

# IR and Spitzer's shakedown of Wall Street

| BY EDDIE RAZAK |

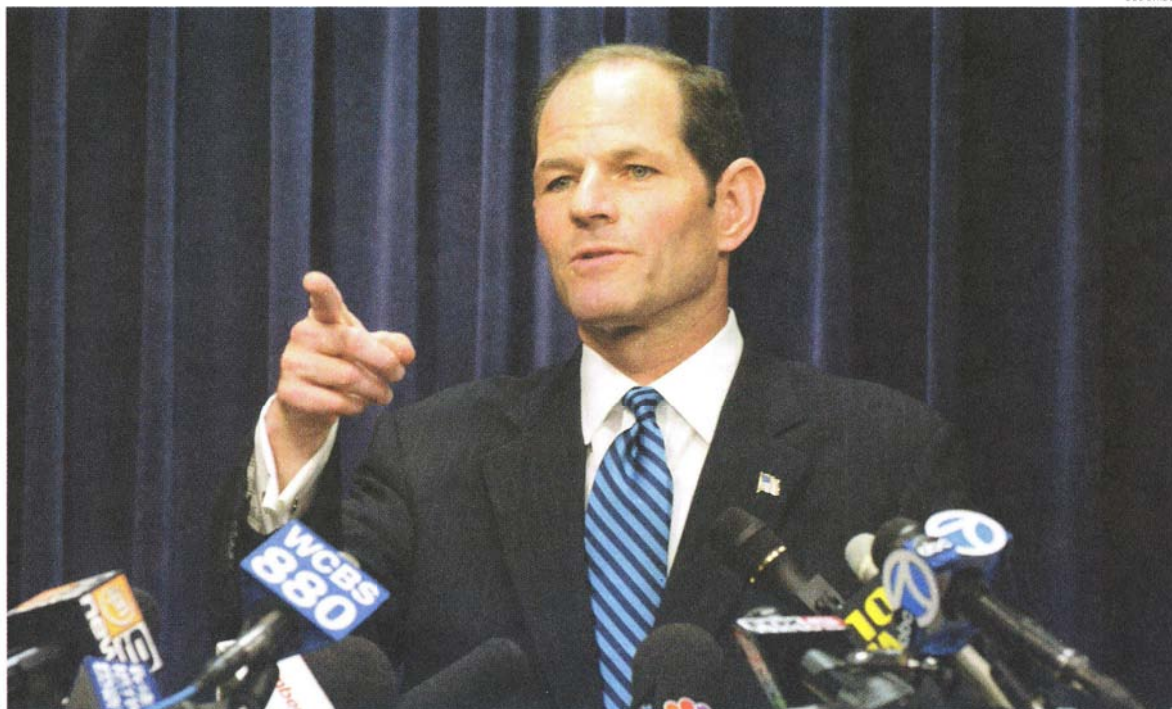
The practice of investor relations (IR) by public listed companies in Malaysia is slowly but surely expanding. Worldwide, IR has indeed grown much more rapidly within the last five years. This is partly because of increasing awareness and also due to certain events that occurred in the US in 2003 that has caused a fundamental shift in perception ever since.

New York State attorney general Eliot Spitzer has led many campaigns to clean up Wall Street and Corporate America. Dubbed the "Sheriff of Wall Street", he was quite a reformist, a hero of sorts who set out to put right the wrongs in investment banking, among other areas.

He eventually became governor of New York but his fall from grace came twice as fast as his rise to glory. A year ago, he was caught with his pants down but with his socks on, so to speak, in a sordid case of what typically befalls men of power throughout the ages.

But what he did during his tenure, indirectly and resultantly, made a great impact on IR. For some time up to 2003, he investigated the huge investment brokerage firms of Wall Street. He charged that many of the independent research reports written by sell-side analysts of these investment firms were not exactly independent and that they tend to give favourable views of their client companies and prospective initial public offerings they were underwriting.

The charges were quite severe and shook Wall Street. But as a conciliatory measure, the biggest 10 investment firms agreed to settle the case out of court for a restitution of some US\$1.4 billion (RM5.2 billion). This was the historic "Global Settle-



Spitzer may have fallen from grace but what he did during his tenure as governor of New York made a great impact on investor relations

ment" case. The settlement terms were with the 10 firms but as their business was global, the effect of the case was worldwide and smaller investment firms felt its ground-shaking effect as well.

In addition to restitution, among other measures, it called for removal of contact and information flow between the investment banking and the research analysis departments of the investment firms. A Chinese wall was required between the two departments to avoid conflict of interest and to uphold the integrity of the two roles.

How the research analysts earn their fees was also affected. The research analysis department cannot obtain a share of investment banking fees nor any form of subsidy from the investment banking operations.

The sell-side research analysis departments found their budgets shrink-

ing and their numbers diminishing. The quality of research reports was somewhat compromised as they had to focus on research that could generate short-term trading volume rather than focus on long-term market performance.

Almost overnight, the role of the sell-side analyst was diminished as readers of their research reports began questioning the reliability and independence of their calls. Institutional funds and buy-side analysts shied away from relying or referring to research reports produced by sell-side analysts at large.

To fill that vacuum, the buy-side fund managers and analysts went directly to public listed companies to search for information and insights regarding the prospects of the companies. They began to rely more on direct contact with companies that they are investing in.

The institutions also began beefing up their own research analysis departments. The aim was not solely to improve their level of research capability but more to maintain an independent assessment and evaluation of the investee company or target company. And with that they began conducting extensive analysis on target companies in greater depth.

The IR officers at those listed companies gradually found themselves sought out and in constant communication with buy-side investors. Their role and contribution became more apparent to the institutional funds and more recognisable within their own companies.

Henceforth, listed companies began realising that IR had an important role in providing significant corporate information which buy-side investors expect and could rely upon for them to make better in-

formed investment decisions.

The role of the sell-side research analyst as an intermediary had relatively lessened, whilst the role of the IR officer became elevated. It became a competitive practice among large listed companies in the US and Europe to have a full-fledged IR team to fill the expectation of the investment community. And with that the IR team and company leaders began upholding transparent, comprehensive and consistent communication with their shareholders and investors regardless of market cycles in order to gain their trust and confidence.

Spitzer had indirectly brought about better IR by listed companies. There were, in fact, a number of other cases of corporate corruption that Spitzer stalked, such as commissions, market timing, price fixing and others. Whether or not his efforts had the desired effect is now a moot point, but this was a regulator who had the teeth for enforcement. For a time, it put a check on the overindulgence of the investment firms, and exposed their inner workings.

Today, we are faced with a global economic crisis contributed largely by the greed and excesses of many of the same investment firms in the Global Settlement case. What we need are more crusaders like Spitzer to clean up the financial system. **E**

*Eddie Razak is CEO of Malaysian Investor Relations Association (MIRA) Bhd. MIRA promotes the development of investor relations through voluntary information flow and consistent engagement between public-listed companies and the investment community. This is the first of a regular fortnightly column that will touch on many other issues relating to the practice of IR, both in Malaysia and internationally.*