The Strategy and Practice of Investor Relations

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Preface

In its infancy, investor relations was seen basically as a job of fulfilling the information requests of analysts and investors. That was then. This is now: Investor relations is a proactive process in which vital and valuable information is continually and broadly disseminated to the financial community and the investing public to ensure that a company will be accurately valued in the marketplace.

The contribution of the investor relations practice to improving valuation has grown substantially in recent years. The institutionalization of the capital markets has demanded it. Additionally, Securities and Exchange Commission (SEC) rules require transmission of information to professional and individual investors alike. Professional investors, with millions of dollars at stake, place a high priority on obtaining the best possible information to make their investment decisions.

As companies achieve the depth and quality of information required by the market to develop fair valuations, they are:

- Creating stronger relationships with analysts, portfolio managers, brokers and individuals — even receiving feedback from them on a regular basis
- Building respect for the investor relations function

Not all companies are at the same place in the investor relations process, however. Some companies are barely fulfilling minimal disclosure requirements. Others are executing strategies and conducting communications programs based on sophisticated valuation analysis.

This book is written for a cross section of companies, with emphasis on those companies that have yet to achieve the full potential of their investor relations programs. Its purpose is to show why investor relations is important and to provide guidance on how to perform the function efficiently and effectively.

This book was commissioned by The Nasdaq Stock Market® for use by its listed companies. It was written by William F. Mahoney, an IR expert who is executive editor of *Shareholder Value* magazine, published by Kennedy Information. Before that, Mahoney served as editor for 20 years of *Investor Relations Update*, published by the National Investor Relations Institute. Mahoney is author of *Investor Relations: The Professional's Guide to Financial Marketing and Communications*, published by Simon and Schuster; the *Investor Relations Guide,* published in 1999 by Kennedy Information LLC; and *The Active Shareholder*, published by John Wiley & Sons, Inc. He also consults with corporations on investor relations and corporate communications.

Part I Purpose and Value of Investor Relations

Part II Implementing the Practice

Part I

Purpose and Value of Investor Relations

Chapter 1

The objective of investor relations is to give investors and analysts the best information possible so that they can accurately apply it to evaluating your company.

Key Components of Investor Relations

Investor relations encompasses three vital and interrelated components. The first is communications, or the flow of valuable information. The objective is to give investors and analysts the best information possible so that they can accurately apply it to evaluating your company. As new developments and financial results are reported by the company, investors see how each action fits into the company's overall strategy. Information creates insight that helps analysts and investors make informed decisions about the fundamental strengths and prospects of companies.

The second involves building mutually beneficial relationships with investors, analysts and brokers. Relationships are built on quality information, timeliness in providing it, thoroughness, candor and honesty, and management's ability to deliver on promises.

And the third is providing feedback to corporate executives on how the market views the company, its strategies and key initiatives to create and sustain value. This role encompasses understanding current attitudes of analysts and investors toward the company, having a strong sense of how the market will react to strategies, and gaining insight into actions investors will favor. Investors approving of certain corporate strategies and actions are likely to respond by buying shares, causing stock prices to rise.

When companies and their investor relations professionals handle these three components well, they are more likely to see their stocks fairly valued. The reason is that the companies are helping investors develop realistic expectations by providing accurate information for analyzing results and making forecasts. Management is also focused on creating value and demonstrating an understanding of what it takes to do so. In seeking fair value, companies are not holding back important information that could lead to a big surprise later.

Analysts and investors favor companies that deliver dependable information and tend to have predictable performance. Credibility is established. Confidence in management grows, along with confidence in what the company says.

The rewards of this relationship can be significant. Value gaps tend to diminish because investors believe management can accomplish what it says. Positive events and developments

earn higher stock gain rewards. A flat or down quarter isn't an automatic sell signal. Investors look for explanations and, when convinced that fundamentals are still strong and growing, are more likely to hold their shares or even increase their positions. Patience is more likely to be accorded. Any shareholder restlessness is more likely to be played out in discussion with management on how improvements can be made rather than in proxy proposals. Or, if a proxy proposal does come, it may not get much support.

Importance of Managing Expectations

Managing investor expectations means different things to different companies. In total, it is a process aimed at creating the best possible knowledge of your company. Studies indicate that there is economic value in information. A well-informed market is more likely to price the stock closer to its full value.

Managing expectations also applies to the efforts of sell-side analysts who estimate a company's earnings for the next quarter and year. Analysts have made these estimates an important part of their work. Many portfolio managers pay close attention to anticipated earnings results; there are several major investment models today that rely chiefly on earnings expectations.

The focus on quarterly earnings can make it seem as though the market is driven by earnings. Miss the analysts' consensus forecast and the price is sure to fall, even if earnings are better than the comparative reporting period. Make the forecast and the price doesn't move — even though the results are below the comparative reporting period.

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Clearly, the market is reacting to earnings forecasts and discounting them in current stock price. That's why a positive surprise often boosts price and a negative surprise often causes price to fall. However, studies show that the price volatility around earnings is a short-term factor. It is likely that earnings momentum and high earnings growth investors are selling their shares to lock in and avoid losing profits.

What happens next determines what happens to share price down the road. As momentum investors leave, institutions with longer-term investment horizons basing their decisions on fundamental analysis of the company are inclined to buy shares to take advantage of the lower price, recognizing the company's strengths to grow over time. These can include current shareholders and institutional prospects with moderate growth, growth at a reasonable price (GARP), or value investing styles, who find the price and prospects attractive. In time, the price recovers and may go higher, based on company performance and whether the market is rising.

