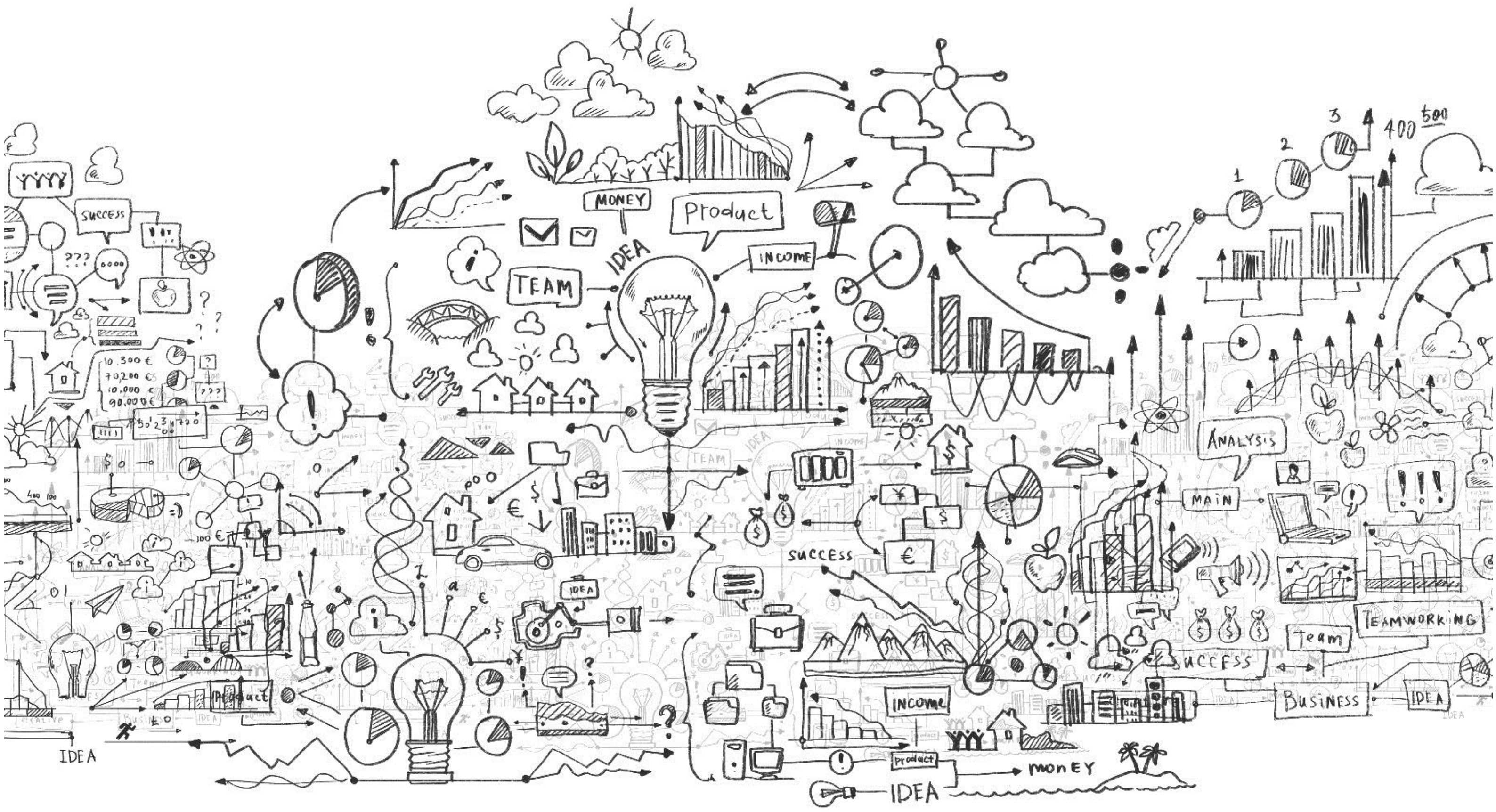
Euro IRP
The European Association of Independent Research Providers

Euro IRP Members Study 2017

'Well researched ideas, presented consistently and priced reasonably, will generate revenue. Get those bits right, and then IRPs can build up their client base.'



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EXECUTIVE SUMMARY

'The future should in theory be bright. But the buyside paying directly for research means the overall pot will unfortunately shrink.'

This report is based purely on the views and insights from Euro IRP member firms. From this annual Euro IRP members survey, a full, confidential report has been compiled and distributed for member firms only. The condensed report here is intended for wider public, media and third party consumption, with highlights of the key attitudes and issues for independent investment research providers.

There seems little doubt that MiFID II, to be formally effective from January 3, 2018, but already spreading its tentacles across the investment industry, will have a fundamental impact on how investment research is provided, consumed and paid for. One of the key drivers of MiFID II is to increase competition, variety and choice in the world of investment research, as part of a fairer, more transparent investment industry generally, eliminating inducements, and giving ultimate investors both enhanced value, and lower costs.

