THE HEIGHTS

Applying Analytics to Investor Relations

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An area frequently overlooked for the application of analytics is developing an investor relations plan and monitoring the company's progress toward a set of established outcomes which support a fair valuation for a company's stock. It is unusual for a strategic discipline involving the highest level of corporate management to be void of planning, particularly an area with easily accessible data.

The following describes four practical analyses corporate executives can use to discern meaningful patterns about the trading activity and equity ownership of their company's common stock. The data is instrumental toward developing strategic investor relations plans which are aligned with the corporation's long-term business strategies and prospects for growth.

Portfolio managers buy and sell shares based upon expectations for future financial performance. Responding to institutional shareholders' concerns about this quarter or next is tactical. Developing investment messages which shift the focus from the company's financial performance last quarter to creating reasonable expectations for a stock valuation two to three years into the future is strategic.

According to the National Investors Relations Institute (NIRI), investor relations is a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation.

It is a team sport which is highly regulated, time sensitive and vulnerable to risks of litigation. As a result, many processes are more tactical than strategic, primarily due to important compliance and disclosure requirements. However, there is no reason to stop there. Executive management teams have the opportunity to manage their relationships with the financial community as efficiently and productively as they manage the rest of the company.

A more proactive approach to investor relations based upon sound analytics promotes better informed investment decisions and stock valuations which more accurately reflect the company's investment characteristics and prospects for growth. Executives can better manage Wall Street's expectations by regularly evaluating the effectiveness of their investor relations activities and making course corrections when necessary.

Another good reason to apply a more thoughtful, analytical approach to investor relations is to show existing and prospective shareholders first-hand how the company operates and how its leaders lead. This assessment goes well beyond compliance, minimum disclosure requirements, transparency and accessibility. It speaks to the culture of the organization.

Institutional Shareholder Mix

Analyzing the mix of institutional investors will indicate the investment styles attracted to the company. Comparing the investment styles of the equity holders with the investment characteristics of the company for which the common stock is held may be the single best measurement of message clarity and efficient utilization of management's time. Oversimplified; growth stocks should have a large percentage of shares held by growth investors and value stocks should have a large percentage of shares held by value investors. An appropriate shareholder mix helps promote more reasonable expectations for the company's future financial performance, and therefore, a more orderly market for the common stock.

Successful investor relations strategies involve creating sound communications around well-articulated investment characteristics and marketing to targeted prospective shareholders with investment styles that match those investment characteristics. Shareholders will change as the company's investment characteristics evolve over time and monitoring the mix of institutional shareholders on a regular basis will help identify when a course correction in messaging and/or time allocation is necessary.

Common mistakes include spending too much time with the sell side at the expense of the buy side or relying entirely on the sell side to prospect institutional investors for the company. Accurate brokerage research coverage is very important and access to corporate management encourages the accuracy of research coverage. However, adequate time should be allocated to the buy side as well. The sell side can be very helpful toward prospecting shareholders; however, achieving an appropriate shareholder mix is too important to delegate. If there isn't a good match between investment styles and the company's investment characteristics, investor perceptions about the company's current financial performance and expectations for future growth could be unrealistic.

Investor Perceptions

Incorrect investor perceptions may be the best explanation for why the common stock of a particular company is mistakenly undervalued. Collecting information about how a company is perceived is very useful and can be accomplished formally or informally. Since perceptions are heavily influenced by investment styles, sample size and selection are very important. Collecting information from the wrong investment style could lead to incorrect decisions about appropriate course corrections.

The purpose of this analysis is to discover discernible patterns of investor perceptions for which the company will take further action. Analyzing the frequency of areas of interest and points of confusion requiring further clarification are useful toward resolving misperceptions and improving the effectiveness of future communication.

If the investment styles of institutional shareholders are aligned with the investment characteristics of the company and inaccurate perceptions still exist, management may need to make a course correction regarding its communication with the financial community. Comprehensiveness, consistency, accuracy, continuity and timeliness are among the areas for further refinement.

A formal investor perception study involves structured interviews with existing and prospective institutional shareholders. Companies usually contract with third parties who can solicit candid feedback with a commitment of anonymity. This type of formal study will help management determine whether investors fully comprehend the company's strategies, investment characteristics and prospects for growth.

An informal process to collect data about investor perceptions is based upon management's interaction with the institutional investors. Speaking directly with shareholders provides ample opportunities to learn more about what they are thinking and represents one more reason why management accessibility is important.

A common mistake is to use sell side research as a proxy for investor opinions. Although published research is more easily accessible than collecting opinions from investors, brokerage research reports reflect the analyst's opinion only. The research does not represent a consensus of investor perceptions, and more importantly, may not accurately reflect investor opinions.

Another common mistake is to assume that investor perceptions are dependent solely upon the information generated by the company. Other contributors to investor perceptions include brokerage research reports and communication generated by peer companies about the industry or similar markets served.

Peer Group Analysis

Since portfolio managers contrast and compare the financial performance of companies providing similar products or services, it is beneficial for corporations to perform the same analysis and monitor the activities of peers on a consistent basis. The information helps management prepare in advance for interactions with the financial community and facilitates opportunities to display their industry knowledge, correct inaccurate perceptions and/or clarify variances between their company and its peer group.

Peer analysis serves another purpose as well. There will be periods when external factors appear to drive the trading activity for a company's stock more than its financial performance and future outlook. Stocks trade with their peer group, their industry and the overall market. Monitoring the stock price and trading activity of a company's peer group can be very helpful toward explaining changes in the company's stock price and trading activity.

Stock Price and Trading Activity

In my experience, evaluating the relationships between stock price, trading activity, investor interest and stock ownership lead to more effective investor relations strategies and practical tactics. Daily monitoring is less useful than analyzing relevant patterns and historical trends.

The purpose of this analysis is to determine the liquidity and volatility of a company's stock over time in order to recognize extraordinary variances which may require course corrections related to managing expectations. Fully understanding why a stock is trading at a premium or a discount to its peer group and why it appears more or less volatile than others in the peer group, can help signal the need for a course correction in tactics.   The issues could include but are not limited to inappropriate shareholder mix and/or inaccurate investor perceptions.

A common mistake is to overreact to fluctuations in the stock price or trading volume without fully understanding the drivers and detractors. Another common mistake is to ignore fluctuations under the assumption that management cannot influence liquidity and volatility beyond reporting quarterly or annual financial results.

Conclusion

Maintaining a presence with the financial community on a planned and consistent basis helps companies achieve the best possible stock valuation relative to its peers over the long term . . . despite short-term fluctuations in the overall market.   An analytical approach is necessary to develop effective investor relations strategies which promote a long-term view of the company while attracting investors at each stage of the company's life cycle.   Analytics have an obvious role in monitoring the success of investor relations activities and signaling when changes in tactics are necessary to maintain a fair valuation consistent with the company's investment characteristics.

The Heights Company, LLC helps companies establish, augment and refine their investor relations capabilities.   The ultimate goal is to help clients integrate proficiencies into their organizations which will last long after the engagement with The Heights has ended. More information is available on www.theheights-planning.com.