In this very real scenario, communications can play an important role. Companies benefit from a program of active communications, building market confidence in fundamental strengths all along. During times of difficulty, it is important to reinforce growth strategy and initiatives. Companies also benefit from targeting institutions with compatible investment styles.

Of course, if a quarterly earnings decline is signaling a weakening of fundamentals and a substantial fall in financial results, companies can expect to see stock prices continue to fall as shareholders leave and as some investors sell short. Eventually, the lower price will attract value investors, willing to buy shares of a company with slower growth. The key word, however, is growth. There must be evidence of continuing growth — earnings and cash flow primarily, but also revenues — even if earnings growth is at 5% to 10% levels instead of the previous 20% or 25% or more. By then, the stock price will be seen as attractive at those growth levels to value investors.

Thus, the best your company can do is provide useful information that enables analysts and investors to make prudent evaluations of corporate performance and financial results. Most companies believe it is better to have all analysts and investors of like mind in their opinion of the company's future. These companies are "guiding" analysts more diligently, providing certain information and numbers aimed at creating a tight consensus.

Other companies, especially smaller ones trying to create interest, believe in leaving room for smart investors to exploit market inefficiencies. As these investors and others start buying shares, they create demand for the stock.

Managing expectations is far from being a fine art. Positive or negative surprises can occur as analysts and investors use earnings as a measure of strength and growth prospects. Positive surprises mean a company is performing above expectations. That's what investors prefer. If your company is going to surprise the market, do it on the plus side. Guidance can be conservative. But surprises can raise questions about management's ability to manage the business and about whether the future is out of management's control. If a company routinely surprises on the positive side, investors eventually will catch on and may start pegging expectations too high.

IR Role in Creating Fair Value

A carefully planned, well-executed investor relations program can improve your company's ability to achieve fair value. And fair market value is what companies should seek.

Corporate managers often argue that performance is all that matters. Improve sales, cash flow, earnings and margins each year and each quarter, and our investors will love us. The flip side: Show a slowdown or decline for even one quarter, and they'll complain and worry and maybe sell some shares. If the problem persists, they'll sell more or liquidate their position and perhaps even short the stock.

These dire responses are less likely if a company's IR efforts maximize the value of information in helping investors fully understand the company. The goal is two dimensional:

- To meet investors' demands for information
- To get investors to be open to hearing and accepting new information from the company, focusing on the future

The latter often results from satisfying the former.

In this communications process, it's important to focus on the numbers that drive performance and to have a clear understanding of the strategies, implementation plans and progress in making the numbers.

Companies willing to lay out their strategies in detail, describe and quantify the initiatives to accomplish them, supported by numbers, stand a better chance of achieving fair value. So the quality of information becomes the critical element in determining how effective your company is at enabling the market to fairly price your stock. (Chapter 3 discusses in detail the information investors and analysts require and prize in working their models.)

Fair Value = Market Efficiency

The question for companies to analyze is where their stocks stand at the present time on the valuation scale. Is it fairly valued, overvalued or undervalued? When a stock is fairly valued, the market is "efficient" in its knowledge and evaluation of your company. Essentially, the market knows all that's important to know in valuing your company's securities.

Market efficiency is a topic of continuing debate among investors and academics.

The consensus seems to be that the market is efficient long-term, inefficient short-term. This applies to individual companies as well. What this means is that the market eventually catches up with the relevant information in valuing a company but, in the near term, there can be information and knowledge gaps that can be exploited by investors for short-term gain. Companies have opportunities to close that gap, using information.

Overall, the market is seen as being more efficient for larger companies because they typically command more brokerage analyst coverage based on the higher number of shares available for trading. These trades can generate significant commissions for brokerage firms. More shares to trade, in turn, attract institutions, who have the flexibility to take substantial positions if they wish, knowing there is sufficient liquidity to sell or buy more shares without severely impacting market price.

Even the biggest, most widely followed companies experience market inefficiency, as is evident in how stock prices react to bad or good surprises in earnings.

Smaller companies need to work harder to gain market recognition. And that's what effective investor relations programs are designed to do.

Undervalued Stock

Managements believing their stocks are undervalued can wait to be discovered or can help the effort along. If you wait, your company may never get discovered. Or it may lose a lot of valuation during the wait. That can affect managers' stock options and compensation. Or the company may be taken over, possibly for less than it's worth, during the wait. That can affect managers' jobs.

A company's stock could very well be undervalued for two major reasons:

- Lack of information in the marketplace. The market just doesn't know the company.
- Doubt about what the company is doing or saying. Perhaps the company's ability to perform consistently, its competitive advantages and its essential strengths are not recognized or believed.

In these situations, the opportunity to change awareness, perception, attitude and knowledge levels through investor relations is very real. And the benefits that accrue to valuation are very real. Dr. Baruch Lev, professor of accounting and finance at New York University, has studied the impact of information on the market extensively. Dr. Lev estimates that there are thousands of mid-sized and smaller companies with market undervaluations caused mainly by the lack of investor knowledge.

Overvalued Stock

A company's stock also can be overvalued. Perception sometimes gets ahead of reality. Whether or not investors and analysts believe the perceptions, they're making money during this period. But they stand ready to change their recommendation or drop a stock as soon as they see cracks in the facade.

