BlueMatrix Research Roundtable 2011
Presentation summary
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While similar in structure, this is not the text of the presentation, but rather a compilation of the ideas included in it, along with links in this color that provide additional content. It is written as if delivered to a representative of a sell-side firm. There were no slides used during the presentation.

The Ecosystem of Research Information is Changing

The world of investment research is evolving rapidly and your research methods and communications need to be revamped to add value for your clients. You have generally viewed your research competition as other sell-side firms. That's *not* your competition. The game has changed.

My comments to you are primarily related to research reports, since that's where some of the most notable adjustments are required. However, there are other aspects of your firm that will need to be reworked as well.

I informed some people that I was going to be speaking on this topic and asked for any comments they might have. One said this: "I know that I find so much information out there from so many different sources that I rely less and less on the sell side and my Bloomberg terminal." He said that "professional blogging and Twitter feeds have made a big impact" and added that the amount of information directly available from companies has also changed how he works. Video feeds, presentation materials, and conference calls are now given directly to investors large and small. Transcripts are a great example—they used to be hard to get and expensive. Now they are easy to find and often free.

Another investor said, "The Internet has already killed the newspaper in many ways; it is chipping away at more restricted information flows, such as securities research."

There are new sources of research coming into play all of the time, with a variety of distribution methods and cost structures from free to very expensive.

The number of firms now tracked by Integrity Research reaches into the thousands, with all asset classes and other types of research represented, although my comments from here on are specifically oriented to equity research.

In addition, the finance blogosphere has exploded, with many high-quality analysts making some part of their work available for free. Take, for example, Asymco, which features postings about mobile computing and technology. It often has a different spin on developments in that area, uses graphs in inventive ways, and may provide a poke at the Street now and again too. There are also great sites that have functional specialties that aren't dealt with regularly in sell-side research. Footnoted specializes in finding information in the fine print, for example, something of a lost art these days.

Each of those sites makes money in other ways, Asymco via consulting and Footnoted by way of a paid site in addition to the free one. Those are common approaches for other researchers too. An ecosystem is developing where there are industry and functional specialists coming to the fore, providing free information plus other services. As that continues to occur, sell-side firms are at increasing risk of becoming marginalized.

In addition, there are many other sites and developments of note. The quality range is, as you can imagine, from excellent to laughable, but it's no longer the case that you can assume that what's widely available is not "professional grade."

There are many single-person blogs of note, delivering interesting and timely information. There are platforms like Seeking Alpha that aggregate the work of thousands of writers, private venues like SumZero, and social vehicles like StockTwits that build on the power of Twitter. (That site and others are also remaking the world of investor relations.) There's a crowd-source estimates site that will be starting soon, others on which you can easily play with fundamental assumptions to do scenario analysis, and on and on.

The below-the-radar rollout of Bloomberg Industries also bears watching. While not "free" to all, it's an incremental service available for free to those with a terminal. Bloomberg has built a sizable staff of analysts and has a massive database with great charting capabilities. Is that enough competition for you?

I could go on, but let me come at it from a different angle. Have you heard of Carson Block? [Of the attendees at the BlueMatrix event, two people raised their hands in response to that question. For a graphical look at Block's Street-smashing work and comments on his rise to "influential" status, look at this posting I wrote after my presentation.]

In the brokerage industry, there is a lot of buzz about social media. While there are rules to learn to be in compliance and some promising long-term opportunities, the hype over it is misplaced in comparison to other challenges for sell-side research that should get more attention.

There are, of course, distribution issues that need to be dealt with, including what platforms to be on (both in terms of the intermediaries that host research and the devices on which it can be read). More important is whether you want to tightly lock down access to your research in the future or to figure out how to accommodate the changing information environment and make some of your work more freely available.

First, there's a bigger question: How do you rethink the research that you create now?

You may have come into the investment research business ten years ago or thirty years ago. Since then, we've had a communications revolution, digitization has destroyed entire industries, the investment business has new players, there are more research providers with new channels of distribution, and investment information has gotten more democratic and more social.

What has happened to sell-side research reports during that time? Nothing much. How is that possible?

Pixels have replaced paper, given the move to PDFs and electronic distribution. The reports themselves are essentially frozen in time, structurally very similar to what they were before and not taking advantage of the technological capabilities that are available. The defining changes have been that reports are shorter and graphics have gotten worse not better.

