

CUTTING THE INSTITUTIONAL CAKE

By Xavier Y. Zacharias

Introduction

The special characteristics that are responsible for a stockbroker being really successful have often been the subject of some concern, especially to other stockbrokers. The list of desirable characteristics can be as long as one's arm or as short as one's memory depending on whether or not one uses qualitative or quantitative terms to define the characteristics. Most people, however, tend to sum it all up in one phrase "superior service".

But what is service? and How can it be shown to be superior to other competitors? In seeking answers to these questions many would say it is a matter of 'quality', 'efficiency', 'extra effort', 'ability', 'better this or that', (usually operating or research in the case of stockbrokers) - or "service which is superior". Even the client, who is in the best position of all to judge service, encounters many difficulties in making such a value judgement. Nevertheless, the services of most brokers can be measured in terms of relative performance. With this in mind it could be helpful to classify the services or functions of a stockbroker as under:

Middleman, or Agency Function
Information Gathering and Dissemination, or Research Function
Provision of Capital and Corporate Services Function

The Agency Function

The agency function incorporates the order-taking, operating, documentation, and settlement services offered by all brokers. These services, because they are available from all and sundry are, in the main, non-motivators of business. On the other hand should persistent errors occur in any or all these areas then that broker can expect to lose business.

It is very difficult to see many circumstances under which an institution would seek out a broker to give him an order because of his 'superior' ability to take orders, to produce contract notes and registration advices, to process transfers and to collect or draw settlement cheques. The following, however, are some reasons why preference may be given to one broker over another. A broker might be used when he is a "stable" broker.

The ability to deal direct with a partner of the firm is a minor, but still important plus for a number of institutions. If a mistake is made in order taking say, for example, a buy order was processed instead of sell order correctly given and the stock has subsequently fallen, then a partner is in a better position to give an on the spot decision to effect the sale as at the date of first giving the order and accepting the double loss than a non-partner order taker.

A direct line to the institutional department in a broker's office is a time saver and a definite plus for many institutions. The institution should have several people that it can contact at the broker's office. A direct line to the Stock Exchange floor is, also, an additional service which can be appreciated.

It is in the operating area where the pluses and minuses count. Again, if dealings are done direct with floor operators an institution may feel a partner operator is under the greatest pressure to provide additional services, such as immediate reporting of floor announcements, early reporting of market rumours and market highlights, and reporting of business done - if this is requested.

The ability to make purchases and sales consistently favourable to the institution would of course be a major advantage to the broker concerned. Institutions, however, would be foolish to believe that one, or a few firms have the cream of the operating talent. Apart from the mobility of operators, and the fact that the larger firms often have five or more operators some of which are trainees, or relatively inexperienced and that the smaller firms with three or less

operators may not be able to cover the boards efficiently, a lot of business does not go to the floor for execution. It is done off-market without senior operating services being rendered at all. Furthermore, if a broker treats all clients equally then off-market sales are likely to be done at a fair rather than a favourable price to the institution. Bad operating rather than good operating is, then, more likely to influence the direction of orders.

The trend away from placing orders with brokers and towards acceptance of offers and bids from brokers is causing some concern. The importance of offers and bids to institutions can be explained in a number of ways.

Prices are generally in favour of the institutions - brokers would lose goodwill if they consistently offered shares at seller or better than last sale price or bid for shares at buyer or lower than last sale price, especially those which can be easily traded on the floor.

The broker has disclosed his hand. The books of most brokers are made known to the institution and this can help in making a decision whether or not to trade then or later. Because the institution deals in large parcels small private investors are not held to ransom, rather institutions themselves and the larger investors are likely to be the other party to the deal. This tends to make both parties deal competitively.

The offer and bid technique is often the only way a small broker or non-institution broker can get part of the lucrative institutional business, but institutions should be on the lookout for brokers who accumulate parcels and run the price up.

Most institutions are fully aware that off-market sales must be controlled. Otherwise the market mechanism will operate inefficiently if the majority of deals are completed ex-floor.

Some broking firms pride themselves on their ability "to get the business done" that is, to operate quickly on large orders. This may be an advantage to a few institutions, but it can be a highly over-rated ability. Nevertheless the individual institutions requirements are important for example the obtaining of the best deal over several days may not be the ideal way of operating if an institution is anxious to acquire as many shares as possible around the then market price.

In summary, there appear to be very few opportunities for a broker to outperform his colleagues purely as an agent. There are, however, a large number of possible mishaps which could result in a loss of business rather than a gain of business. It is the broker who sets up a separate department, headed by a partner, for his institutional business and limits the number of sins of omission and commission to an acceptable figure that will increase business.

The Research Function

During his recent visit to Australia the Rt. Hon. J.R. Marshall, Prime Minister of New Zealand told the story of the parliamentarian who, lost in the country, on coming upon a farmer walking up the road asked "Where am I?" The farmer replied "In your car mate". The parliamentarian remarked to his passenger that the comment reminded him of some of his colleagues' speeches which he described as "brief, factual, but added nothing to what was already known." Most brokers research could be described in similar terms.

The fact is often ignored that a number of the larger institutions are staffed by people skilled in the analytical techniques necessary for successful investment selections. The elementary and shallow recommendations put to institutions as considered opinions by a large number of brokers is useless in fact and can be insulting in the extreme.