Companies can contribute to overvaluation through actions or words. When a company announces new technology, products, or gains in market share, it should exercise care and caution in its communications. The point is to help keep investors' and analysts' expectations at realistic levels.

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The risk in being overvalued is that shareholders may eventually recognize the situation, sell hard and fast, possibly causing the price to fall more than a fair valuation suggests. Investors move quickly to lock in profits by selling, or they sell to cut losses, or they sell for seemingly irrational reasons.

So here's another situation where good information can help keep a company out of trouble. Make sure information enlightens investors and doesn't mislead them. Sketchy information can lead to inaccurate conclusions. Overstating prospects or results, making promises that don't come true, and giving information that isn't accurate are actions that can negatively affect your company. They can cause the company to lose credibility, induce selling instead of buying, cause the price to drop and investors to sue. It can take a long time of proven performance and communications to restore credibility once it's lost.

Analysts and investors sometimes make the wrong decisions for lack of information. Or they ignore the company because there are other equity investments to pursue with information available to use in making a buy decision. Smaller companies often are neglected simply because the lack of information causes investors to fear they will be surprised by bad news.

Rewards of Communicating with Investors

Clearly, companies have a duty to communicate with their investors. Through quality information, they can develop a supportive base of shareholders who will be patient as long as progress is being made.

Companies that recognize their duty to provide useful information and seize the opportunity are rewarded. A comprehensive 1993 study ("Corporate Disclosure Policy and Analysts") by

Professors Mark Lang of Stanford University and Russell Lundholm of the University of Michigan confirmed this: Forthcoming companies have more analyst coverage; the analysts' forecasts are more accurate; and, as a result, more investors are attracted to the stock.

Professors Lang and Lundholm wrote that "more forthcoming disclosures cause the analysts to place more weight on the common firm-provided information, thereby increasing the consensus of their forecasts." The authors also stated that forthright companies "have a larger pool of potential investors, and these investors have more accurate beliefs about the firm's future performance and greater consensus in their expectations."

IR as a Marketing Function

As the investor relations process has matured, companies have realized the benefits of taking more of a proactive than reactive approach. Being proactive enables companies to make investor relations a marketing function. Thinking of it that way opens all kinds of opportunities to increase valuation.

Being proactive means you're providing a steady flow of good consistent information to make the market efficient for your company. You're making sure the information that's vital in valuing the company accurately is in the marketplace. Indeed, this information is often referred to as the company's "value drivers." It can include a franchise technology, superior products and a strong pipeline, great marketing finesse, solid brand reputation, pricing and cost advantages, close customer ties, a highly-motivated and productive employee force, and a smart management team.

You're also having some influence on your company's shareholder mix. Companies influence investors' decisions by their actions and the value of the information they provide. By reaching out to investors, serving as sources of useful information, companies can lead investors to make better decisions — on whether to buy, not buy, hold or sell.

Investor relations is working at its best when the company's shareholder base reflects the investment profile of the company. Institutions are highly compatible based on the match of their investing styles with the company's investment characteristics. Individuals find the company attractive for its growth prospects, kinds of products, community and social citizenship.

If there's such a thing as an ideal mix of shareholders, it consists of a combination of longer-term holders (institutions and individuals) with strong beliefs in the future of the company, and shorter-term holders who are in the stock because their investing styles are consistent with the company's current investment characteristics. Knowing your company is moving from being a

growth to a value stock, you can anticipate the shareholders who will sell and those institutions that will be most interested in buying shares, and communicate with each group accordingly.

In tailoring communications to different groups, companies can use their knowledge of investor behavior and appeal to individuals through brand awareness, local loyalty, good corporate citizenship, and consistent financial performance. For institutions, the approach is to identify and build relationships with both long- and short-term holders following investment approaches compatible with the company's investment characteristics.

Even as changes occur within a company, if good relationships have been established, it's possible to keep many of the current so-called "trading" investors. Show them how company fundamentals will remain solid, and they could stick by the company indefinitely.

The information drawn from a good investor relations program helps the company understand the investment approaches being used by current shareholders; analyze their compatibility with the company's financial characteristics, strategic and operating objectives; and prioritize potential investors in the universe based on making the best matches. This means certain investors can be wooed with confidence that they will be favorably disposed to buying shares as they learn more about the company.

Real Purpose: Reducing Cost of Capital

The best justification for building an effective investor relations program is reducing the company's cost of capital. Companies can measure the value of communications this way.

Traditional theory suggests that more volatile and risky stocks will not command as high a valuation as "safer stocks." A company's cost of capital can be viewed as how costly it is for the firm to raise money. In the case of borrowed funds, or debt capital, the cost is the interest rate that must be paid. For equity capital, it is the valuation that would be placed on the shares offered for sale. If a company's stock price accurately reflects the full value of its business, the company should have a lower cost of capital for both debt and equity capital.

Making the market efficient for your stock reduces the risk from uncertainty. So information that helps create a fair value is a powerful weapon in reducing the cost of capital. On that basis, an effective investor relations program can be worth millions of dollars.

A 1996 survey of some 1,200 sell-side and buy-side analysts and portfolio managers by *Investor Relations* magazine supported the link between communications and shareholder returns. The 24 companies cited by the 1,200 investment professionals as having the best communications programs also recorded shareholder returns well above the S&P 500 Index average for the year. Follow-up surveys by the magazine indicated similar results. The study showed that investors reward these forthcoming companies with higher valuation. And, higher valuation enables these companies, with superior communications, to enjoy a lower cost of capital.

