

# INVESTOR RELATIONS: COMPLIANCE vs COMMUNICATION

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The contribution of investor relations (IR) is no longer a matter of debate within the listed company marketplace. We know that the cost to a company of not recognising the importance of communicating effectively with its shareholders and the investment community can be meaningful when measured in terms of an underperforming share price and a company's ability to access equity capital when needed.

Within the top 100, an investor relations department or a dedicated team of IR specialists within the Corporate Communications function is the norm. For the vast majority of companies outside this group, however, IR remains a work in progress. If it is resourced at all, the role is almost always a dual one. Many mid-cap companies address the need by representing IR as an extension of its broader communications activities and will assign responsibility to the person in charge of media relations and PR. With a few exceptions, this is almost always a compromise as the skill sets required for IR and PR are quite different.

Understandably the smaller the company the more likely that IR becomes part of the job description for one of the C-suite executives, most typically the CFO or Company Secretary. Where the CFO is also fulfilling the Company Secretarial role, it is not hard to imagine where IR sits on the priority list between managing compliance and balancing the company's books!

The Company Secretary, with a focus on governance and compliance, has a vital role in supporting a company's ability to communicate effectively with its shareholders. However the fact that IR is frequently integrated into the Company Secretarial function suggests that many companies simply view it as one of compliance with continuous disclosure

and keeping shareholders informed through their statutory reporting obligations. This is both restrictive and out of step with current practice, particularly in North America and Europe, which increasingly views IR as a discipline integral to the execution of corporate strategy.

The primary purpose of this article is to challenge this state of affairs: to ask why companies are prepared to marginalise this function by outsourcing IR to PR companies; to ask why a company that adds IR to the demanding roles of the CFO and/or Company Secretary could regard that as an appropriate alignment of skills and allocation of resources? There are alternatives but before we explore them, we should first ask the obvious question... **What is IR?**

## 1. IR is not PR.

In Australia for many years it was accepted practice (and still is for some) for companies to employ PR agencies to 'do their IR'. After all, goes the thinking, investor relations is simply just another form of communication. In my view, for many people this has led to an unfortunate association of IR with 'hype' where the purpose of an ASX announcement is seen as putting the best possible construct on the information in order to deliver an increase in the share price.

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For many companies building awareness through a media or PR program is a valid strategy. However to believe that this can proxy for the discipline required of an investor relations program, designed to inform and articulate a company's investment credentials, would be a mistake.

It is worthwhile to expand this slightly. Most PR companies (certainly, not all) are not capable of assessing with an analyst's eye the information provided by the client company. In all likelihood, they will not be able to assess the draft financial results and offer insightful, objective comment. This is not to denigrate them, but clearly, unless you have the appropriate background, you cannot debate the pros and cons of accounting information that, very often, is extremely complicated.

An investor relations firm can and does. In other words, an IR practitioner will seek to influence how the communication is crafted based on a deep understanding of what the results reveal or, sometimes, don't reveal. A PR practitioner, by contrast, will generally be obliged to accept on face value what's provided and then turn it into a silk purse, even if the results are a sow's ear. There must be a link between IR and PR but they are separate functions and one – PR – follows the other.

### **2. IR specialises in communicating a company's strategy and its financial performance to its shareholders and investors**

In much the same way as PR consultants or in-house corporate affairs specialists often have a background in media, journalism or current affairs, the IR specialist brings to the table experience in financial markets and an understanding of corporate strategy.

To communicate effectively to financial markets requires an awareness of the complexity and interconnectedness of the many influencers and decision makers associated with a company's stock. Understanding how the various different segments of this diverse community operate and what information broker analysts and investment advisers need to be effective in writing their research and recommending stocks to their clients is vital. It is not solely about creating attractive slide presentations or media releases with affirming quotes from the MD.

It begins and ends with the content and whether those who receive it believe it and are confident that the information has been represented in an open and transparent manner.

### **3. IR is about targeted communications to potential investors**

Knowing how to present your investment case to the institutional investor, and understanding that not all fund managers are the same, avoids a lot of wasted time and energy. The conversation you have with a hedge fund for example will be very different from one with a long term value investor.

Understanding the broad investment philosophy however is only the start. Each fund manager will put in place filters that serve to reduce the size and risk profile of the investment universe in which they operate. Common filters are market capitalisation, liquidity, gearing levels, positive cash flow and various exclusions on ethical or social grounds e.g. tobacco stocks, armament manufacturers etc. So before a company even steps out the door it pays to have done some homework to avoid wasting the time of both management and the investor it is seeking to impress.

