It's Time to Rethink IR

"The problem with investor relations today is that it continues to get more primitive as the markets keep getting more sophisticated."

FALLS
COMMUNICATIONS

Historically, the flow of information between a public company and the investing public was a relatively straight line (fig. 1). Public company news was consumed and compiled by research analysts (the "sell side"), who then made investment recommendations to their institutional clients (the "buy side") and to the stockbrokers who served individual investors ("retail"). Once investment decisions were made—largely influenced by those recommendations—the sell-side analysts would then filter market sentiment back to the company to help its senior management team and board of directors understand its valuation and trading volume.

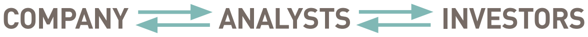


fig. 1

In this environment, the sell-side analyst helped corporate leaders understand market dynamics and investor perceptions, while looking to eliminate information asymmetry and create the time advantage necessary to drive profitable investment decisions for its buy-side clients. The former frequently rewarded the analyst with lucrative investment banking business. The latter paid healthy fees for proprietary research.

In recent years, this symbiotic relationship came to an end as U.S. policymakers changed the "rules of the road" on Wall Street in the wake of declining investor confidence and corporate scandals. With these changes, coupled with the digital revolution that ignited today's "data flow culture"[1] and the indelible effects of the Great Recession, it's become a whole new ballgame.

This is not your father's stock market

We all know the chain of events: first came Regulation FD ("Reg FD"), then the Sarbanes-Oxley Act ("SOX") and then, finally, the $1.4 billion settlement between then-Attorney General of New York Eliot Spitzer and the Wall Street banks.

Typically overlooked in the ongoing debate related to these actions is the undeniable impact that each had on investor relations:

- Reg FD caused many management teams and their boards of directors to lean more heavily on their legal counsel for traditional investor-relations activities to avoid any unintended regulatory missteps. For most companies, the increased legal influence in this area resulted in a decreased level of context and market commentary in company disclosures.
- SOX created an equally strong voice for accounting firms and auditing firms[2] in investor relations—further dampening the level of information being provided to investors by many companies.
- The settlement triggered a domino effect that greatly damaged the traditional communications channel between companies and investors, and in so doing, hurt both. For example, the settlement changed the compensation model[3] for analysts, which motivated them to direct companies towards stock *traders* who were good for their firm at the expense of those stock *holders* who were good for the company. Many investors also lost in this settlement as it left them without a key source for investment ideas and company/industry data—especially investors with long-term investment horizons based in secondary money centers.

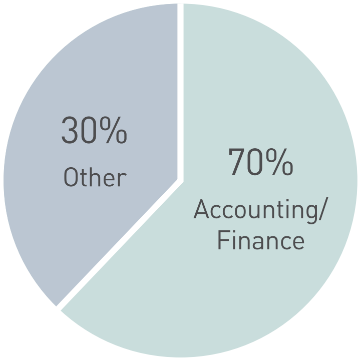
Investor behavior also began to change as technological advances created a new generation of investment vehicles—such as Exchange Traded Funds (ETFs)—and high-frequency trading strategies based on computer algorithms. The cumulative effect of all these factors resulted in an extremely difficult and volatile environment for companies in which to compete for capital.

The more things have changed, the more IR has not

Yet, even as the pitch of "the Street" has gotten steeper and the pace faster, IR strategies and tools for most companies remain largely staid. As a result, according to one highly respected, senior member of the investment community who asked to remain anonymous, "IR continues to get more primitive as the markets keep getting more sophisticated." The timing of this dichotomy could not be any worse.

Research continues to show that an effective IR program can create a median premium of 10 percent to valuation, while an ineffective program can cost a median discount of 20 percent to valuation[4]. Among other things, effective IR is said to provide investors with insight into a company's growth potential and the strategy by which it will achieve this growth[5]—the type of information investors typically used to receive from analysts. Yet, many companies today limit their narrative on historical results.

Some of this discrepancy is certainly the result of regulatory changes that caused many companies to view IR predominantly as a compliance function. It also is due to the fact that those in corporate IR positions now largely come with a financial background rather than a communications background. A 2012 study conducted by the National Investor Relations Institute and Korn/Ferry International found that more than 40 percent of IROs surveyed previously held accounting or corporate finance positions, compared with 12 percent with a background in corporate communications/public relations. The 2013 IR Compensation study by Rivel Research will show nearly 70 percent of IROs previously held accounting or finance positions (fig. 2).



BACKGROUND OF IROs IN 2013

fig. 2

Regardless of the contributing factors, it is clear to us that traditional IR is not enough to compete for capital in today's environment. "Companies that complain about their valuation typically aren't doing enough to market themselves to investors," noted this same senior member of the investment community.