The study also showed that the most important attributes of a good corporate communications program are accessibility and timeliness. Having access to information immediately means more to professional investors than anything else.

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Chapter 2

Trading has become global and takes place around the clock.

A Profile of the Investment Market

The investor relations function applies the TQM (total quality management) concept in seeking investor satisfaction. The process begins with understanding the investment marketplace — essentially, a structure and system linking organizations (and people) needing capital with those willing to provide it at a profit. Companies issue equity and they borrow money. To expand investment opportunity, the markets have created equity and debt derivatives as well.

Key market players providing the structure and mechanisms for capital exchange include brokerages, with their analysts, traders and sales staffs; investors, comprised of individuals and institutions, that manage money professionally for others; The Nasdaq Stock Market, New York Stock Exchange, American Stock Exchange and Electronic Communications Networks (ECNs); regulatory agencies and Congress.

Proceeding through the process, companies issue the securities. Investment banks put these securities into the marketplace. They collect fees for this work. Brokers facilitate the exchange of securities between sellers and buyers, collecting a commission for their effort. Often, investment banking and brokering resides in the same firm.

The trading process itself is a significant activity. Trading is handled through a variety of methods:

- electronically and directly between Market Makers on behalf of investors through The Nasdaq Stock Market,
- on the exchanges in a specialist central auction method,
- directly between institutional investors through ECNs, electronic intermediaries such as Instinet and Posit, and
- via the Internet, through online brokerages.

Trading has become global and takes place around the clock. After-hours and global trading has led Nasdaq® and the exchanges to extend trading hours. Additionally, Nasdaq has initiated a series of international alliances to start building the foundation for a global market without time or geographic limits.

The "sell side," made up of institutional brokers and traders, also analyzes companies, recommending securities to buy or sell. Traders conduct the transactions, trying to have the smallest impact on market price at the time. Sales representatives (retail and institutional) interface with investors, recommending securities to buy and sell, sometimes helping manage portfolios.

Institutional and individual investors constitute the "buy side." Individuals invest in stocks and bonds, either directly using full-service or discount brokers or conducting transactions over the Internet, or indirectly through mutual funds.

Pension funds make up the largest single institutional group, growing rapidly since the end of World War II. Over the last decade, public funds have picked up the pace, consistent with more people working in governmental positions or as teachers. Stock and bond mutual funds have grown even faster the last few years as individuals take charge of their retirement and pour money into these funds. The other big institutional players are banks, insurance companies, endowments and foundations.

And the list certainly includes investment management firms, hired by pension funds, banks and other institutions as well as by high net-worth individuals. This group also includes the capital management sides of brokerage firms and banks. The latter are among the biggest money managers in the country.

The Institutionalization of Markets

Individuals traditionally were the chief holders of equity, even into the 1960s, but by then, the institutionalization of the market was well underway. It was fueled by the steady buildup of assets from an economy that began to grow after World War II. Enormous amounts of money were moving into pension funds, banks, insurance companies and mutual funds. These sums needed to be managed and invested to cover retirements, interest on savings, insurance payments and the like and still make profits for the managing organizations.

Institutions are driving the demand for information.

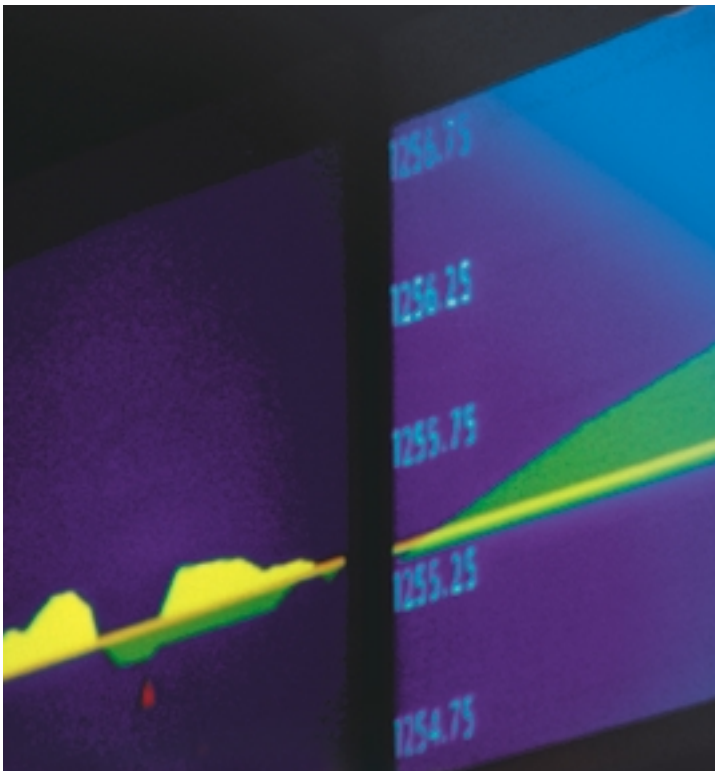
Of course, the pie has grown incredibly since the mid-1960s when individuals held about two-thirds of the billions invested in stocks. Today, individuals hold about half of the investments in stocks, including money managed by stock mutual funds. The numbers have continued to skyrocket in the last decade, fueled by the equity market.