On the other hand the 10 to 20 page monster full of historical information and annual accounts statistics is of little value other than as a reference tool, or material for the keen young research trainee's personal library. More often than not these extensive reviews are done on blue chip stocks, are buy recommendations, and are in complete harmony with the institutions views on that stock anyway. Brokers should be brave enough to also make sell recommendations even though this may need to be done quietly.

It is useful if the analyst who has done the work is shown as the author as this will let the institution know how much notice to take of it.

It is often a point of merriment to institutions to get their sixth recommendation on B.H.P. in as many days and to hear the last broker complaining he didn't get the order. The broker that does original or topical research has a better chance of getting the order than the one who consistently rehashes old favourites.

A major problem with regard to research is finding the time to read all the material. If a particularly good piece of research is ignored by the institution the broker should share the blame. The broker should present his case more attractively and follow up with personal requests, if necessary, to get the material read. If the brokers research is selling ideas, it is important to get to a decision maker or at least to ensure that the ideas are passed on to the decision maker. But he would have to be confident it is a special situation; we all know what happened to the boy who repeatedly called 'wolf'.

The gathering and dissemination of investment information can be divided into that which is historical, and that which is current. The majority of research proffered is historical in nature and presented as a sales proposal. Current information is of greater importance and what a pity more brokers don't realise this.

A number of institutions hold the belief that many brokers do themselves a dis-service by not preparing separate research material for private clients, for institutions, and for overseas clients who more than anyone else could be expected to need historical information.

The important research motivators are -

- regular in depth company studies including profit projections, light on historical information and hard sell and strong on current and original information,
- accurate, regular, and updated company and industry statistics for reference and library purposes only,
- organised company and industry visits and tours,
- immediate notification of company irregularities, important news, and special situation investments, and
- early in-depth studies on new companies, or early and original attempts to interpret the effects of a major change in a company's fortune, for example a new oil zone, or significant mineral find, takeover, a repayment of capital, etc.

Corporate Services Function

The institution that participates in underwritings, sub-underwritings, floats, placements, and the like will be strongly motivated to reciprocate with orders. Mutual Funds, Trusts, Investment Companies, etc. will willingly direct business to those houses selling and promoting their wares.

Whilst these participations are the key positive motivators of new business, problems do occur in allocations. It takes a top salesman to keep all clients both small and large happy when a particularly attractive money making opportunity is available to the market.

Most institutions would feel that allocations should be done on a business received basis. Often this is not the case. Those institutions who are active in the portfolio management field are aware that in a large number of instances their clients can negotiate better terms than the institution. As both are aware that the clients business is relatively small compared with that of the institution managing the portfolio, the loyalties of the broker concerned is quickly noted and kept for reference.

Other Influencing Factors

Broker lunches are not as many think an important motivation to do business. It is possible that if a broker is known for his prodigious eating habits but ignores to invite one or two institutions he may create negative thoughts in the minds of those not sharing his table. Most institutions see such lunches as an extension of their working hours, as I am sure do most brokers.

Personality, of course, is a major factor. For those seeking to capitalize on their strength in this area it would do no harm to remember to cover all the people associated with the initiation of orders and not just the boss or just the 'phone operator.

Integrity and financial stability are important. Reputations can be ruined by being a party, even if innocent, to dubious deals.

Brokers who actively deal "as principal" or on their own account must expect some hesitancy in placing orders, if any hint is given that the client comes in second.

The conflicts of personalities are seen most where the broker forgets he is often put in the role of adviser to advisers which is slightly different from telling Widow Brown to put her savings into fixed interest securities.

Conclusion

Assessing the merits of brokers is not as difficult as assessing the merits of the two major political parties in Australia, but just as a Government loses rather than wins an election most brokers lose rather than gain clients with their agency services.

Not having a Research Department is a negative factor, but the provision of Research facilities is not always a plus just because it is there. Quality research produced specifically for the institution is the major way to win friends and influence business.

No institution can say no to money making opportunities for his firm. Participation in capital raisings is the key motivator of new business and is especially important for brokers trying to break into the institutional field.

But above all personalities on both sides can make or break the contact. In this regard business getters, who are strongly research or operating oriented, would do well to accept that judgement developed from long experience in the industry and from technical and analytical training is not the prerogative of brokers, or their staff.

Brokers, then, are given business, more often than not, in accordance with the benefit the institution receives in return for its business.

QUEENSLAND PRESS LIMITED

By H.G. Belcher and G.N. Davidson

(Queensland Branch of the Society, March 1972.)

Activities

Queensland Press Limited dominates the Queensland newspaper field through the daily Courier Mail and Telegraph, and the weekend Sunday Mail. The company also owns or has interests in various country and suburban newspapers, as well as a 28% interest in Brisbane T.V. Limited (Channel 7), and a number of radio stations.

The Herald and Weekly Times holds 40.45% in Queensland Press, which in turn holds 4,034,247 Herald and Weekly Times shares as well as shares in Advertiser Newspaper Limited (Adelaide), Davies Bros. (Hobart), and Australian Newsprint Mills Holdings Limited.

Metropolitan Newspapers

The publication of the three Brisbane newspapers forms the back-