

# The Role of Independent Sponsored Research

## Research makes a difference...

### ... to a company, its shareholders and its market capitalisation:

- » 76% of investors rely on analyst research in preference to annual reports
- » the value of UK researched companies can be as much as 163% higher than their un-researched peers (*source: Multex/Objective Capital*)
- » trading costs can be as much as 10% of the share price on under-researched companies
- » trading volumes can be less than half of those for comparable better researched companies (*source: Inpartners*)
- » it helps to enable institutional investors to justify an investment to their trustees

*"In a world of regulatory straightjackets, free-thinking and speaking analysts ... are essential to the integrity of the markets. They help keep companies and their share prices honest."*

**Edmond Warner**, Chief Executive, IFX Group

## Independent research is growing rapidly...

### ... as a result of the conflicts of interest inherent in the traditional model of investment banking research:

- » in the US this has been dramatically highlighted by Elliot Spitzer and the Enron and Worldcom scandals.
- » the same trend is now developing in the UK with independent research sponsored by over 200 companies. Companies as large as BP and Invensys have sponsored independent research.
- » independent research enhances credibility with investors
- » 80% of investors believed that "a company that hires a legitimate fee-based research firm is making a positive statement about its investment potential"

**With the current direction of regulation and corporate governance, independent research is likely to become the norm.**

*"We ... continue to promote the use of independent research as a credible alternative for companies to inform the market without the conflicts of using their broker's "in house" research"*

**Ben Thomson**, Chief Executive, Noble Group

*"Companies are desperate for more independent coverage"*

**Cathy Malins**, Parkgreen Communications

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## The importance of being objective

**Investors require objectivity** - investors now perceive independent research to be more credible and accurate than traditional investment banking research:

- » a UK poll in December 2004 by PollWatch found that more than twice as many high net worth investors believe independent research to be **very accurate** compared to traditional investment banking research.
- » a US poll by Investopedia found 81% believe tradition research is “biased” while 88% believe “legitimate fee-based research is objective and useful”
- » a poll by Charles Schwab & Co showed 78% of active shareholders now “value research from independent firms over analysis by Wall Street firms with financial ties to the companies they are rating”

### **The FSA requires objectivity:**

*“Firms should organise the investment research function ... in a way which minimises the potential influence of the commercial interests of the firm, its employees, its associates, or its clients, on the impartiality of its investment research.”*

**FSA Handbook**, October 23rd 2004

*“We have continued to challenge the prevailing model of integrated finance and broking firms that also provide investor research and market making on stocks where the firm acts as the corporate adviser. We fundamentally believe this is a conflict of interest that cannot be properly managed by investment banks”*

**Ben Thomson**, Chief Executive, Noble Group

## Why do firms sponsor independent research?

**Because traditional research coverage is declining** - the trend is for investment banks to provide less research, particularly on small and mid-size companies

- » in the US less than 40% of companies now have analyst forecasts, in the UK less than 50% have more than the house broker providing coverage
- » cross subsidies between investment banking and research have been undermined putting research departments under increasing financial and resource pressure
- » compliance is increasing the cost and restricting the effectiveness of analyst coverage

### **It demonstrates their commitment to good corporate governance** - .

- » the Higgs report places responsibility on non-executive directors to participate in strategy and seek independent knowledge of the company’s environment.  
*“(Non-execs) must be well-informed about the business, the environment in which it operates and the issues it faces. ... Developing such knowledge can not be done within the confines of the boardroom alone”.*  
Sponsoring research demonstrates that non-executives are actively taking external opinion
- » the FSA is increasing emphasis on timely disclosure, and keeping the market fully informed.
- » in the US, Sarbanes-Oxley has required directors to certify the accuracy of their company’s systems and procedures. The FSA may well follow their lead.
- » sponsoring objective, independent research demonstrates the Board’s commitment to the best standards of transparent corporate governance

## **It delivers a universal readership - research distributed free to all interested readers, not just institutions**

- » the explosion in Internet use allows Objective Capital to distribute to market professionals and high net worth individuals across the world
- » independent research accesses the network of private client brokers, the rising class of high-net-worth investors, and the burgeoning number of small investment houses and private banks
- » it stimulates further coverage by the financial media

## **It leverages existing efforts** - greater market knowledge can save Directors time and increase marketing focus

- » as our research is freely available and is designed to educate and stimulate investors there is greater knowledge and understanding of their business, so management can focus on the key issues not just educating the market

## **Why firms use Objective Capital**

**A readership demanding insight, and stimulation, a model for possible mis-pricing, and the security of knowing that we aim to cover “good quality” companies.**

### **Unrivalled distribution:**

- » we have the largest distribution reach of the UK providers.
- » our proprietary distribution reaches 10,000 professional and one million sophisticated and high-net-worth investors globally and further 600,000 money managers through our partners
- » we are the only provider who distributes research in North America, Asia and the United Kingdom
- » we are the only provider who reaches both professional and High Net Worth/ sophisticated readers in North America and the UK

### **A rigorous research process:**

- » our readers have confidence that our research incorporates the work of both experienced sector analysts, the economic outlook, and the latest quantitative and valuation methods
- » triple validation procedures ensure the quality of our research

### **International certification :**

- » we are the only UK provider who can offer the credibility of complying with the international standards set by FIRST, the international industry body for sponsored research

### **A programme of continuing, pro-active coverage**

## **Conclusion**

### **Regulators increasingly see the traditional provision of research and broking/advisor services as conflicted**

*“[Our review] confirmed our view that conflicts of interest were inherent in the role of the analyst in an integrated investment bank, and that they can, and do, compromise the objectivity of investment research”*

FSA, CP171

### **Sponsoring research ensures that the market has access to quality unconflicted research and builds recognition of the value of a business**

***Take control of developing an informed market that is not reliant on the vagaries of brokerage coverage***