What you have, then, are billions upon billions of dollars chasing highest returns — all managed by fiduciaries obligated to achieve highest returns. And that puts pressure on corporate performance and communication.

Pressures on companies to perform and to provide investors with the information they need to make good investment decisions have risen in direct proportion to the institutionalization of the capital markets. Institutions are driving the demand for information. Because information is an essential ingredient in evaluating performance, institutions want all the valuable information they can get.

Impact on Shareholder Mix of Companies

What does all this mean to companies? Several things. The shareholder mix of most companies has been shifting predominantly in the direction of institutions. The extent depends on a number of factors:



- Amount of shares available — institutions favor highly liquid stocks to facilitate large volume buying and selling.
- The company's fundamentals and prospects — good companies attract all types of investors.
- The industry — despite their size, dividend-paying utilities are still heavily held by individuals.

Large capitalization companies clearly attract institutional holders because liquidity and the number of shares available enable institutions to buy and sell shares in substantial numbers without affecting prices dramatically. Institutional holdings in the biggest companies today average above 60% and are well into the 80% range for some companies.

Some institutions will only invest in large capitalization companies. In their search for stocks, they won't even consider companies with total market cap under a certain amount — $1 billion or $500 million. However, there are many large investment management firms with multiple portfolios, some dedicated to mid-sized and smaller companies. Others manage separate funds consisting of smaller companies.

Mid-sized companies readily attract institutions. Thanks to ever-rising valuations, mid-sized companies today have market capitalizations above $1 billion. These companies can readily have close to half or more of their shares held by institutions.

Smaller companies also can attract institutions. Businesses with total equity values below $1 billion are seen as small cap companies. Micro cap has been coined as a phrase to distinguish the smallest companies, typically with market caps below $500 million. The numbers keep changing, as market values fluctuate. There are ample opportunities for small companies to attract institutional investors. Some smaller institutions, especially regional ones, like to invest in smaller companies they can get to know well. Over the years, strong markets have motivated numerous portfolio managers to break away from larger firms and set up their own management businesses. It is estimated that over 4,000 small money management firms operate today.

Most of the large institutions, including mutual funds, also have small cap portfolios. Indeed, it is likely that the largest institutions have several small cap funds, separately dedicated to growth stocks, value stocks, or industry specialization, as examples. Managers of these funds become specialists over time in picking the best prospects from among the segmented universe. History shows that small cap companies can outperform the market during certain times.

What is a good mix between institutional and individual investors? There's no set answer, however a balance between individuals and institutions is definitely advisable.

Institutions drive stock price and, when they are buying shares, that's good news. They create positive momentum. But when they sell shares, they can cause the price to fall. Institutions also tend to hold shares for less time as they put their money into investments likely to appreciate quickly.

These two realities suggest that companies should broaden their base of institutional holders, attracting investors with a variety of investing styles to protect against mass selling. It's also a good idea to aim communications at institutions known to hold shares longer. These essentially are institutions using fundamental analysis as their investing method. They prefer to find good companies with favorable long-term prospects and to have the opportunity to buy and hold shares or buy more shares as pricing opportunities occur.

Companies can identify longer- and shorter-term institutions by looking at their portfolio turnover levels. Earnings momentum investors may turn their portfolios over several times a year, while institutions using fundamentals models may turn only 20% or 30% of their portfolio annually, on average. Institutions, including mutual funds, provide turnover data as part of the descriptions of their investing disciplines. This information also is available from consultants and vendors providing targeting services.

In contrast, individuals tend to be longer-term holders, making decisions to buy stocks in certain companies for the dividend income as well as for price appreciation. They believe a company's value will rise, and they may also like the company because of its products, services and reputation or because it's in their home town.

Nonetheless, individuals also are doing more research, pursuing higher returns, and showing a greater willingness to sell when performance is lagging or better opportunities occur. This trend appears to be growing as individuals take more and more responsibility for their financial growth, not relying on pensions or social security.

Shortest-term shareholders today are the day traders, buying and selling the same stocks on the same day as they try to capture returns from trading, news flashes, rumors and information inefficiencies. Day traders range from institutions, working with sophisticated trading models to reduce risk, to individuals, who may be working with precious little solid information and are taking great risk. Losses by many day traders have served to curb this fad of individuals seeking a quick fortune.

For most companies, a balance between individuals and institutions is best. A perfect balance is probably impossible because of: size and liquidity factors, institutions' desires to favor certain industries, number of shares purchased by indexers, etc. Companies worried about their valuation and price being overly influenced by institutions are smart to make an extra effort to attract individuals. Companies concerned about a lack of stock price movement are smart to pursue institutions.

Individuals Increasing Their Investment Expertise

We are inclined to view institutions as having more experience and expertise in the investing process. They are the professionals, in the sense that they make a living by analyzing investments and managing funds. Certainly they have substantial resources to use in their work. They spend considerable amounts of money to build models, buy consulting help, acquire the best information, and make sure they receive the information immediately as it enters the market. They have the best contacts with companies.

But individuals can be highly successful investors as well. And their impact on the market has never been greater. Individuals returned to the market in the 1990s with a vengeance, motivated by the high returns that were enjoyed throughout the decade and also by a heightened sense of the need to take personal responsibility for planning their retirement and managing their assets. Individuals have become far more knowledgeable about the markets and more confident about making their own investment decisions than ever before.

