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Attention deficit

- New issues in Asia struggle for coverage
- Exchanges launch research schemes to help
- Investors divided over credibility of this approach

By Ben Bland

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Despite the supposed benefits of a public listing, many small and mid-cap companies find themselves in a catch-22 situation, where there is not enough trading in their shares to convince investment banks to give them the research coverage they need to attract the attention of new investors.

If it was a struggle to get analyst coverage before the global financial crisis hit, the position has got a lot worse since, with equity research teams shrinking and many investors shunning small caps as they belatedly look to reduce their risk profile.

The problem has proved particularly acute in Malaysia and Singapore, where the ambitious stock exchanges attracted a glut of new listings in recent years, many of them smaller companies. Singapore Exchange (SGX) now has nearly 800 companies, while Bursa Malaysia has almost 1,000. Outside of the top 100, however, few get any worthwhile coverage.

As elsewhere in the world, some companies have turned to issuer-sponsored research to counter this lack of attention but this has not taken off due to the high costs and perceived lack of independence among investors.

So, with the backing of their respective regulators, SGX and Bursa Malaysia have each championed new research schemes designed to help smaller companies get more coverage that is credible with investors.

While listed companies still have to pay hard cash to get research, they get a handy government subsidy and the overall costs are brought down because of economies of scale. At the same time – and much more importantly – the exchanges get to appoint the research firms, thereby introducing a level of credibility lacking under the issuer-paid research model. Even though hundreds of companies in Singapore and Malaysia have signed up, however, do investors really trust the independence of this research? And is the subsidized, exchange-backed model a sustainable solution in the longer term?

Post-IPO blues

There's no doubting the scale of the problem. 'Many mid and small caps find it almost impossible and I think that's largely because so many companies have come to the market over the last few years,' explains a director of a mid-cap Singapore-listed shipping group.

That view is shared by Lucy Carmody, a former banker who recently set up Responsible Research, a Singapore-based company that provides institutional investors with bespoke research on environmental, social and governance factors.

'Too many companies listed too quickly,' she suggests. 'Regulators in Asia need to focus on after-market provision, encouraging more market-making and research coverage and perhaps bringing in some commitment from issuing banks to continue coverage beyond the IPO.'

But Lorraine Tan, head of Asian research at Standard & Poor's (S&P), which is an official research provider under both the SGX and Bursa Malaysia schemes, thinks the problem is not just limited to Asia. 'Everyone tends to cover the top 80 percent of the market by capitalization, which means many of the smaller stocks don't get covered,' she explains. 'It's the same in the US and elsewhere because the trading and liquidity is always concentrated on the bigger stocks.'

Although he doesn't believe too many companies have been allowed to float in Singapore, Lawrence Wong, head of listings at SGX, accepts that 'companies come and get listed to raise funds – research is another issue.' That said, exchanges and financial regulators in Asia need to resolve this situation if they are to improve the transparency of the marketplace and increase trading activity in small caps.

Counting the cost

In Malaysia the companies pay a flat fee of MYR30,000 ($8,600) for two years of regular coverage from S&P and one other local research house. Thanks to the high level of subsidy – the Capital Market Development Fund pays in the same amount as the issuers – more than 300 companies signed up to the two-year pilot scheme that ran from 2005 until 2007, and more than 200 have stuck with the arrangement since then.

Meanwhile, SGX has just launched a new, streamlined scheme – SGX Equity Research Insights – under which research will be provided by S&P and DnB Nor Markets, the Norwegian financial services group. Companies will have to pay an annual fee of S$12,000 ($8,400), although the Monetary Authority of Singapore and SGX will provide joint subsidies for smaller companies on a sliding scale, whereby companies with a market capitalization of less than S$100 mn will receive a S$2,000 subsidy and those smaller than S$300 mn market cap will receive S$1,000.

Both the Malaysian and Singaporean exchanges make the research available on their websites and distribute it directly to institutional investors via Bloomberg and Thomson Reuters First Call.

Taking responsibility

With a much less generous level of subsidy, SGX's previous Research Incentive Scheme attracted significantly fewer companies than the scheme operated by its Malaysian counterpart. But Wong says this approach is deliberate. 'It's important that companies show their support – for that reason, our subsidy is not huge,' he comments.

Bursa Malaysia is also keen for companies to take more responsibility for their own investor relations and it has indicated that it may reduce the level of subsidy when it reviews its research scheme in the coming months.

The challenge for small and mid-caps in Asia, the majority of which do not have dedicated IR professionals, is how to deploy their limited resources effectively, and it's difficult to assess the benefits of these research schemes.

There are some academic findings that suggest such schemes can be positive, however. An independent study in 2007 analyzed the effects on trading patterns and stock performance of initiation reports produced by S&P under the Bursa Malaysia scheme. It found that 'buy' recommendations had a positive effect on returns, while 'sell' and 'strong sell' ratings had negative effects. The study also found that trading volumes picked up following the release of positive initiation notes.

Fund managers are divided over the credibility of this approach, however. Shireen Muhiudeen, managing director of Corston-Smith Asset Management in Kuala Lumpur, believes the schemes are a good way to help retail investors.

'This is a long-term education process that I think will help raise the level of shareholder understanding of how to invest and what to look out for,' she says.

One European fund manager based in Singapore agrees the research may help retail investors, but he doubts the level of difference it will make to professionals. 'We are always on the lookout for new investment ideas but if a company is so small that it can't get coverage without paying for it, it's unlikely it will suddenly turn up on our radar,' he points out.

Not recommended

The new Singapore scheme has also come under fire after SGX decided to dispense with investment recommendations, apparently because some participating companies were unhappy about paying to get a 'sell' rating.

Mak Yuen Teen, co-director of the corporate governance and financial reporting center at the National University of Singapore's business school and co-author of the Bursa Malaysia/S&P study, took the rare step of writing to Singapore's business daily to criticize the decision. 'Removing the recommendations will, I believe, make companies and analysts less accountable, reduce information relevant to investors, and be a backward step to improving the quality of our market,' he wrote. 'It is akin to professors deciding to increase class intake by offering not to assign grades.'

Wong defends the decision, however. 'We want investors to learn and understand how to read research – that is more important than a buy or sell recommendation,' he states.

Despite the doubts, most observers agree these exchange-backed schemes will help bring up the overall level of information in the market. Ultimately, however, if smaller companies are serious about improving their research coverage and liquidity, they will have to take responsibility themselves.

'If companies want good investor relations, *they* will have to do it,' concludes Wong. 'We can't bring in regulation to do it for them.'

Exchange of ideas - other research schemes

Independent Research Network

A joint-venture between NASDAQ and Reuters, IRN was meant to independently allot research firms to under-covered companies but it was canned in 2007 because of high costs and a low adoption rate.

PSQ Analytics

Launched by the London Stock Exchange earlier this year, the scheme will independently assign one of three research houses to cover any participating issuer. PSQ is still in its early days, with only five reports published on the website to date. Some observers have criticized the lack of price targets and investment recommendations.

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