ON DEALING EQUITABLY WITH BROKERS

By Xerxes Y Zorba

"We take offers from anybody"

institutional operator

Introduction

Once upon a time in a clearing in the deep, dark forest there lived a big, old stockmarket which was getting bigger and bigger. The big, old stockmarket was very alluring to the institutional operators who lived in the sunshine outside the forest, but to get to the big, old stockmarket they had to venture through the dark forest.

Now, in the depths of the forest lived many stockbrokers lurking about amongst the trees, waiting to catch an institutional operator. Some had nice big friendly smiles, some had exciting stories, some had appetising picnic baskets, and some alas, had nothing.

This was all very frightening to the newest institutional operators and when they were caught in the forest they would stammer "We take offers from anybody", "Send us your exciting stories" and things like that, just to escape the clutches of the lurking stockbrokers who wanted a piece of the cake the institutions baked on the outskirts of the deep, dark forest. And things were so nervous that the stockbrokers lurked harder and harder, and the institutional operators had to admit they really did not know what to do. When the cake was cut there was such a fight over it that sometimes, the best stockbrokers got none, or only a few crumbs, and some of the hardest lurking stockbrokers would run off with almost all of the cake. And the poor newest institutional operators just got nervouser and nervouser and that was not very good was it?

Some of the older more experienced operators though, did not find their trip through the forest frightening at all; they just looked the stockbrokers in the eye and asked "Why should we give you any of the cake?" and "What have you got to offer?"; and then the stockbrokers would behave themselves, and if they were good and did what the institutional operators wanted they got a nice piece of cake and everybody was happy. The institutions got what they wanted and the stockbrokers could stop lurking about in the forest and get on with doing their proper work of attending the stockmarket.

Is it not a pity that the very newest institutional operators and the lurking brokers could not get on like sensible people? But you see the main communication with the brokers and with the big stockmarket is cake and you will remember what the shining Knight said "the power of cutting a cake is frightening and the absolute power of cutting a cake is absolutely frightening".

- a Sydney Stock Exchange fairy tale -

Do institutions really know what they want?

My old friend Xavier Y. Zacharias writing in August's JASSA gave readers a good insight into how some institutions view brokers. All of my broking friends with whom I have discussed the paper thought it was a fair commentary, but one institutional operator thought it was "rubbish" and another thought it "very wide of the mark". Which only goes to show that if you become accustomed to being wooed by brokers then as with a woman who is being pursued you can be as fickle as you like. The only snag is that you may make some bad friends along the way and end up with a poorly equipped partner (broker).

Do institutions really know what they want? A few do as I shall shortly reveal, but as to the others I am compelled to say no they do not.
Attitude, Background and Performance

Some of our leading institutions have taken the trouble to measure their performance as money managers. How can this be done? Obviously you have to know what you are managing and some will say fixed interest securities, others real property investments and yet others will say shares, or a mix of all three. How do they perform? One gets a 7.1 per cent yield on his fixed interest portfolio and has an interesting yield curve. Another will proudly point to his understanding of his latest property lease-back complete with escalations, participations and anti-inflations, whilst an equity portfolio manager may reply in terms of the number of bonus issues, percentage capital rise above base or yield on cost.

What does this all mean? I must admit the belief that some desire above all to be appreciated as oracles of the latest trend in financial mumbo-jumbo than as demonstrably effective managers of money.

Of all the money managers those who most clearly should know what performance is required of them are the life company and general insurance companies. They know from their actuaries what performance is required to meet the insured risk and create an actuarily acceptable surplus and their general managements know the cost of lost policy sales if they are not competitive with other companies in terms of investment performance.

Others may choose to compare their performance with the Sydney All Ordinaries Index or the overall performance of competing companies and funds. But why does one company believe it needs sixteen analysts and another believe it needs none?

In the field of equity management why does one company subscribe to S&L and another do all its own investment calculations? Why does one company deal with any stockbroker and another deal through an irrevocable panel of only a few brokers?