Individuals are investing in stocks through mutual funds and directly, using full-service and discount brokers as well as trading through the Internet. Stock mutual funds crossed the $1 trillion mark in total assets in 1995 and just kept climbing. Online trading has absolutely exploded. The number of investors with online accounts changes by the minute. Most of these are thoughtful, thorough individuals who conduct their analysis and manage their portfolios with care, but a portion are day traders sitting at computers trying to catch the waves and sometimes making a bundle, sometimes losing their proverbial shirts.

Individual investors have many sources of information, starting with their brokers and financial planners. Many individuals are avid subscribers to the numerous market letters available. They read financial magazines and newspapers and watch television shows devoted to investing. Television coverage devoted to the financial markets continues to grow, with programming being added to CNNfn, CNBC, PBS stations and others regularly. And individuals are increasingly searching the Internet for investment information.

Individuals are tapping into the numerous computer-oriented investment tools now available. They use software that provides both investment information and portfolio management. They subscribe to database services and tap into online sites that monitor market movement, give market information in real time, report news, provide corporate information, and offer extensive advice on how to manage a stock portfolio.

Many people believe the Internet is leveling the playing field for individuals. They can get the latest financial

results, corporate news and financial documents by checking out a company's Web site. Almost all public companies today have Web sites, and many of these are supplemented by participation in super IR sites, produced by such access providers as InvestQuest, StreetFusion, Yahoo Finance and others. They are using these sites to enhance their investor relations efforts.

A Closer Look at the Pros

Investor relations efforts should be aimed at all the key players in the market — analysts, brokers, institutional investors and individual investors. Information must also be made available to everyone through printed materials, phone and fax, meetings, electronic communications, and media exposure.

Relationship building is likely to be focused on professional investors: analysts and brokers, who drive much of the decision making of investors; and institutions, which take big positions in the stock and set the price for most companies.

Relationship building logically begins with the sell side. Companies need what the sell side brings to the table — capital, investors, merger/acquisition partners, buyers of businesses or product lines or facilities, securities analysis and recommendations, trading and liquidity. Investors like brokerages for many of the same reasons — deals to invest in, research and analysis, trading and liquidity.

The foundation of most investor relations programs is built on contact with sell-side analysts. They are the key link to the buy side — both institutions and individuals — providing research, recommending stocks and overseeing transactions.

In delivering information, companies benefit from keeping their eyes wide open, exercising some caution in their sell-side relationships. Broker influence on investors cuts both ways: analysts and brokers recommend selling shares as well as buying them.

Institutions use brokers for research, recommendations and trading. They also maintain in-house research, especially the larger money managers. In fact, institutions are doing more of their own research, taking advantage of computer data retrieval, modeling techniques, and improved communications from companies. The biggest firms, with substantial in-house research capabilities, more often use the sell side for industry research, specific company input or to gain consensus or contrary views on specific companies.

Many investors express skepticism over the research and recommendations of companies that also are investment banking clients.

Still, there are hundreds of mid-sized and smaller institutions and thousands of one- and two-person shops, collectively managing billions of dollars, that continue to rely mainly on the sell side for their research, analysis and stock suggestions. These are important shareholders for companies. Bottom line: Analysts remain important conduits of information from companies to investors.

How Active Managers Operate

Conventional wisdom says to focus information and relationship building on active, traditional investors instead of passive, quantitative investors.

Virtually all traditional managers focus on active investing techniques. These investors make up the prime audience for companies. They are fundamentalists, driving their analytical processes in seeking the best performing companies in the future. Their focus is on evaluating companies. They may be stock pickers, bottom-up investors searching for the best companies, or they may follow a top-down approach, first selecting the industries to shine, then the stars within them.

Active investors follow set investment approaches, favor certain styles, and often use intricate methods and models. But, in the final analysis, they want to talk to companies to better understand strategies and primary initiatives, evaluate management first-hand, ask tough questions, probe for weakness and seek to uncover true gems offering the potential for growth.

Top-down investors study the overall economy first in an effort to gauge the industries that are likely to do well and not so well. Then, after picking industries to favor, they analyze companies to judge the ones likely to excel in the current environment. These investors also are called sector rotators, because they rotate in and out of industries.

Bottom-up investors also are known as stock pickers. They go right to the company's fundamentals, looking for strength wherever they find it — the best technology and products, low-cost produc-

tion, market genius or smart management. They believe these companies will perform well in any economic environment. However, these investors are prudent. They still analyze industries and macroeconomic factors. If it's obvious an entire industry is going to take a beating, they'll wait on even the outstanding companies within that industry.

Growth, Value and Income Investors

Almost all professional investors profess to favoring a style, typically defined as growth, value or income. Growth means predictable consistency in certain measures — earnings, sales, cash flow. Growth investors may be aggressive, looking for high levels, or moderate, looking for more reasonable levels. Moderate growth investors — who tend to be favorites of companies — are likely to hold shares longer than aggressive growth investors. They will hold shares and keep buying more as long as the company stays within their valuation model's parameters — maintaining sales and earnings growth in the range of 10% to 15%, for example.

Value investors are looking for companies seen as having value above current market recognition. The current price may be considered cheap, based on fundamentals indicating good growth ahead for the company. A basic way to measure a value opportunity is through a price/earnings ratio. When the P/E ratio is less than the company's industry peer group or the market, it indicates the market doesn't have high expectations for the company. Investors who decide to buy shares may have done an analysis that indicates otherwise.