"But we're regulated," you might say. I'm neither a lawyer nor a regulator, but I know the research industry well and believe that is not an excuse. How much is convention and tradition versus regulation?

What would you do if there was no regulation? That's your competition. Now figure out what you *can* do given the regulations that are in place. There's much more that you can do and should do. The clustering of research output and methods in the industry might make some sense in a closed world, but not in the open one of today. It is a prescription for obsolescence.

So, which firm or firms will finally do something different? What will it be?

The obvious place to start is with the design and content of the written reports. First up is the effective use of graphics. Most Street reports feature substandard graphics if they are included at all. Cut-and-paste efforts from analysts who don't understand data visualization are equivalent to what you might find from undergraduate finance students.

The graphics don't have to be fancy necessarily, just good at conveying worthwhile information. Why has Ed Hyman been on the top of the charts for so long? He takes a simple graph, draws a circle around something, and writes, "Watch this!" It is amazing that not very many others have followed his lead.

There are so many angles to the creation of good reports, from having the right "look" to enforcing some quality standards as to the presentation of information. A report should make the critical factors and differentiating aspects of an analyst's work crystal clear, yet many don't. A large percentage *do* have an earnings model with many columns, small type, absolute values instead of indexed or common-sized ones, no highlights of the key fundamental drivers, and some even use center justifications of values, which make them much more difficult to read. All of those choices lower the probability of the client getting value from the report.

In considering potential changes to research reports, a more dramatic approach would involve getting away from the focus on "the big three" of recommendations, estimates, and target prices. There are surveys done by a variety of firms that try to measure what investors want from sell-side firms. No matter the methodology, "the big three" usually come out at or near the bottom in importance. Yet, that's where the focus is.

Thus, there have been more than five hundred academic research studies about analysts, basically all regarding those metrics. The perception of sell-side research in the public eye is driven largely by the failures of analysts to play a game that their real clients don't even care much about. Instead of being the "expert network" for professional investors, as one portfolio manager described what the Street should be, a lot of time and effort is spent on the wrong things.

So, could it be that some shops would start to approach research differently, by de-emphasizing or eliminating or changing their approach to "the big three"? There are lots of players in the new world of research that add value without worrying about such things. Perhaps a traditional Street firm will rethink that model some day. Interestingly, since certain regulations are triggered by the presence of recommendations or target prices, the regulatory burden would change as a result.

To reformulate research successfully, you have to ask some basic questions:

Who is the audience? Portfolio managers or analysts, growth or value, big firms or little ones, traditional shops or alternative ones, institutional investors or retail investors, and for what time horizon? A "buy" is not a "buy" for all anyway, which is one of the big problems with providing ratings. The situation demands customization, adaptability, perspective, and an acknowledgement of the complexity of the information environment, while the sell-side model for reports amounts to "one size fits all."

How do you add value? How *can* you add value? Good research should be representative of the firm and the analyst; most today is virtually interchangeable from one firm to another.

What's the purpose of research in your business model? What will it be five years from now, given the changing ecosystem?

How can you stay relevant?

You might feel that your reports are just fine as they are, that "this is what the client wants." To that, I would say a) I don't believe it, b) you haven't tried anything different, and c) they are getting information elsewhere, in essence voting with their feet.

In any case, it's worth considering the philosophy of the most admired leader of the last ten years—Steve Jobs. [That's not just my interpretation; it was the answer of the attendees at the BlueMatrix presentation.] He famously said in regard to developing products, "It's not the customer's job to know what they want." The consumers of your product, with rare exceptions, will not help you one bit. They are wholly unsuited to the task. But, as with the purchasers of iPods and iPhones and iPads, they will respond to something that is different and useful.

So, you need to create research that represents the unique nature of your firm, including your decision processes and those things that differentiate you. It must help clients to make good investment decisions and be positioned to reflect how information flows are evolving.

To produce research that will be noticed, you'll probably need to make changes in your operating structure too. The roles of analysts need to be re-imagined and members of the support staff must become experts at guiding the production of attractive and effective materials.

Given the rut that sell-side research is in compared to the vibrant ecosystem of research outside of it, these ideas might seem bold indeed. But the firms that succeed going forward will need to be bold to compete in a different world.

There are big changes going on—and you can't avoid them.

Written October 1, 2011 from notes for my BlueMatrix presentation on September 22.

For more writing on investment research, see the PDF guide to **the research puzzle**.

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