### **4. IR is about developing personal relationships**

Company CEOs and CFOs of Top 200 companies will typically spend up to 40% of their time on investor relations activities. Whether it is briefing the market on its financial results, meeting with shareholders, presenting at conferences or marketing their company's investment credentials to potential investors, these interactions do matter.

Smaller companies outside the top 200 have a different challenge - they must compete for the attention of a limited number of small cap analysts, fund managers and investment advisers who act as the gatekeepers to the large pool of superannuation money seeking a home. Unlike the top 200 companies, institutional investors and main-stream brokers are not beating a path to their door so it is up to these companies to be proactive and make sure they are noticed.

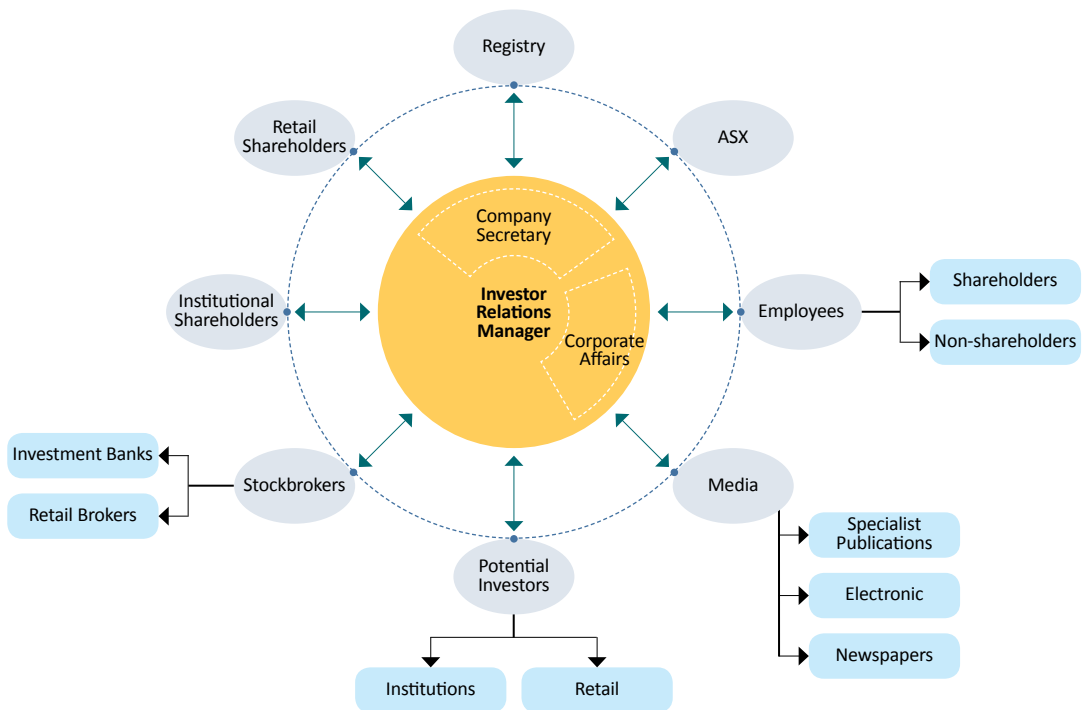
The choice of who companies meet with will be the catalyst over the short to medium term for whether stock is bought or sold. In the longer term however it is relationships that play a big part in whether capital can be raised at critical times, the discount that must be applied to a company's share price in raising new capital or whether the board can rely on shareholder support in a fight for control.

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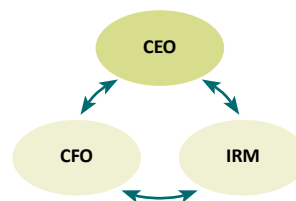
### Fitting IR into the Corporate Structure

At the macro level, the investor relations function interacts with a diverse range of groups. Within the corporate, much of the day to day responsibility inevitably resides with one or more senior executives within the management team, namely the IRM, Corporate Affairs Manager and Company Secretary. The degree to which these roles intersect and overlap is typically determined by the size of the organisation.



The larger the organisation, the greater the degree of specialisation. Primary responsibility for the communication of the key messages surrounding the company's strategy, operational outlook and financial performance rests, at all times, with the CEO and CFO. The role played by the IRM is pivotal in facilitating that process through knowledge of the market participants, understanding of the issues and access to market intelligence and resources. This ensures that management time is utilised efficiently and communication strategies are accurately targeted.

It is important that the core function of IR revolves around the triumvirate of the CEO, CFO and IRM.