Income investors need dividends to be satisfied. Typically, they look for companies that meet a threshold dividend yield level, to guarantee a certain amount of income, and have some price appreciation on top of that.

Type of Investor	Investment Targets
Growth	Companies with moderate to high earnings, sales and cash flow levels
Value	Undervalued, unnoticed companies as measured by price/earnings ratios in their industries
Income	Companies with high stock dividends or that meet a desired dividend yield level

Price appreciation and dividends equal total shareholder return. Most investors have a total return target in mind when they make investment decisions. The aggressive growth investors are expecting to get all return in price movement from strong earnings. The value investors lean toward appreciation, but many decide to invest in certain companies because of the dividend kicker. Income investors base their decisions on meeting dividend yield requirements.

Chapter 6 discusses the role of valuation in the communications process and how companies can develop strategies that will attract institutions.

More About Quantitative Managers

Quantitative managers are still candidates for contact by investor relations professionals. These investors focus on the overall construction and performance of their portfolio. They are looking to create the best asset mix (stocks, bonds, cash), then the best combination of stocks based on meeting return targets. Efficient portfolio construction is their goal. They are balancing risk against an expected return. Returns typically are measured against the results of a benchmark, such as the S&P 500 Index, with the objective being to beat the benchmark. Their quantitative models have years of risk/return results, correlated and back-tested to indicate high predictive value.

Quant approaches and models can be mostly passive or they can be quite active. The active quant is balancing risk, return and cost, again seeking to do better than the benchmark. Otherwise, the investor might as well invest in the index or its equivalent. The quant investor is probably using a stock selection algorithm designed to predict "alphas," which represent an extraordinary expected return for the company.

Passive managers do invest in indexes, with a range of them available today — from those listing large to small companies to those focusing on value or growth stocks.

All this means that even passive, index-driven investors can be somewhat selective, favoring large, mid-sized or small cap stocks, for example, and value or growth stocks. These passive investors don't necessarily buy shares in every stock in the index; they select a basket of stocks that will replicate the index's overall return.

So most companies have part of their shareholder base consisting of quantitative and index investors. The extent can depend on the company's contribution to an index — which, for many large companies, is substantial. While these investors aren't candidates for close relationships, knowing the extent of their holdings can be important. They are likely to be part of the more stable group of shareholders. By breaking out its mix by investor type, a company can develop a better basis to focus communications on each group.

The direct communications path to quants isn't completely closed. They have distilled data on your company and are evaluating the risk/return equation. They are keenly interested in information that may cause the company to perform above or below expectations. In contacting these managers, keep the information focused. They have lots of companies to cover.

Investors build their models according to their market beliefs, input the data, and get results. Quant investors rely on the models to make investment decisions. Active investors use the model as a tool to determine the companies that merit further evaluation, a process that very likely includes face-to-face or at least telephone contact with senior management and the investor relations officer.

Chapter 3

Investor feedback can be a vital component in strategic decisions.

The Investor Relations Process

The value of investor relations is fully realized when it is thought of, planned and implemented as an essential strategic function. The many tactical components become important parts of the implementation process. These include meetings, conference calls, press releases, annual reports, surveys of shareholders, and others. They are tools of the practice — ways to learn more about your shareholders, communicate valuable information, and build relationships.

Making investor relations a strategic function means using it to:

- Help develop the company's strategic course and direction
- Support the critical decision making process
- Make sure key constituencies understand and accept management's actions to continue growing the company

Corporate management is acting in the best interests of investors and the company when it seeks to maximize the value of investor relations. The role is two-dimensional: (1) providing investors and other constituents with the complete story so the company can be well understood and fairly valued; and (2) bringing back to management relevant information and opinion that exists among investors, analysts and other major constituents to help managers focus on value creation.

Investor feedback can be a vital component in strategic decisions. It certainly helps to have a good sense of how investors will react to corporate strategies and actions. Essentially the questions involve assessing the most viable ways of growing the company.

The choice may be between an acquisition to strengthen a product line or continued investment in technology, between overseas acquisition or internally-driven overseas market expansion, between investing earnings in new projects or giving the excess cash to investors in share buybacks and dividends.

Investors' opinions of corporate strategic decisions are reflected in their buy, hold and sell reactions. Through constant dialogue and by building close relationships, companies can gain

advance feedback on attitudes toward their plans. Companies also can use outside research firms to conduct "blind" interviews without risk of tipping their hand on possible future actions. All this is part of the investor relations process.

Essential Components of the Program

The strategic purpose of investor relations is fulfilled by taking a programmed approach to the function, determining the key activities to realize benefits, then successfully implementing these programs to maximize results. The various components of a full-scale investor relations program can be organized into four basic categories:

- Market Research, to develop knowledge and expertise on the capital markets, investment process, investor behavior, investor perceptions and attitudes toward the company, and to track progress in the communications process.
- Message and Information Development, aimed at communicating the investment strengths, major factors and points of information important to the market that will help create fair value.
- Communications Vehicles, namely the best ones to use in getting the message and information to the market, investors, analysts and brokers in the most effective manner.
- Office Administration, involving the use of staff, consultants, suppliers, technology-based and other tools to manage the investor relations process at highest efficiency levels.

Maximizing the Value of Market Research

Under market research fall three key activities: market intelligence, audience analysis, and benchmark surveys.

