The changes that have taken place in the stockbroking industry in the five years since deregulation began have been truly remarkable. What is at least as remarkable is the radical reshaping that still lies ahead. The demands of keeping up with the coming decade of change have set the form of an industry that will bear little resemblance to that of the past - or the present.

Before detailing a view of the industry during the 1990s, it is worth looking back at the development of Australia's stock exchanges and their role in the financial system.

The fundamental purpose of the stock exchange is to provide facilities for the maintenance of a fair and fully informed stockmarket - the marketplace where securities issued by companies, trusts, governments and semi-government authorities are bought and sold.

The stockmarket encourages the flow of savings into productive ventures and enables investors to convert their investments into cash at any time or to re-allocate their savings to securities which best meet their needs. An active and efficient stockmarket helps to ensure that funds are available not only to established companies with prospects for further growth, but also to smaller businesses which might want to expand beyond a limited private or family environment.

The Australian Stock Exchange Limited came into being on April 1, 1987, with the amalgamation of six state exchanges with histories of a hundred years or more. The move was, in part, a response to the pressures of international competition and the information technology explosion of the eighties. Financial information is now instantaneously available from all around the world and can be sorted and used by anyone with a personal computer and the appropriate software.

Computer technology is also threatening to change forever the traditional stockmarket trading floor as institutional dealers install terminals for systems such as SEATS (stock exchange automated trading system) in their offices.

Until recently the providers of information technology were the servants of the stock exchanges. Now they are looking to become players in the marketplace. Instinet, a service of Reuters, has applied for an exempt stock exchange licence. If it is successful, Instinet will be able to create a second market by offering clients bundles of information and dealing services at attractive prices.

The pooling of the six Australian exchanges' human and financial resources was an effort to meet this competition. Among the ASX's priorities are two immediate challenges.

One of these is the development of automatic order-execution facilities along with, but separate from, stock exchange facilities. The demand for this comes from institutions which want to trade with institutions which have histories of a hundred years or more. The move was, in part, a response to the pressures of international competition and the information technology explosion of the eighties. Financial information is now instantaneously available from all around the world and can be sorted and used by anyone with a personal computer and the appropriate software.

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One of these is the development of automatic order-execution facilities along with, but separate from, stock exchange facilities. The demand for this comes from institutions which want to trade

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Sydney's exchange trading floor. SEATS has brought changes – and even more revolution is ahead.

through screens in their own offices, or at least to get enough information from their screens to enable them to deal outside the central market.

The other challenge is the prospect of a leakage of trade in major stocks to foreign markets. The Australian exchange had not been challenged, until recently, in the field of clearing and settlement – but now it finds itself far from free of international competition.

One of the greatest influences on the industry will be the introduction of a paperless settlement and scrip system, which should dramatically reduce the brokers' back-office costs. The exchange needs to meet this challenge head-on. It has made a start with the pilot FAST (flexible accelerated security transfer) scheme but much remains to be done.

**Challenges for broking**

Three emerging trends in stockbroking spell out a challenging future for the industry:

- Broking is not profitable for most firms;
- Corporate ownership has changed the culture of the players; and
- Computer and communications facilities will end the nature of exchange trading as we know it.

Turnover figures for the ASX go some way to explaining why broking is not profitable for most firms. During the bull run, daily turnover averaged more than $400 million and topped at $600 million, giving an equivalent annual running rate of $120 billion. In the past financial year, the value of shares traded fell by 27 per cent to $49.5 billion, giving an average daily turnover of $195.6 million. This compared with $269 million in 1987/88 and was below the $200 million regarded as the break-even point for the stockbroking industry.

In 1985 the ASX member organisations numbered 105, employing 3,897 people and achieving a turnover of $16 billion. In 1989 there were 104 firms employing 6,023 people with a turnover of $49.5 billion – and they were dealing with the full effects of deregulation.

Despite strong economic growth (demonstrated by the 36.6 per cent rise last year in net earnings of the companies listed in the All Ordinaries Index), investors have become defensive and cautious about markets. Even the most bullish observers talk about shares as a reasonable long-term investment.

The figures on equity turnover and employment levels in the industry paint a somewhat different picture. The figures also suggest that the slump in the market is only one of the reasons the industry has been finding the going hard. Archaic back-room operations, burgeoning overdrafts, inadequate screening of clients, excessive dabbling in futures and options markets, and the practice of firms greedily holding on to part of the action in company floats and underwritings, are other factors to blame for the present troubles of the industry.

Australian stockbrokers need to clean up their back offices.