Theoretically, that should be all be good news for independent research providers (IRPs), as by very definition IRPs have no conflicts on what they write; depend only on the quality of their ideas and insights in order to get paid; and add significantly to the variety of views and sentiment in the market. So, is this the case? What are IRPs seeing, and how confident are they about the future?

Rollercoaster Pricing IRPs see prices for investment research decreasing over the next two years; but then likely to rebound over the next five years. At the moment, some 85% of IRPs see prices as either declining or at best flat over the next two years; whereas 35% believe prices will increase over the next five years. The concerns on destructive pricing practices are being writ large though – one in five IRPs are forecasting price drops exceeding 25% both over the immediate and longer term horizons. Many IRPs are seeing the sellside undercutting aggressively on prices, and/or offering little granularity or transparency

Payments Nearly all IRPs have subscriptions as either the prime component in their pricing policy, or at least as part of their offering. Nearly half offer bespoke pricing, and a quarter provide a commission-based price (to enable CSA payments). These numbers are then pretty much mirrored on the other side, as it were, with some 80% of IRPs receiving more than half their revenue via subscriptions, and 60% seeing that revenue coming via direct hard dollar payments

MiFID II Most IRPs, some two-thirds, believe they are now ready, or always have been, for the onset of MiFID II. A further 10% are still working on it, but are confident of meeting requirements. Which leaves nearly 20% of IRPs either unsure what, if anything, they may need to do, or currently assessing what actions they need to adopt. These figures align with the near 30% of IRPs looking hard right now at passporting requirements

More Clients Over two-thirds of IRPs anticipate that the number of clients they serve will increase on the next two years, and some 35% expect that number to grow significantly. But that is from a low base – over a third of IRPs currently have less than 25 clients each

Bloomberg First IRPs are split almost equally between those who have their own dedicated sales team, and those who don't. However, even for those who do, the size of their own distribution platform is dwarfed by any big broker, which makes third party platforms all the more important for IRPs. Of the mainstream platforms, Bloomberg not surprisingly leads the way, with around 40% of IRPs using this channel. The main rivals, such as Thomson Reuters, Factset and CapIQ, all have about 20% take up. The difference is most marked when looking at the value derived by IRPs from any platform. Only Bloomberg is seen as really adding value through client engagement and sales opportunities

New Platforms We've seen a myriad of new online services, all claiming to be MiFID II compliant of course, aimed at taking advantage of the new world for research and ideas that is opening up. For Euro IRP members, by far the most popular is RSRCHXchange, with over 25% of IRPs onboard. But neither this service, nor any others, are widely seen as adding true value by respondents

RESEARCH PRICING

'Many investment banks seem to be looking for market share by low pricing for research and this is creating cost pressure for IRPs. It also seems that the price for research only has come down in the last 6 months from approximately £200k to £100k and now even £50k.'

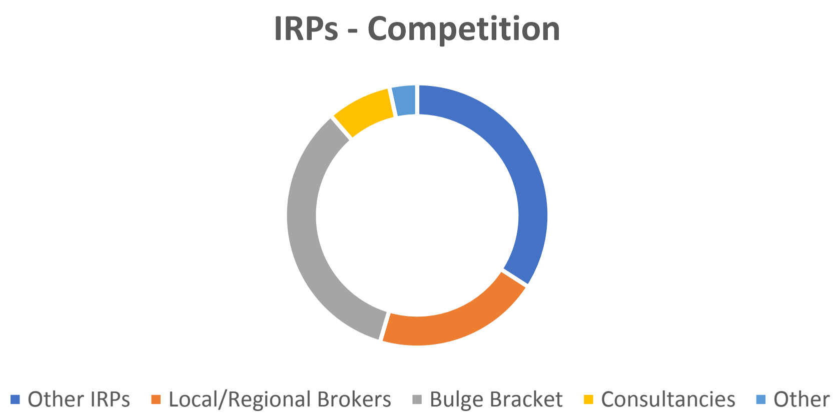
	Decline by 25%+	Decline by 10-25%	Decline by up to 10%	Flat	Increase by up to 10%	Increase by 10-25%	Increase by 25%+
Over Next Two Years	19.6	15.2	19.6	30.4	10.9	4.4	0
In Five Years Time	19.6	10.9	4.4	28.3	21.7	13	2.2

MiFID II is intended to increase market transparency, remove inducements and eliminate competitive bad practice, to foster a fairer, open market, adding to choice and reducing costs, especially for ultimate asset owners. There has been much debate around the 'unintended consequences' of MiFID II, perhaps more on the challenges facing providers of small & mid caps research than anything else. Yet it is clear that regulators, both in the UK, and on a European wide basis, are genuinely concerned that MiFID II does what 'it says on the tin', and does not create fresh market imbalances.

