reviews by property managers of investment problems should continue, as these have proved to be of considerable benefit to all those participating.

**General**

During the year institutional investors have occasionally been criticised in the Press and elsewhere for their alleged failure to improve the management performance of the companies in which they invest. Those making these criticisms are evidently unaware of the beneficial influence already exercised in this respect by institutional investors in the pursuit of their normal investment objectives. Competition between offices in the search for investment outlets, and the function of the market in channelling finance to the most profitable units within an industry, in themselves provide a recognised stimulus to efficiency.

The committee has always been prepared to resist malpractices in the administration of companies, but insurance offices are not equipped to conduct a continuous efficiency audit of all the businesses in which they invest, nor can they hope to be experts in the complicated techniques of production, etc. Where there have been shortcomings of management it is essential that any necessary reorganisation should be carried out with the minimum of publicity if the credit of the company and the market value of its capital are not to be needlessly harmed. For this reason the committee does not publicise its activities on the occasions when the intervention of offices is required. It prefers to assist rather than to harass management in the solution of problems confronting their companies, and a worthwhile degree of co-operation can be achieved only in an atmosphere of mutual confidence.

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**ARE RESEARCH DEPARTMENTS OBSOLETE?**

by J. R. FROST, B.Com.(Econ.)

**Purpose and Scope of This Paper**

Some critics have questioned whether or not, under present conditions (1970), medium or smaller broking firms or institutions are achieving economic results from their Investment Research Departments. The point is made that such departments can only be justified on economic grounds if they have as their major objective the gathering and dissemination of investment information rather than the search for investment opportunities. The purpose of this paper is to investigate this claim.

To assist in this discussion it may be useful to define the terms used above.

**Investment Research Department**

The major function of this department is normally accepted to be the selection of securities for investment by the firm’s clients. This is usually effected by using fundamental and technical analysis techniques, economic research, and by interpreting market data. More often than not the initiative in making investment recommendations is taken by this department. In fact, in many firms the investment advisers or sales staff are not encouraged to make recommendations outside those approved by the research department. Typically, the department is staffed by highly qualified people, who are trained in economics and/or accountancy and who command a generous salary because of their analytical abilities and their experience in this type of work.

**Investment Information Centre:**

The major function of this department is the gathering, sorting, classifying and dissemination of investment data. Interested parties are able to call on this department to supply investment information to assist them in their private analysis of selected securities. Buying and selling recommendations are not usually a part of this department’s function, although it would be expected that any special situations noted by the department would be brought to the attention of the firm’s principals. This department has a supporting role to the firm’s sales activities. Typically, the department would be staffed by people skilled in librarian and information retrieval techniques. A well established organisation may use the facilities of a computer for this type of work.

**Assumptions and Definitions**

This paper is only concerned with the operations of small and medium size broking firms and

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**CONTRIBUTIONS**

Members are advised to address all contributions to the Journal to

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The Australian Security Analysts’ Journal
institutions. Although by no means the key criteria, for sake of simplicity medium size is here defined as a firm which employs between 60 to 120 people.

Measurement of performance by the firms under study is usually based on total revenue rather than on return of investment, that is turnover rather than net operating profit.

Cost, not profit responsibilities, are delegated to departmental heads. Where this is so the Research Department would be at a performance disadvantage to other departments, including an Information Centre.

The environment is the 1970's and one in which short term investment and speculative needs of the firm's clients are just as, or probably more, important if turnover is considered than long term investment and income needs.

Problems

Objectives of the Research Department are rarely, if ever, clearly defined. In many firms this would be vigorously denied, but only vague generalities are offered when challenged, such as, to highlight special situations, to service clients, to stimulate advisers, etc.

Without clearly expressed objectives there is no real means of measuring the performance of the department. Where goals are stated clearly, then performance yardsticks, such as the number of annual reports analysed and reported upon, the number of company or industry studies completed, the number of company and field visits made, the number of circulars produced, the number of successful investment recommendations made, etc., over any given period, could be used. But the true measure of performance is return on investment; however, it is not within the scope of this paper to present detailed analysis of objectives. It is sufficient to point out the need and to give some illustrations of what is understood by the term.

The major problem, therefore, facing the average Research Department is its inability to prove results in terms of contributing to the group's profitability. The reason for this can usually be found in management's lack of real involvement in this department's activities and a lack of understanding of the department's hidden profit potential because means of measuring performance are inadequate.

The same problems, such as clear statements of objectives and measurements of performance, will exist whether or not the firm uses a Research Department or an Investment Information Centre. In the second case, however, the department can legitimately be viewed as a cost centre and, therefore, by setting expenditure limits its performance can be more easily measured. The Research Department, which is often responsible for increased sales revenue as well as providing investment information and other supporting facilities, is not as easily measured.

In a boom market fed on rumours it is usual for an investment firm to receive speculative investment information from its clients and outside contacts and for the Research Department to vet this information. Unfortunately, too often speed and lack of supporting data precludes proper assessment. Rather opinions given quickly and orally backing up the rumour are more likely to be requested than a searching analysis which might highlight the risk factors. Under such circumstances the initiative is taken from the Research Department.

These days most advisers feel they are skilled in research techniques and are often loathe to accept directions and recommendations from the Research Departments. To them the need is for support to handle volume rather than to produce quality investment advice. With advisers desiring to make their own recommendations and doing so a major reason for the research effort ceases to exist. What is left are exercises which are normally time-consuming and which can be done more efficiently by semi-skilled staff.

Alternatives

Where the department is functioning as a public relations or advertising section, or is used deliberately as a prestige gimmick, or is a managerial ego outlet, or is used as clerical support for the sales section, there is some justification for its existence. Nevertheless, even in these areas a spade should be recognised as a spade even if it is not called so.

The enormous duplication of investment effort which usually results through the proliferation of so-called Research Departments is an economic waste. Quality investment information is available from specialists who normally concentrate their resources in one or two major result areas, such as fundamental, technical or market data analysis. There are organisations which can produce security analysis in depth, company reviews, portfolio valuations — more and more a Research Department function — bar charts and other technical and market data, and other basic research. The cost of using these services can be relatively inexpensive, and certainly economical.

Portfolio managers who wish to achieve outstanding performance concentrate their investments in a small number of select securities. In the same way the Research Departments of the medium and smaller investment firms that concentrate their efforts in those areas in which they excel should outperform those firms which spread their resources thinly over many areas of research. The principle of concentration explains the excellent performance of the few investment firms who have cut their cloth to suit their pockets.

Perhaps the best solution to the problems highlighted in the foregoing is to re-direct the emphasis away from investment selection by the department and towards provision of investment information. In many firms this would only involve the changing of the name of the department and the transferring of qualified personnel to the result areas of the firm. The work being done by security analysis could be handled as efficiently by trainee undergraduates, librarians and information retrieval experts.

Unless the firm is really serious about original and basic research and investment selection using accepted security analysis techniques, those supporting the Information Centre approach appear to have some powerful arguments in their favour if return on investment is the final criteria.