Some of the answers to these questions lie with the boards of directors, some with general management and most with the practising fund managers and analysts.

A typical investment manager today may be in his early thirties. He is almost certainly a graduate probably in economics or accountancy, or both. Very probably he did his degree part-time whilst he worked at some more menial task in a large organisation. Almost certainly he started his career in investment as a junior analyst or clerk, in an investment department and gained his reputation for writing reports, dabbling in shares on his own account and his ability or lack of it to expound the conventional wisdom.

Others in JASSA have written of the inherent insecurity of occupation brought about by traditional accountability for mistakes and rarely, if ever, the awarding of marks for success. Such an environment it has been said does not encourage performance.

Performance is a function of the investment manager's ability to assimilate the various investment service inputs to allow his decision making processes to have some chance of being informed. This statement is in contradistinction to the widely held myth that performance is a function of some inherent, intuitive sixth sense.

What of the investment service inputs and do brokers form part of them?

Investment Management Paths

To coin a phrase simple paths through the investment jungle are said to be covered with traps. To be sophisticated one must presumably be abstruse lest others discover what a simple fellow one is.

Rather than be placed in the position of information overload so alarmingly described in "Future Shock", surely there is scope for institutions to plan their investment strategy and select the information and services they require. No well run business is without a performance goal, a budget and a review of management performance but do investment institutions admit to performance goals, budgets and management reviews?
For all the problems associated with investment goals some institutions do have them, if only as a desire to beat a Stock Exchange Index. A few are critical enough of their own performance to take effective internal steps to improve it, but most unfortunately, grind along a well worn if abstruse path ready with nitpicks about company management's and brokers' shortcomings.

Without laboring the point, institutions really owe it to themselves to know what they want and having decided that and whilst retaining an intelligent flexibility should be prepared to say what they want especially to enquiring brokers.

Assessing and Improving Services

Without going as far as Xavier Zacharias did with this comments on brokers and dictating precisely how institutions should conduct their business the following observations may prove helpful to them.

For many years institutions have criticised the wasteful trend toward incessant and tedious recalculation of financial data both by themselves and brokers. Yet, what support have they given a first class service like the Sydney Stock Exchange Statex Service which still has only some 20 institutional subscribers out of about 50 in total.

A constant complaint about brokers is the poor quality of published research and other services. Yet, any member of the Society knows of excellent work that has failed because the broking analysts were not 'marketing orientated'.

Readers amongst institutional ranks particularly, will view with disbelief the fact that a few of their competitors will frankly tell a broker what they want, will encourage better work and maintenance of good service by informing him that his efforts have resulted in him being awarded a stated percentage of their business. Also, they are prepared to tell him if he is employing himself wastefully where they are concerned, and suggest remedies!

The result is that their brokers can get on with servicing and cut down on woeing. How strangely this contrasts with the institutions who classically reply "send us your investment material, floats, sub-underwriting, etc.", "offer us stock" and "keep in touch".

What a broker needs to know so that his services can be improved (and the same goes for non-brokering investment services) is whether he has any chance whatever of doing business, under what specific conditions he would be entertained, how long a trial period he must endure and a knowledge that his shortcomings or excesses will be frankly discussed with him.

All too often the work of years in building up acceptable service is set at naught by a cowardly institutional operator who takes the easy way out by taking the next cab in the rank without explanation. One needs as a broker to be a masochist to enjoy finding out what went wrong.

Broking Practices are a Mirror of the Investment Environment

This sub-heading warrants a second look as it is a statement in contradiction of the conventional belief that all stock market practices, vogues, mining booms, etc., are conspired at by the broking profession. One needs to be a practised apologist to draw converts to the idea that the Securities Industry is a service industry and not a manufacturing one, but is it not a fact?

Institutions have such a large and increasing influence on brokers and stock markets that they have a very real responsibility to encourage higher standards rather than connive at the breakdown of the long standing efforts of broker professionalism.