THE THREE Cs OF INVESTOR RELATIONS

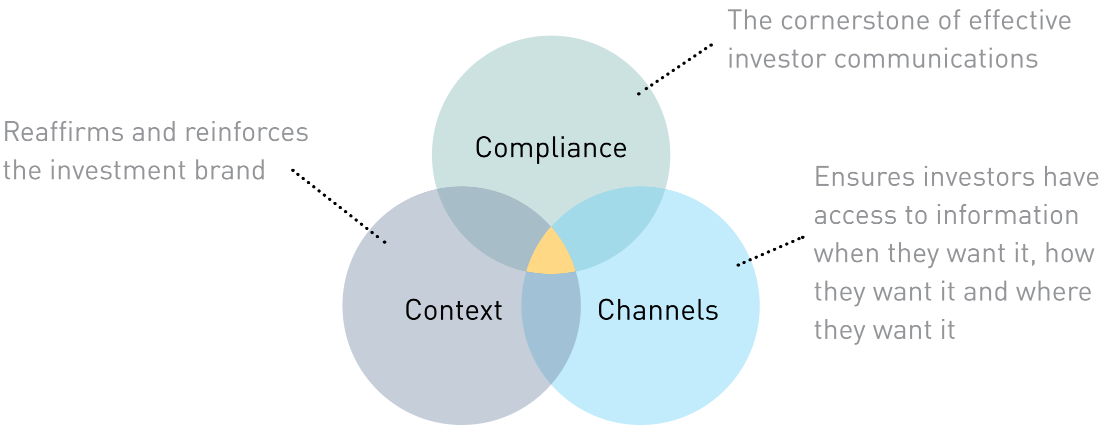

The cornerstone of effective investor communications
Reaffirms and reinforces the investment brand
Compliance
Ensures investors have access to information when they want it, how they want it and where they want it
Context
Channels

fig. 3

Traditional IR Is No Longer Enough

This is not to say that the IR function is completely broken. As a compliance and financial reporting tool, IR is as good as—if not better than—it ever has been. And this is critically important as no sustainable IR program can be built without this foundation.

But compliance is only one-third of effective IR today; the other two-thirds being context and channels. In order to engage investors and enhance value effectively through communications, IR also needs to complement and support its compliance mandate with sophisticated branding and marketing strategies. Among other things, by utilizing all three of the "3Cs of IR" fully (fig. 3), companies can create an authentic and differentiated "investment brand" that cuts through the daily noise of stock traders and enables them to make genuine connections with long-term investors. The investment brand not only reflects the central essence of the company but speaks to the company's competitive advantage.

Remember, most investors have neither the time nor the patience to unpack a company's value proposition, which is one reason they historically relied so heavily upon sell-side analysts. Investors want to understand quickly why now is the right time for them to take a position (or increase their position) in a particular company. In order to do so, they need insight into both what happened operationally and what's ahead strategically. The companies that simplify the complexity of the enterprise and neutralize potential value deflators have a competitive advantage in the financial markets.

Investors also do not want to search for the information they need to make investment decisions. For this reason, it is equally advantageous to make the company easy to follow by bringing a marketer's approach to channel development, thus combatting the static that now exists in the traditional line of

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communications with investors. From responsive web design to mobile apps to such emerging social platforms as Stockr, companies need to cultivate a diversified channel strategy to ensure that investors have access to desired information when they want it, how they want it and where they want it.

This marketing approach to IR also enables companies to engage investors and enhance value more effectively, as well as protect their investment brand. Similarly, this approach aids companies in serving a broader investment community, including customers and employees. If properly cultivated, this extended investor base can provide needed stability during periods of trading volatility or support during proxy contests.

Rethinking IR

The investment community has changed—from the manner in which investment ideas are surfaced and researched to the rate at which investments are executed and portfolios adjusted. It has never been more difficult to compete for capital.

In today's market, companies need a differentiated investment brand that underpins all of the communications and touch points with stakeholders. They also need a diversified channel to market to ensure that the brand is resonating with investors clearly and consistently—and that a secure and reliable feedback mechanism with the financial markets is in place.

Therefore, companies cannot rely upon the tactics and tools of the past and expect to be heard above the roar of the global financial markets.

As Matt Sonefeldt, who heads up investor relations for LinkedIn, posted on October 2, 2013, "Storytelling who you are = the future direction of building a relationship b/w public companies & long-term focused investors. The good ones will do this well."

The time has come to rethink IR. Companies that cling to the status quo are leaving money on the table.

Notes

[1] Glen Hiemstra, "What Is Your Image of the Future" presentation at National Investor Relations Institute Annual Conference, June 2012

[2] Global accounting firm KPMG bought a leading UK-based IR consultancy in April 2013

[3] "The settlement cut the link between an analyst's bonus and the amount of investment banking fees he or she helped generate, forcing analysts to eke out a more meager living from sales and trading commissions alone…" The Financial Times, June 2011

[4] Rivel Research, June 2013

[5] Ibid.

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