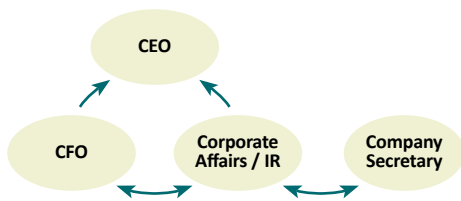
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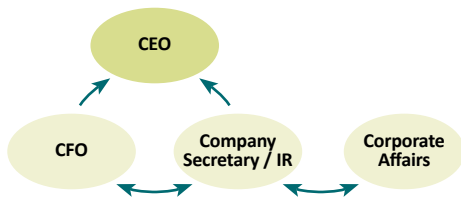
### The Company Secretary / Corporate Affairs Manager / IRM

While role specialisation is preferred, the reality is that few companies in Australia follow this approach - particularly in relation to the IR role.

The IR function often evolves out of either the Company Secretarial or the Corporate Affairs area. The outcome from an organisational perspective will mean IR often is an extension of either Corporate Affairs...



or Company Secretarial.



Whilst we would not regard this as best practice, it does reflect the practical reality for many small to mid cap sized companies. While the structures outlined above represent only two of many combinations, they are preferred due to the placement of IR within the senior executive.

In Australia the model is still very much a work in progress. At FIRST Advisers we reviewed<sup>1</sup> the organisational structure of 200 small to mid cap companies that we would have expected to see resourcing this function either as a dedicated or hybrid role. We identified only 23% of companies with a dedicated investor relations function and another 8% which specifically nominated Corporate Affairs, Company Secretary or CFO function as having this dual role.

1. Companies selected were from the ASX300 Index, excluding the top 100. Annual reports and company announcements were reviewed for reference to the position of investor relations as a dedicated role or in conjunction with another function.

*Interestingly over two-thirds of companies had no nominated contact at all in relation to investor relations queries.*

We can however safely assume that these companies, which have market capitalisations of up to \$1.6bn, will have developed their own internal protocols around servicing the needs of investors, particularly institutional investors, and the broking community. Our experience is that responsibility for different facets of the IR role is often shared among two or more executives in the C-suite. There are limitations to this approach as the following discussion demonstrates.

### The Limitations of Functional Overlap

Companies that choose to resource a function by simply allocating those new responsibilities to an existing role may be implicitly assuming that:

- the individual has spare capacity
- there are areas where the two roles overlap
- the individual concerned has the qualifications and experience to do equal justice to both roles

If a) is assumed, the efficacy of adopting the hybrid role will be determined by b) and c) and whether these are reasonable assumptions in the first place. In order to gauge how this might play out in reality, we must first look at the job specs for each of the roles most frequently encountered in a hybrid IR position and secondly to identify where the points of overlap might exist.

### Investor Relations Manager

The person in this role is responsible for communicating financial results and business strategy to shareholders and the investment community. At its core, the goal of investor relations is to ensure that the value of a company's share price reflects the value of the business based on all publicly available information at the time.

The investor relations professional must understand the investor audience and the information it requires in order to make investment decisions and recommendations. To do this without having worked in the financial markets on either the buy-side or sell-side is possible but is challenging.

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It is tempting to look at the public face of the IR role as simply one of “developing the key messages” for investor communications including the annual report, investor/analyst meetings, the company website and other materials. Add to that the co-ordination of meetings and roadshows, creating slide presentations and writing scripts and one can see why those in PR would be thinking this looks like familiar territory. Indeed many PR firms are happy to advertise themselves as IR specialists on this basis alone.

It is however what happens behind the scenes that distinguishes the practitioners from the pretenders. An IR manager with a finance/markets background should be able to influence how a company’s financials are presented to ensure that analysts and professional investors have the necessary financial data and qualitative input required to make informed judgements. The slides in the briefing pack should provide additional layers of analysis to place the numbers in context historically, various ratios and investment metrics should be presented to highlight underlying trends in performance and the answers to questions anticipated in the commentary.

By keeping in close contact with the investment community, the IR Manager will identify issues and concerns of existing and potential shareholders. For smaller companies, which are not in the fortunate position of having to prioritise the stream of requests for meetings, knowing who to target and how to get on the radar of key decision makers is key. Forming these relationships is vital and requires a working knowledge of who’s who in the market and, in particular, which individuals offer the best prospect of being able to invest in or write research about your company.

*Qualifications typically required include a Bachelor’s degree or equivalent with an MBA or CFA regarded as a plus. An IR professional should be able to evidence knowledge of investor relations practices and rules regarding disclosure of corporate information as well as the ability to understand accounting principles and analyse company financial statements.*

### The Company Secretary

The communications role of the Company Secretary is largely compliance orientated with a strong bias towards ensuring that the company meets its reporting obligations and all other legal requirements associated with its status as a publicly listed entity. This typically includes the following:

- Meeting continuous disclosure obligations under LR3.1
- Responsibility for reporting on corporate governance within the organisation’s annual report
- Maintaining the company’s share register and advising ASX of any changes such as buying or selling by directors, the issue of new shares or buyback notices and substantial shareholder notifications.
- Organisation of the AGM including sending out the Notice of Meeting, liaising with the registry on the lodgement of proxies and notifying the ASX of the outcome of voting
- Responding to queries from retail shareholders, typically concerning the status of their holding or payment of a dividend.