A core finding from this study is that Euro IRP members are uncertain that these best intentions will deliver the best outcome. As the data shows, most see prices for research declining, often quite sharply, over the next two years; and whilst more are optimistic on a five year horizon, over 40% are not. *'Near-term pricing stays under pressure as market consolidates. "Me-too research" will be completely commoditised. Proprietary product will gradually and eventually (re)gain share as content/service is proprietary and adds value. Longer term, that proprietary content will be valued so pricing rebounds over time.'*

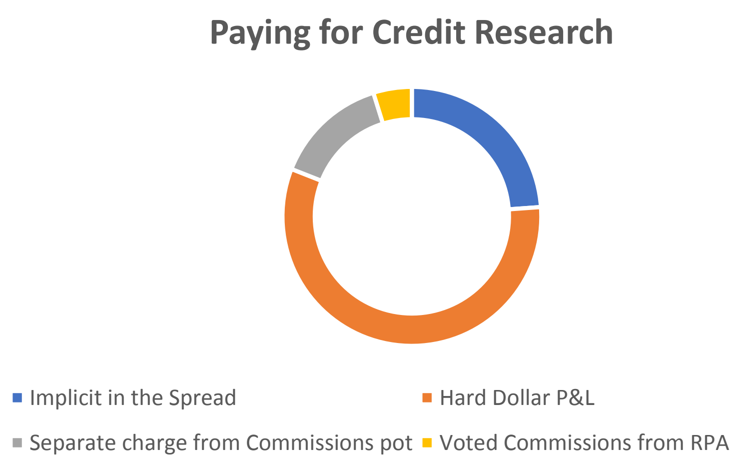
As alluded to in this comment, there are solid commercial reasons why prices for research may decline. It has long been a truism in the market that there is too much investment research, and too much of a poor quality. Full adoption of a regime that requires asset managers to only pay for what they actually value, and to pay only for that, and not something else, is very likely to reduce supply of unregarded research, and cause the buyside to assess even more carefully than now, the amounts they are paying.

All perfectly logical. But take that logic forward, and a reduction in supply, allied to a far more specific focus on quality and relevance, should mean an increase in prices, certainly over time. The worry for IRPs is that this logical dynamic is potentially being undermined by sellside brokers and investment banks. One or more of several themes come through. Firstly, they are offering prices at exceptionally low levels, to retain and win market share. *'The big brokers are undercutting and maintaining subsidies from primary business. This is predatory.'* Or secondly, there seems to be loss-leader approach, where written reports are marked down in price, to attract 'people through the door', as it were. *'They are undercutting on report only.'* And thirdly, that the sellside is still being coy about what the charges are. *'Conversations to date suggest that even now the big banks do not want to put a price on what they're offering & are reluctant to provide menu pricing.'* All these approaches would seem at variance with the intentions of MiFID II, and present a challenge to regulators, as well as to the IRP business model. For it is vividly clear that while IRPs are naturally competing with each other to win clients and business, they are also going head to head with the investment banks and other brokers.



IRPs do not exist in some sheltered backwater – and indeed the recasting of the investment landscape that MiFID II will bring about, in fact only adds to the common ground here. So, although IRPs are telling us that they can see genuine opportunities, and appreciate the clear distinctions around payments for research, they are unconvinced such opportunities can be realised. *'We are being strangled by ill-informed regulations, and expect a price war.'*

Now, this is primarily from an equity and macro perspective. The fact that MiFID II applies in exactly the same fashion for fixed income and debt markets is well-known; what the impact will be remains very uncertain, at the moment. . *'FI client universe still very much in price discovery process so not clear yet what price the sell side will achieve. Tending to divide by product type - FI & FX together, equities separate.'*



Business Models & Structures of IRPs

'The bulge bracket are still treating things as if unbundling never happened.'

Within this section of the question set, IRPs were asked about the basis of their business, staffing numbers and responsibilities, their clients and revenues, and what the breakdowns were here, and how they saw their business in the context of the market.

The key outcomes are -

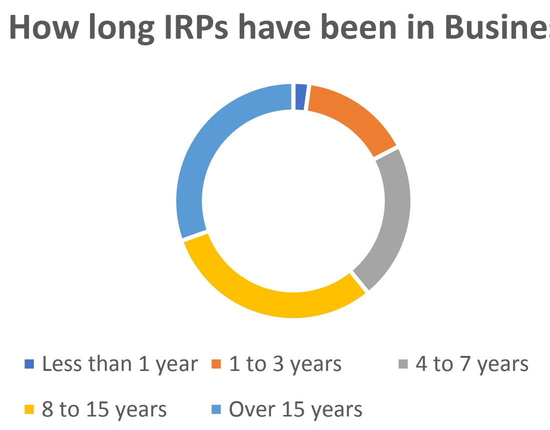
- IRPs have more heritage and stability than one might imagine, with some 60% in business for eight years or more

- The number of clients served by IRPs has been largely stable over the last two years. There is optimism amongst IRPs that they will be able to increase the number of clients going forward, although this must be seen in context against real concerns around predatory pricing and anticipated short-term revenue declines

- Subscription revenues are at the heart of the business for IRPs. Income from commission pots, from a voting basis (from what is becoming RPAs or hard dollar) is increasing, but for many IRPs, there is still a disconnect from the major sources of research payments

One concern, and a perfectly valid one, from the buyside, is whether they can rely on an IRP staying in business. An asset manager will take time to develop a relationship with any research provider, from the biggest bulge player to the smallest new IRP; and that investment in time and effort by the asset manager needs payback, in the sense of being able to build on it over time.

