QUINTAINANALYTICS

RESEARCH SERVICES' CONSUMPTION & COST; FINDING THE HIDDEN VALUE IN A DELUGE OF DATA

This is not another "demise of the sell-side" article

Since the introduction of MiFID 2 in January of last year, there have been many pieces written by journalists, industry practitioners and other experts on the impact for both buy-side and sell-side professionals. Much of what has been written focussed on shrinking sell-side research budgets, the hit to IRPs, the exodus of research analysts and the general implosion of parts of the industry.

What is evident over this period is that there is frustration from both sides and the true impact of MiFID 2 and how it impacts the industry will not be seen for some years to come, however, there is still an important dynamic at play. Buy-side firms continue to seek accretive service from their research providers and, as both adapt, what does it really mean for the cost of research services and future negotiations.

The path of least resistance is the one most trodden

Over the course of the last two years significant changes have been seen. The sell-side, who are struggling with lower research budgets, are continuing to assess the worth of individuals who are still on their platforms (some have left willingly taking refuge at IRPs or headed into corporate IR roles; others unwillingly as firms make changes to their analyst roster). Buy-side firms are being forced to think harder on how to spend valuable research budgets to get the most accretive service and justify to either their CFO or investors on this cost.

In reality both sides have taken a path of least reistance to achieve certain goals which has direct implications for both data integrity and the value of research services in particular;

- Sell-side professionals are still perceived to be more valuable driven by the amount of interaction data inputted in their internal Client Relationship Management (CRM) system as data showing interactions is a well used measure of productivity. Their path of least resistance comes from not wanting to hightlight, and draw attention to, potential dwindling demand for services from buy-side professionals and to just keep logging interactions regardless of accuracy (creating a sense of worth, and thus job security)

- Buy-side firms chose to take in and rely on sell-side interaction data as their preferred source of price discovery and on-going research cost management alleviating the need for investment professionals to do anything outside their core role of seeking fund performance and as such, take the path of least resistance. The sell-side data was deemed to be comprehensive enough and given very few buy-side firms had adopted technology of their own to register these interactions (or if they did is was using basic Excel spreadsheets) seemed like the obvious route to follow

This has resulted in a data collision with the sell-side sending exhaustive and at times questionable data sets and the buy-side struggling with a data deluge in an effort to manage their research costs.

Validating research interactions – seemed so easy right?

Buy-side firms have used sell-side interaction data for many years, with the larger, global players using it for vote-related purposes. As such, sell-side firms were incentivised to throw everything they had at the buy-side (more services equals more value?), emphasising the breadth of the waterfront servicing model.

This made it difficult for buy-side investment professionals to indepedentally remember much about the services received over a vote cycle. Sell-side data was used as one way to measure part of this, at times more from a intensity and consistency basis, versus quality.

As we entered the post MiFID 2 world there was a scramble by many other buy-side firms to use sell-side interaction data as their way to ensure they had something when it came to price discovery for research agreements. Many of these firms assumed their investment professionals would validate their interactions to ensure there was a "match" between services the sell-side said were provided and actual services received.

What they didn't count on was the general lack of validation given investment professionals' usual time pressure and impatience with new technology and process. What they have been left with is a one dimensional sell-side view of services consumed which is frustrating for those with the responsibility of having to manage research agreements and the overall process.

Can someone help me understand what an interaction tagged "Other" is?

Tasked with the up-hill challenge of working through a one-sided data set of unvalidated interactions, buy-side firms set about trying to spot check the integrity of sell-side data to at least get some confidence in it. What they found shocked many but on the sell-side it is normal operating procedure.

There is no consistent industry standard CRM system that the sell-side have adopted, with many of these systems implemented over a decade ago. Most are custom in-house builds, and what one firm defines as a certain type of interaction often differs from another and in the absence of a category that fits the interaction, "Other" is usually the default choice. Many buy-side firms are now rejecting interactions tagged as "Other" however, the more widespread data consistency problem comes from how a sell-side analyst or salesperson marks interactions - a voice mail can be marked as bespoke request; an invite to join a conference call could be marked a bespoke meeting.

Essentially what an individual sell-side user determines is the right category of an interaction the buy-side is stuck with, unless they have a better way to constantly validate it.

Many buy-side firms have chosen technology vendors to help aggregate and "normalise" sell-side interaction data. In practice though, none of these vendors have the ability to standardise how these interactions should be tagged by the entire sell-side universe (even though there has been an effort by the industry to do so) which again passes the responsibility back to the buy-side firm to sift through the data deluge and try to make sense of it.

In short, sell-side firms are using their own data to price their services. Unless the buy-side can validate it, proper price discovery and ongoing research negotiations will be challenging.

It only takes one bad apple

Not all sell-side data is of poor quality and many firms have sent their staff back to CRM training to ensure accuracy. However, most firms will struggle to produce high quality, clean data, given;

- Volume will still be the name of the game as it demontrates utilisation of employed resources. With the battleground getting fierce for sell-side firms, especially given falling research budgets, staying relevant has increasingly become a game of numbers. All buy-side firms will argue 'value over volume' but when many have signed all inclusive research agreements, sell-side analysts will have a hard time arguing internally that one quality call a quarter is more valuable than a bunch of voicemails over the course of a week. We all know this to be true but in reality, the sell-side has not set up an incentive scheme that way and changing that behaviour will be an uphill battle. But why would sell-side firms want to change this given many charge out voicemails as part of research services

- Small- to mid-size sell-side firms may not have the same level of sophisticated CRM data systems, especially in emerging markets, so getting them to comply with interaction data requests is sometimes not possible

Understandably, questions continue to be raised about the integrity of sell-side data sets.

Now is the time for primary data

Last year was a year of discovery for most and the reliance on sell-side data alone, especially given the lack of participation and validation from investment professionals, has sent many buy-side firms back to the drawing board to establish a core primary data set to work with.

As a simple start point a primary data set can help at least validate the sell-side data and give firms the ability to really scrutinise their research costs more closely.

A far more complicated and important point is how regulators will view the buy-side's existing practices around price discovery, especially all-inclusive research agreements. Some recent reports argue that these "all you can eat" models could actually be considered non-compliant under the regulator's inducement rules unless a precise breakdown of the actual price of research services (all foms, not just content) and how that price was arrived at, can be provided. Relying on sell-side data without any form of validation or attribution of value will make it difficult to justify costs unless a more systematic way to capture primary data can be adopted.

The truth is out there

If the sell-side could focus squarely actual services provided and tag them appropriately, and the buy-side recognised these as accurate interactions, we could just find a version of the truth which would ultimately set what is the right price for research interactions. It would also help the sell-side to focus more on value-add services knowing this is what the buy-side will be happy to pay for.

But that day appears to be a long way off and in the interim the sell-side data deluge will continue.

How Quintain Analytics can help you

Our focus is on creating primary data sets for buy-side firms which can be used to validate their sell-side interactions. As a standalone system or working complementary to existing data capture processes, our unique user interface requires little to no work on behalf of the investment professionals and when combined with our sophisticated databases, we provide buy-side firms with solutions to help them navigate their way through both the new regulatory and research cost management environment.

For more information of our products and solutions or to discuss more of the content in this paper, you can reach us below.

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