Company Secretaries most often have a Bachelors degree in law or accounting and will have attained the appropriate certification from an industry body such as Chartered Secretaries Australia.

### Corporate Affairs including Government and Media Relations

While a pure Corporate Affairs role is usually only found in larger organisations, variants of it can exist in smaller companies where managing external relationships with community, government and the media is a necessary part of doing business. Its primary focus is on managing and protecting the company’s brand and reputation.

Corporate Affairs, therefore, manages communication with a range of audiences including: the wider community, governments, media, employees and any other groups that can potentially impact the organisation’s licence to operate. The role may include managing crises, introducing new products, negotiating prices, managing media placement, maintaining the corporate website, administration of sponsorship and philanthropic activities and writing corporate literature. More recent responsibilities that have emerged might include oversight of the company’s Corporate Social Responsibility (CSR) activities and monitoring the impact of social media on corporate goals.

Corporate Affairs Managers often come from the media or journalism but are also frequently hired from a wide variety of backgrounds. Prior experience of the sector is often not the most important factor. However, for companies operating in regulated industries, preferred appointees have a track record of experience in government and public affairs.

As the following table highlights, delegating IR to either the company secretary or corporate affairs, will realistically enable a company to resource only 25-30% of those activities undertaken by an IR professional. Around half of these could be characterised as having an event management or administrative function. Designing outreach programs, analysing broker forecasts, monitoring perceptions, crafting presentations that avoid ambiguity around interpretation of the financials and delivering a clear and consistent articulation of strategy, may not be delivered either because of a lack of time or skill or perhaps both.

IR Activities	Investor Relations	Company Secretary	Corporate Affairs
Design and execute company's annual IR program	✓		
Meeting the company's continuous disclosure obligations	✓	✓	
Monitoring broker forecasts and tracking consensus estimates	✓		
Organising meetings with institutional investors	✓		
Ensuring avoidance of selective disclosure to investors	✓		
Organisation of the AGM	✓	✓	✓
– Write speeches, draft presentation, provide Q&A for AGM	✓		✓
Responding to queries from retail shareholders	✓	✓	
Responding to queries from institutional shareholders/investors	✓		
Manage production of the annual report	✓	✓	✓
– Drafting the business overview and Chairmans review	✓		✓
Reporting to the board on shareholder movements	✓	✓	
Analyse composition of register and trends in institutional ownership	✓		
Manage reporting of results announcements including:			
– Drafting ASX release	✓	✓	
– Organise investor briefing including presentation and Q&A	✓		
– Manage roadshow including shareholder and investor meetings	✓		✓
Identify new institutional shareholders through targeting programs	✓		
Actively monitor and/or survey investor perceptions	✓		
Identify investor conferences for company presentations	✓		
Build relationships with brokers to facilitate research coverage	✓		

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### The External IR Specialist

Where IR is managed by someone with dual roles, external specialist expertise can supplement or proxy for in-house resources. For companies in Europe and North America, engaging an external IR firm to support their in-house resource is relatively commonplace, in much the same way as Australian companies think nothing of supplementing their in-house legal counsel or accounting functions with external advice. In Australia, where once it would have been enough to engage a PR firm in the belief that this would address any shortcomings in IR, there are some signs that this is no longer regarded as acceptable. A collaboration which uses the skills and experience of a qualified, experienced IR consultant to supplement those of the in-house Corporate Affairs/PR department or the Company Secretary will always produce a superior outcome for the company than any hybrid IR role.

In summary, I believe strongly that it is a mistake to diminish the IR function by folding it into other specialist roles or simply to view investor relations as nothing more than another form of PR. It's acknowledged that cost control often dictates such decisions but, generally, there will be a price to pay and it can be quantified.

Interviews with institutional fund managers and analysts in the US<sup>2</sup> attributed a premium of 10% of a company's valuation to good investor relations and a discount of 25% to bad investor communications. Recent surveys in Canada and Australia<sup>3</sup> have replicated these findings.

I believe it is incumbent on listed entities to view and treat Investor Relations as a vital function in their continued successful existence. For companies that do not need a full time IR specialist, accessing the required expertise by seeking external advice should be viewed as an investment they cannot afford not to make!

2. Rivel Research conducted in 2009: refer their website [www.rivel.com](http://www.rivel.com)

3. Australasian Investor Relations Association (AIRA) press release 20 July 2011

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