As the graphic shows, over 80% of IRPs have at least a track record of four years or more, and some 30% have built a successful business with more than fifteen years performance. This data mirrors the growth in independent research since the turn of the millennium, and the first stirrings from investors and from regulators that the inherent conflicts in 'classic' sellside research needed to be offset with a strong dose of independence and impartiality.

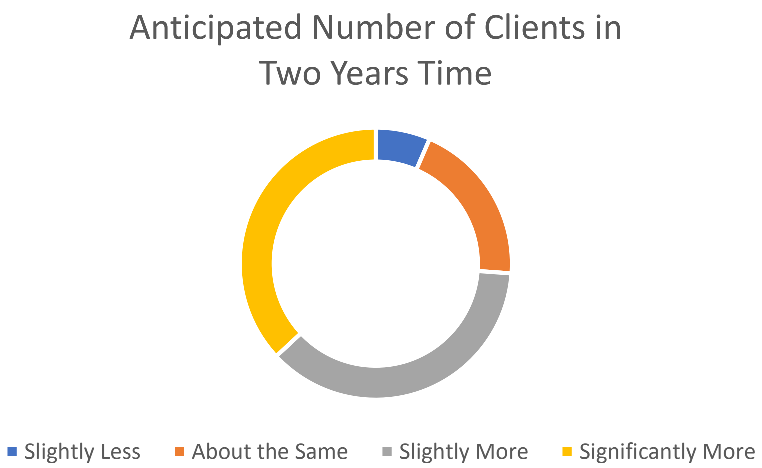


For every business, the name of the game is providing service to clients. IRPs of course, being in general smaller operations, have an equivalent smaller number of clients overall. An interesting point here would be that major sellside firms, both the bulge bracket and others, have increasingly sought to reduce the number of clients they actively serve, in their drive to make their research business 'independently' profitable. It is a likely impact of MiFID II – where brokers and indeed all research providers can only deliver services to clients who are paying them – that this trend will accelerate.

	1 to 10	11 to 25	26 to 50	51 to 100	100+
Two Years Ago	21.7	15.2	17.4	13	32.6
Currently	19.6	15.2	13	19.6	32.6

What we see is a very consistent picture of the number of clients IRPs have now, as against the numbers two years ago, with one exception being the trend of IRPs who had 26-50 clients, have now moved up to having 51-100 clients. There will doubtless be many reasons behind this change, but one element must be the desire just noted of brokers to eliminate from their lists any clients they consider unprofitable. Profit, of course, depends on two components – the price charged and the costs incurred. There is much evidence to show that historically, IRPs offer substantially lower fees, and have a lower cost base too.

The onset of MiFID II is giving some confidence to IRPs that they will be able to grow client numbers in the future. As the chart shows, some 74% of IRPs expect the number of clients they serve will increase, with this equally divided between those looking for a moderate gain, and those foreseeing more significant advances.

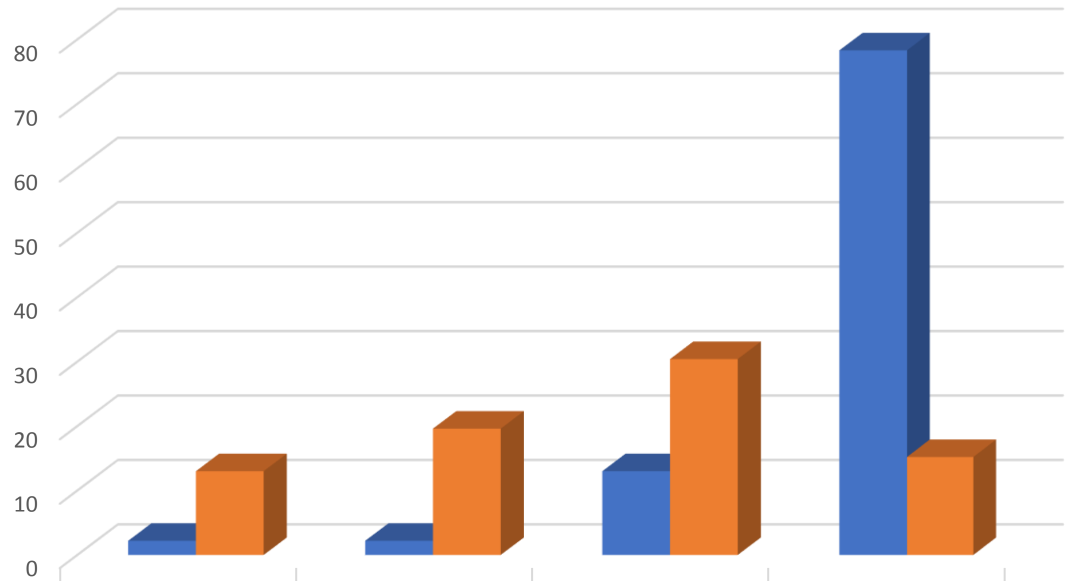


Whilst IRPs believe that they can either maintain or expand their client lists (and given IRPs exist and prosper purely on the quality and relevance of their insights and research, such expansion is due to these services resonating with clients); there are genuine caveats and concerns, with two key points above all. Firstly, as we have already discussed, is the big question on pricing, and the growing indications of how the traditional sellside is approaching this. And closely linked to that is the actual definition of chargeable research, and how that will be interpreted and monitored.

