **Winner** at national level Business Plan Competition sponsored by www.yourstory.in
- **Finalist** at Genesis '09 – A **global case study competition** conducted by **General Electric (GE)**
- **1st Runner-Up** in PlanIT, an IT focused competition at IMT, Ghaziabad
- **1st Runner-Up** in 'Arvneeti', the national **Business Plan** Competition at DFS, Delhi University
- **2nd Runner-Up** in 'Prayaas', a **Case Study** Competition at NMIMS, Mumbai
- **2nd Runner-Up** in '**AD-MAD SHOW**', an event on marketing and advertising at VJTI
- **Winner** of '**Crack the Logic**', mathematics and logic quiz at Amdocs, Cyprus