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WARWICK
BUSINESS SCHOOL

BRIAN T. HOULDEN
BSc, PhD, DIC, ARSM, FInst.D

INSTITUTE OF DIRECTORS
PROFESSOR OF BUSINESS STUDIES

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Sir Adrian Cadbury
Rising Sun House
Baker's Lane
Knowle
Solihull
West Midlands
B93 8PT

Dear Adrian,

Short-termism?

I promised to summarise the main points coming out of a talk on short-termism, given to those on our Part-time MBA, by Brian Harding of James Capel.

Brian is unusual amongst stockbroking analysts in his background. He is not from Oxbridge. He also has several years of industrial experience including corporate planning with GKN, BLMC and Alfred Herbert. With Capel he specialises in small/medium sized engineering companies. I understand that he is one of the most respected analysts in his area of specialisation.

Previously he has talked to this group about the nature of the market, the role of the analysts, stock salesmen and market makers versus the institutions. Some points he made then seem to me to be important. There must be a degree to which, using the analysts recommendations of 'buy' or 'sell' the salesmen in the same stockbroking firms are under pressure from the market markers to cause more volume of business, particularly when the overall volume of business is significantly down. In the less ethical stockbroking firms this can result in the analysts making far too few recommendations to 'hold' and too many 'buy' or 'sell'.

The question that this raises in my mind is would the institutions buy and sell so frequently if the analysts were forced to be either independent or were part of the institutions themselves and hence free from these pressures? Currently my picture is that those in the institutions who are responsible for deciding on large sales or purchases, have far too large a portfolio to do sufficient analysis themselves and do not have in-house sufficient help to do it better. For the same reason they are less able, than I feel appropriate, to see when one of their companies is slipping and needs a nudge to pull its socks up. Too often things slip until they sell and if they all do that, it does not create pressure where management needs it.

The picture of high velocity of sales compared to earlier decades is only increased by the improvements in IT.

If one also looks at the way the analysts are trained I think there is some evidence that many rely too much on figures and too little on soft information such as understanding the company's strategy, the quality of its products, the quality of its chief executive, the balance within the board etc. Too much evidence on figures is not only dangerous, it also pushes the emphasis towards the short-term.

His more recent talk on short-termism added a different set of information. This covered the 1980s and summarised UK total investment in 3 categories - R&D, capital investment by companies and investment in takeovers. This clearly showed a major swing by a factor of 10 or so in the second half of the 1980s, with companies spending much more on takeovers. Some of this was a reflection of some companies becoming more Europe-based or global but there was also a strong feeling that takeovers (and buy-outs, buy-ins etc.) had been overdone. It was interesting to note that while this growth in funds for takeover was initially from the institutions, after the 1987 stock market crash the banks virtually took over. Most takeovers are failures rather than successes. Most of the shooting starts like Coloroll, Ward White, Blue Arrow etc. are now out of the way but why were the institutions and the banks prepared to back these so far? Hopefully they will learn some of the lessons and try to look beyond the next recession next time to long term quality of earnings!

As a result of the interest in the discussions, I have now arranged for Brian Harding to address a meeting of the Strategic Planning Society at Warwick University from 7.00pm to 8.30pm on Wednesday 12th February. If you would like to join us you will be most welcome. I will send you details if you wish.

Yours sincerely,

Brian

Brian Houlden.

P.S I am glad to see the changes which are proposed as far as company accounts are concerned. Playing with 'exceptional' versus 'extraordinary' is one of the many dodges which Brian Harding warned those who judge companies by looking at their accounts, to be wary off.

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