For IRPs, the traditional source of revenues has been hard dollar subscription payments from clients. This has carried an element of frustration, as the 'budget' for IRPs has often been a distinct, more Information Services type activity, and therefore constrained and excluded from the potential largesse residing in CSAs and voted payments. This should, at least in theory, completely change under MiFID II, where the buyside spend on research services is quite simply that, whether paid for by hard dollar, or by RPA, or by any variety of the same. But for now, subscription revenue is the clear leader for IRPs.

The mechanisms the buyside are using to make these payments for IRPs, unsurprisingly, reflect this subscriptions led focus. Well over 60% are using hard dollar P&L.

How IRPs are being paid for Research Services



	None	Under 20%	20-49%	50%+
Subscriptions	2.2	2.2	13	78.3
Voted Basis	13	19.6	30.4	15.2

SALES & DISTRIBUTION PLATFORMS

'Open prices and technology will lead to innovative fascinating offers that will change the shape of the sellside industry. Closing the door to new creative research will put many traditional fund managers at risk.

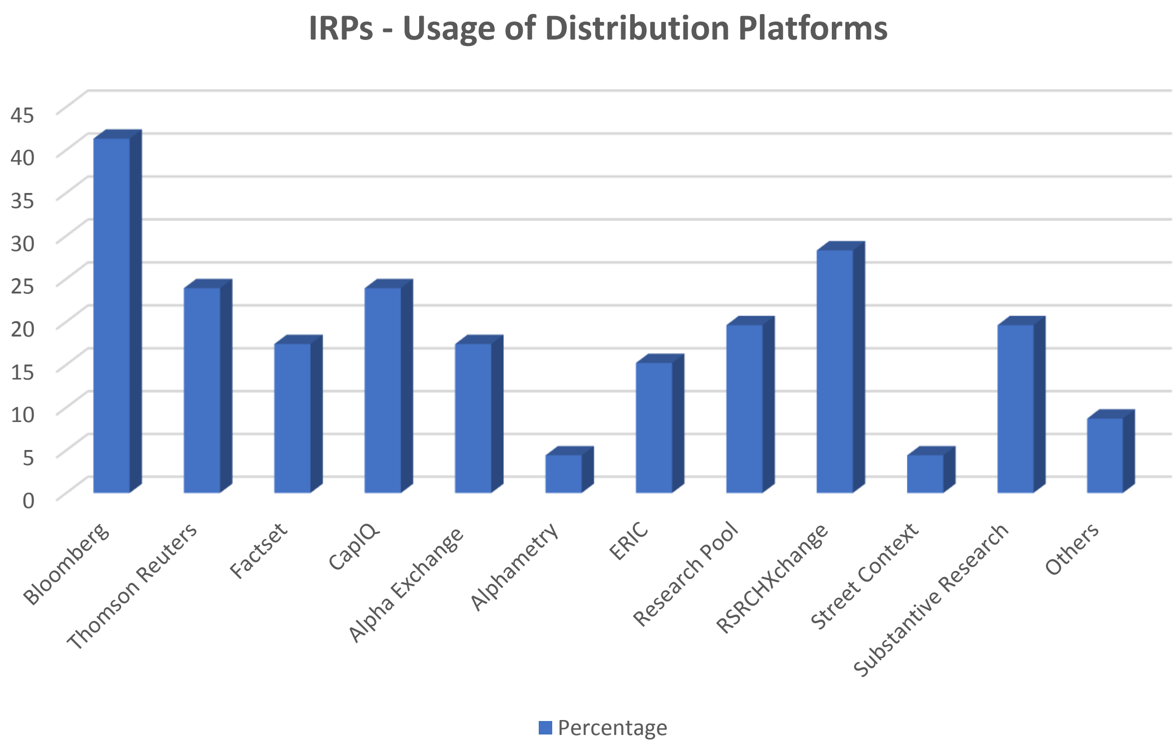
In this section, as we have already addressed the pricing issues, we asked about third party platforms, both the established providers, and the new kids on the block, as entrants seek to turn their technology into unicorns.
There are two key points –

- Bloomberg is the clear platform of choice for IRPs, and there are good reasons for this

- No new wave platform is seen to be really delivering value, but RSRCHXchange is the clear leader for content, and others have gained traction too

Bloomberg and Thomson Reuters have been around for quite a while. What has made the position far more complex, but interesting too, has been the rise of new distribution platforms. These have been propelled by twin imperatives. First, the changes under MiFID II are arguably creating fresh ways research can be provided, consumed, evaluated and paid for. Secondly, web technology and delivery mechanisms for data and services continues to evolve at a rapid pace, be it Uber, Deliveroo, or those ancient beasts like Google and Facebook. Leveraging such technology in the provision of investment research services is a fairly obvious ploy – finding the 'killer app' is much more challenging.