The industry is one of the most inefficient in the world. The infrastructure, where settlement is manually intensive and flooded with paper, imposes this inefficiency. Back-office costs cannot be reduced in this outdated environment. The infrastructure must be abolished and replaced with an automated system.

The industry is estimated to have chalked up losses of more than $100 million in 1989. With 104 broking firms in the field, and fewer prizes to be won, only the tough and lean will survive today’s overweight broking community.
Only those with efficient back-room operations, manageable overdrafts and a tight rein on wages and rents will cope on today's turnover.

The industry should have rationalised in 1984 with the advent of deregulation but the process was delayed by the boom and the entry of outside ownership. Without the capital which came into the industry in 1984, market forces would have forced much more rationalisation. There would be fewer brokers now and the industry would be suffering less.

Degregulation brought the theory that there were two roads to success: a broker had to build a large integrated house offering all things to all men, or become a specialist. At best, the integrated-versus-niche view has been proved to be far too simplistic.

Corporate clients do not want an integrated approach. They want independent and competitive advice. Institutions have not based their business on price alone, as had been predicted. Instead, they want research, dealing relationships and the inside running. Private clients, by contrast, want cheaper service than they had been offered – and the brokers have found them more expensive to deal for than expected.

Before the abolition of fixed commissions, brokers' institutional business had subsidised their retail operations. This did little to encourage a cost-conscious management of private-client departments or a much-needed investment in up-to-the-minute settlement systems to cope cleanly and cheaply with new volumes of business. When institutions started to negotiate commissions, so ending the cross-subsidies, brokers woke up to how much the retail business had been costing them.

Although technology favours smooth, 24-hour trading, clients – who are the real determinant of business – do not. For this reason, no foreign security house has so far really penetrated the Australian domestic market. But it is a danger for the future.

The message that can be drawn from this is that, among the large houses, only those whose parents have stout hearts and deep pockets will survive. Since April 1, 1984, we have seen a rapid reduction in the number of independent firms and, with it, two fundamental changes.

One was the ending of the partnership and the transfer of the business to corporate bodies. Managements were no longer the partners, bearing the losses of failure and the profits of success. The new owners were from highly structured backgrounds, with well-tried organisational policies, which they had introduced to what were formerly largely unstructured and entrepreneurial partnerships.

The new corporate culture is under pressure. Many firms are struggling to accommodate it and to create effective profit-making motivation. People can no longer aspire to a partnership; the potential for gaining equity and profit-share is severely restricted; their own responsibility and entrepreneurial potential is similarly limited.

This has resulted in many firms losing their drive and entrepreneurial spirit. Brokers are by nature risk-takers who actively capitalise on risk; banks' strategy is always to minimise or remove risk.

While the market and the brokers were making money, the cultural difference was not so apparent. But in continuing lean times, the new corporate owners are keeping the firms on tighter reins. (However, many individuals find the corporate environment, with its more disciplined approach, more suited to their needs and more able to nurture their skills.)

The second fundamental change is the growth of high technology in the stockbroking industry.

The successful firms of the 1990s will be those which begin now to put in place strategies which will be relevant to the conditions of this decade – not to the troubles of the 1980s.

Technology will have come of age by 1995. The problems which beset firms today and the pain of developing dealing systems will be forgotten. Automation of markets and functions, both at home and internationally, will be universally accepted. More significantly, the industry will be on the threshold of the paperless office. The back office's settlement problems will be replaced by a fully integrated system for stock and money companies with most stock holdings in nominee companies.

How will today's broking firms evolve to meet the challenges of the 1990s?

I believe we will see the advent of structured securities industry comprising three sorts of brokers:

First, there would be the securities brokers who would be the central funding operators for the industry. They would handle the clearing-house operations and would hold all holdings in nominee companies. Securities held in nominees would form the basis of all their stock borrowings and lendings, and would also provide cover for their funding of client loans and market transactions.

Second, we will have operating brokers who would act, in the main, as high-level institutional operators and market-makers, serving the professional markets and the private-client brokers. They would rely on the securities brokers for their funds and stock borrowings and may be partly owned by them.

Finally, there would be client brokers, high-volume brokers servicing the needs of the private client. They would not be the same as traditional private-client stockbrokers because of the advent of integrated mass marketing by organisations with extensive networks which would have segmented the market.

Apart from this structure, there would probably be specialists and niche players. Corporate finance, research and portfolio planning will still need to be attended to by specialists, and there is always a place for operators in unique market plays such as futures and options.

If the reality of the 1990s resembles even part of this new scenario, radical changes will have to take place in most of today's broking houses. Brokers will have to re-think their present strategies - in the context of a competitive Australian Stock Exchange playing its part on the world stage.