Despite the plethora of new platforms, it is the mainstream who hold sway with IRPs. As the table shows, Bloomberg is clearly out front as the core research platform for IRPs, with Reuters and Factset also scoring well. But there is a new kid making waves – RSRCHXchange – which is actually number two to Bloomberg in the number of IRPs providing content. And others are generating visibility too – most notably Research Pool, Alpha Exchange and Substantive Research.



All well and good, but which platforms are actually adding value for IRPs? We asked this, against three separate criteria – ongoing client engagement, generating new sales opportunities and most important of all, helping generate revenues. None of the platforms have 100% read across, either from basic usage or for each of the value factors. However, Bloomberg ranks first in each category, and up to nearly half the IRPs using Bloomberg to distribute their content believe they are getting added value. As naturally it is easier to score higher with higher usage numbers, it is worth pinpointing Research Pool and Substantive Research. IRPs using either of these platforms are more inclined to see them generating new sales opportunities, than for any other platforms.

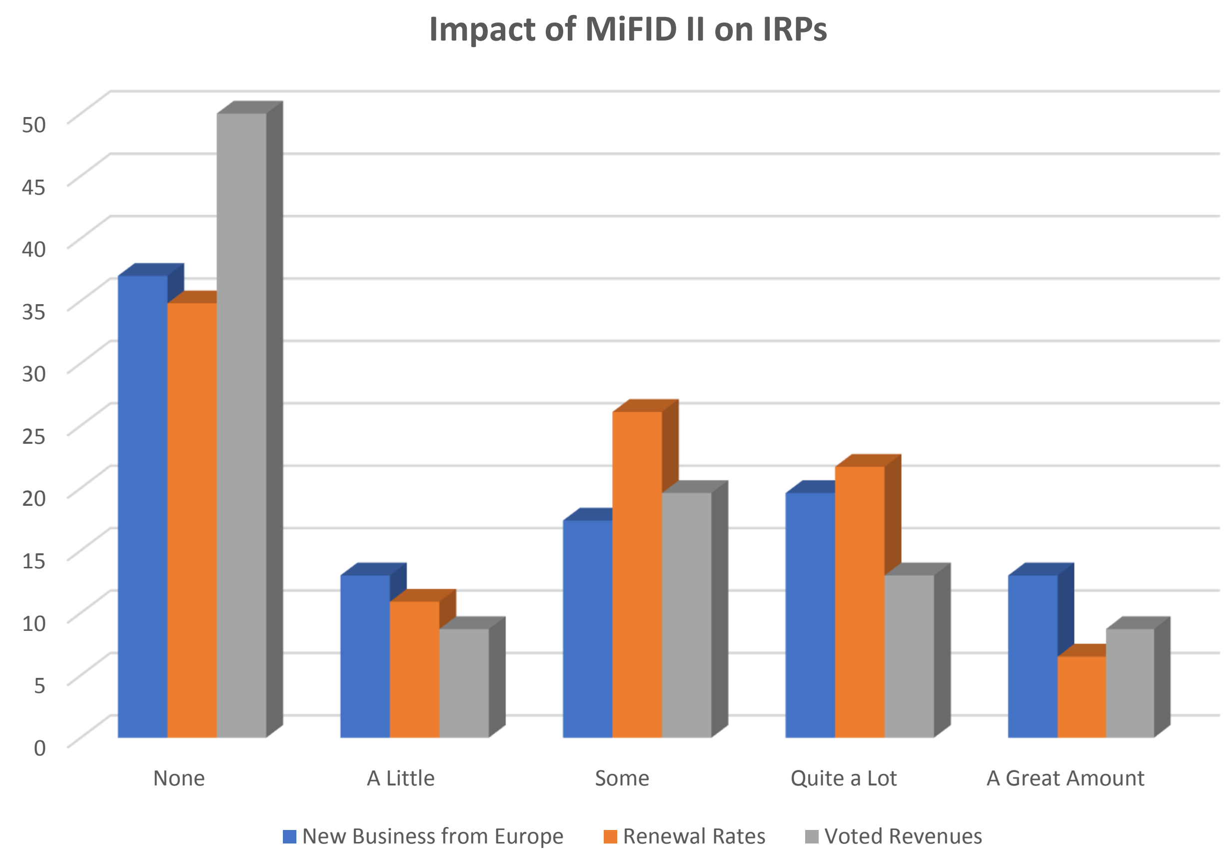
THE FUTURE

'MiFID II has without a doubt had an impact on new business. Roll on 2018 to see if there's an improvement. In theory there should be…'

It is the nature of this report, and the questions we asked of IRPs, that many of the findings speak to the future – the future for IRPs and for the investment community more generally. It is very clear IRPs are uncertain; they can see opportunities, but they can see threats too.

There are multiple references in this report to the projected impacts of a MiFID II on the investment industry, and for IRPs themselves. Most of these allusions come either from comments, from wider industry interaction, or as a by-product of a different headline topic. Looking directly at data collected on the three points asked around new business, revenues and renewal rates, in general IRPs are not certain how matters will unfold, with the largest number in each case seeing that they will be no appreciable influence that could be laid at the door of MiFID II. This trend then applies across the board, with perhaps the greatest optimism coming from the anticipated increase in market share that may result in continental Europe.

Time will tell, and we look forward to conducting this study in 2018, and seeing whether future sentiments have been on track or not.

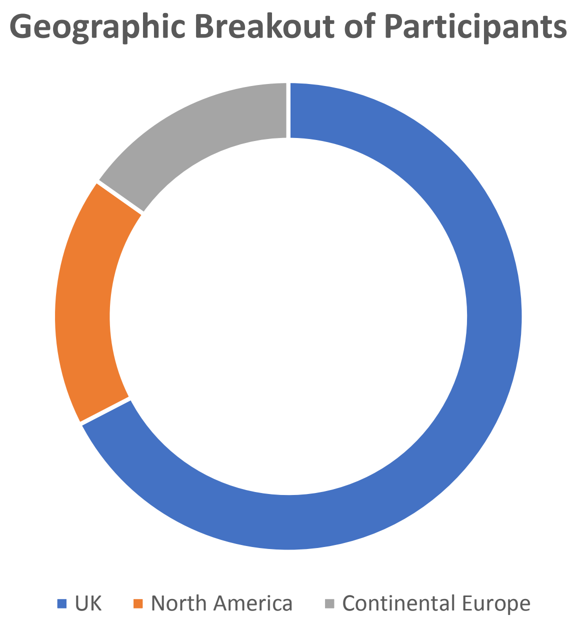


STUDY SCOPE & PROCESS

This study, the most comprehensive and far-ranging assessment of IRP sentiment and experience, was set and conducted by Euro IRP. A question set was drafted, based on discussions and feedback with a selected small group of Euro IRP member firms. Following that, the draft was circulated to this group for comments and review. The final version was then agreed.

All responses to the survey were collected online. Euro IRP utilised the services of Worldflow (who also provide the online Directory service for Euro IRP) to set up and distribute the survey online. Responses were sought from 72 member firms. 46 completed submissions were received, and a further 10 member firms responded to apologise for their inability to participate, or to offer reasons why they wished to decline.

It is intended to conduct this study on an annual basis going forward.



Respondent Comments

In the question set, we included several ‘open’ questions, where we invited member firms to provide comments and views. We present these following, against the relevant question heading. Clearly, all comments are unattributed.

Are there any comments you would like to add about your business, and the way you see the market?

The challenge will be to maintain revenues in the face of discounted research prices from the bulge bracket. Also, price discovery will lead to price deflation from our biggest and best clients. However the overall quality of research in the marketplace continues to decline and being conflict-free at the stock level will be key to maintaining pricing power.

I expect IRPs, ourselves included, to be able to take a larger share of a shrinking pot post MiFID II. I see the US as a major growth opportunity & we are assessing whether or not to partner with a sales outsourcing firm there in light of the time/cost of developing our own client base. I also think research partnering in other markets where there is a common interest (& it is non-competitive) is an effective way of adding depth & perspective to our research. This is something we have only recently embarked on but is an area we hope to build on. We see a lot of opportunities to grow but are always starved of time.

MiFID II is proving a headwind for clients short-term as they grapple with the allocation of reduced budgets and a potential medium term (1 year +) business opportunity as clients re-rate the value of IRP.

MiFID II and unbundling is creating significant negative value for the buy-side, the sell-side, corporations and end-consumers. It is damaging economic growth and employment at a time that the UK/EU can least afford this. It is a solution for a problem that does not exist.

I see the potential for significant price wars for the future as the market becomes more saturated.

Its perfectly obvious to us that all regulatory manoeuvres have simply had the unintended consequence of diminishing / destroying our industry and business.

Our impression is that unbundling (MiFID II) is not working as everyone expected - Buy-side are using pricing models of IRP's to negotiate with bulge-bracket research providers - it is not driving them to buy IRP research - in fact, the opposite as budget cuts force cancellations

There has clearly been a move away from commission based payment systems, but they are far from dead.

Although we do a small business with corporates as buyers of research on themselves, this is completely segregated from the main product/service i.e. subscriptions paid by investors. The two universes are never mixed and trade under different commercial names

We are not involved in the voting system. We believe that MiFID II might be good news in the mid-term, but brings a lot of confusion in the short term

How do you see the sellside pricing. Are tariffs granular, are they undercutting?

3 models - tiered pricing, exclusive list of clients or discount volume pricing. They are undercutting on report only.

We are expecting deflation over next two years, inflation longer term

FI client universe still very much in price discovery process so not clear yet what price the sell side will achieve. Tending to divide by product type - FI & FX together, equities separate.

Whilst our perspective is limited by our short timescales, our perception is that clients value flexibility in the pricing scheme.

The impression I get from clients is that they do provide granularity , but do so at an uncompetitive price so that the bundled price looks like a no brainer. As an illustration , i.e. not based on any direct knowledge, this could be £50k for one analyst team....£150k for every research team and product produced by the banks

Bulge bracket are still treating things as if unbundling never happened

(The sellside) seem panicky and are underpricing the access to research as a product

Most bulge bracket firms are completely opaque on pricing. We have had a clear pricing structure, broken down by service level and sub sector from day 1.

Evolving in the context of MiFID II - not much transparency or clarity yet. Looks like a move to undercutting.

Yes, RSRCHXchange accommodates a significant chunk of providers that 'dump' their research at very low prices. Also have received a request by one of the content aggregators that they wanted to bundle research from different providers for buy-side users and offer that at a fixed price. User would then allocate the subscription fee for the bundle over the various providers on the basis of a vote. Price of a bundle would imply that we would have to sell all our research for just a few grand per annum. We therefore decided not to co-operate with that initiative

Whilst investment banks continue to be the largest suppliers of investment research it will be impossible for a "market" for research ever to exist. This is simply a fact.

No clear visibility on sellside pricing as yet. Ranges floating in the market are quite wide.

The brokers started with high prices but apparently now are becoming very aggressive in pricing too.

Tariffs are not granular and so represent unfair competition. Unlikely they are UNDER-cutting. More likely using oligarchic power

No changes - if anything, we expect to hike our subscriptions

They appear to be primarily going for tiered pricing. There is a danger that they will attempt to exploit "minor non monetary benefit" loopholes to continue offering parts of their product range for free. In general however they would have to cut their prices dramatically to undercut what is currently paid to the IRPs.

Sellside pricing seems to be setting a low subscription for research only with premiums then paid for analyst access etc. Many investment banks seem to be looking for market share by low pricing for research and this is creating cost pressure for IRPs. It also seems that the price for research only has come down in the last 6 months from approximately £200k to £100k and now even £50k

Any further comments you would like to add about pricing?

The sellside is being rebuffed when asking high prices, so the response appears to be ultra-low prices (subsidised) but extensive distribution (volume). IRP's will have to emphasise independent thought, experience and non-conflict in order to maintain pricing power.

IRPs are in a strong position to take share but the overall pot is destined to shrink significantly.

Our view on research pricing relates to the price charged for highly valued research.   Much current research will see significant falls in price

Pricing is increasingly a concern as investment banks in particular are being very aggressive for research only to keep clients

Once clients have seen the merits of independent research, the precise pricing is less important.

The comments re pricing are with respect to our own business, as an industry average I would suggest prices for research reduce as the impact of MiFID II hits the sellside

We post a list price for everybody to see and we mail with price quotes. The strategy is to force brokers to quote a price for a similar coverage and eco hit ratio

Near-term pricing stays under pressure as market consolidates. "Me-too research" will be completely commoditised. Proprietary product will gradually and eventually (re)gain share as content/service is proprietary and adds value. Longer term, that proprietary content will be valued so pricing rebounds over time.

Despite the regulators best efforts to destroy our business by creating a level playing field, it is perfectly clear that the investment banks will still be in a position to subvert the market with predatory pricing.

What comments you would like to add about the buyside?

They are worried they won't be able to afford the research they need - especially smaller players. Finding an edge will be harder than ever.

It strikes me the real world is catching up with the buyside & is putting it under increasing pressure: to perform; to justify fees; to justify active management; to justify paying for research. Consolidation will continue because there are still too many halfway house operators who would struggle to identify how or why they add value. We are heading towards big or boutique with not much in between.

The buy-side is finding it difficult to adapt to MiFID II in the UK which causes the risk that many will go down the volume rather than value route for deciding what to pay. Furthermore, they are under huge pressure to reduce fees ((ETFs etc) and it is at this time that the regulator is forcing UK fund managers to pay for research out of their own pockets.

Most of them still don't have a consistent process for evaluating new research products

They currently, probably, look at compliance, structural and regulatory issues as more important than the research itself

Most buy-side clients are indoctrinated into economic data – our greatest challenge is to educate into non-linear dynamic methods that can achieve higher alpha performance

They do not put their fiduciary duties as a priority.

Re MiFID II, the negative we're experiencing is that some European prospects are turning down introductory meetings –- with replies such as "We don't wish to receive unsolicited research offers; we would contact you if we are looking" -- which is our traditional way of introducing an analyst's expertise. How best then to make capabilities known?

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Euro IRP

Euro IRP exists to represent the interests of the European Independent Investment Research industry. Most of its members have representation in Europe and specialise in providing investment research to the funds management industry. It is also open to other firms who currently provide investment research into other markets and who are interested in developing a European fund management client base.

Membership of Euro IRP enables our members the opportunity to share in their experiences, discuss current economic viewpoints, promote their research and network within the industry. Euro IRP members benefit from a free listing in the online and fully searchable Euro IRP Directory.