Market Intelligence

Gathering and maintaining market intelligence enables a company to understand how it is viewed by the equity market in both absolute and relative terms. It is essential to both corporate strategies and communications to know how and why the market is behaving toward the company as well as how the market is pricing the stock.

Market research provides the key information to make these analyses. The following information is needed for a composite analysis of the company's position in the stock market:

- Daily trading volume
- Patterns of volume to indicate liquidity and volatility
- Stock price against industry and other peers and against the market

- Comparison of volume and price
- Comparison of relative measures of investor confidence, such as the price/earnings, price/cash flow and price/sales ratios
- Comparison of measures of relative performance, such as price/book ratio, return on equity and return on assets
- Analysts' earnings forecasts for the company and peers

These data are essential for analysts and investors to appraise companies and make investment recommendations and decisions. Being a vital source of valuable information strengthens relationships and builds the confidence of investors in the company as a reliable resource. In addition to their own data, they'll use your data to:

- Project sales, cash flow, earnings and margin growth in absolute terms
- Study how the market is valuing the company in comparison with their projections
- Measure risk by liquidity and volatility
- Assess market confidence by matching pricing patterns with performance
- Identify companies being ignored or under appreciated by the market

Audience Analysis

Who are your current shareholders and why are they investing in the company? What would cause them to buy more shares or sell? What actions can the company take that institutions will or will not like? How best can we identify other institutions to target based on compatible investing styles? Investor relations program priorities flow from this kind of market intelligence.

Companies can aim their messages at both institutional and individual groups. The company can appeal to individuals by increasing contact with retail brokers and by actively participating in investment clubs. Getting brokers interested starts with creating a relationship with the firm's analyst covering your industry. Brokers are more inclined to promote the stock when it carries an analyst recommendation.

Analyzing the investment styles, approaches and methods of your company's institutional holders provides insight into why they are investors in your company. The information helps you determine whether your company's stock is perceived as a growth stock or a value stock and enables the company to direct its information flow in the best way to satisfy the needs of specific investors.

With this knowledge, the investor relations officer can find other investors with similar styles and approaches and focus communications to show how the company fits their profile.

Communications can lead the way, too, when a company's strategies change, and certain shareholders are expected to sell because the company no longer fits their model, while others will buy because the company does fit their model. You may be able to convince investors that strategic changes are expected to result in even stronger fundamentals.

There is much to be learned from audience analysis, including:

- How well your company's strategies and implementation initiatives are being recognized and accepted
- Extent to which analysts and investors have absorbed your investor information
- Attitudes of investment players toward the company, generally and specifically
- Accuracy or inaccuracy of perceptions
- Investors' evaluation of management and the investor communications program
- Strategies and programs investors will favor and will respond to by buying shares
- Actions that will turn off investors, causing them to sell shares

Benchmark Surveys

The third important piece of market research is benchmarking. The important research being done by a company can be benchmarked and repeated periodically to track changes in investors' knowledge levels, perceptions and attitudes. The research also can be used to measure progress both in business management and communications. And it can be correlated against valuation and stock price to show the value of certain strategic decisions as well as the communications effort.

Benchmark research typically is conducted for companies by consultants with expertise in interviewing techniques and an understanding of the investment community. Maximizing the quality of these interviews is important to achieving their full value. Third-party interviews also elicit more candor from investors, leading to better results.

The Importance of Message and Information Development

Market information leads logically to message development and a more quantified understanding of the information investors need to properly value the company. The message is the answer to the question: Why should I invest in your company? Or, for shareholders, why should I continue to hold the shares and buy more? Or, for analysts and brokers, why should I recommend your shares to my customers?

The answers center on the various reasons your company is a good investment. When they buy shares, investors are essentially looking for higher returns, measured in total shareholder return. Current price is not as important as whether the price will rise, fall or stay the same. They may buy the stock at $75 a share or $5 a share because they believe the price is going to go up at that point in time. Expected Return is the basic measure used by investors.

Investors buy shares because they believe revenues and earnings will increase, the company will improve margins to create higher earnings, or it will generate excess cash, which can be used to invest further in growth opportunities, buy back shares or increase dividends. Investors analyze companies to determine how companies will achieve these financial gains. This analysis leads them to study a company's competitive strengths and advantages. In short, it defines your company's value drivers.

What are some value drivers, competitive strengths and advantages? Here is a list of examples to help you decide the ones important to your company:

- The ability to deliver customer service that is truly superior to competitors
- Franchise technology that enables the company to continue to innovate, create new products, and maintain top product quality
- Production efficiencies that make you the low-cost producer
- Margins that give you price advantages and higher profitability
- Marketing and sales skills that stand out
- A culture led by a smart management team that has built a motivated, results-oriented employee base
- Financial strategists whose deal-making record proves they know how to buy money at the least cost and save money at every turn
- A record of successful acquisitions, resulting in a stronger product base, expanded market participation and/or economies of scale

Corporate initiatives to fully capitalize on these drivers and advantages involve well-planned expansions:

- Finding new applications for technology and products
- Entering new markets to capitalize on selling skills
- Moving into higher-growth-rate global markets
- Adding capacity or making acquisitions to capture more market share

Three Categories of Information

The specific information desired by investors and analysts flows from the company's strategies, strengths and programs. Information falls into three categories: (1) financial and operating details that thoroughly explain business operations; (2) the company's vision, mission, strategies, direction and programs; (3) the industry context for the company.

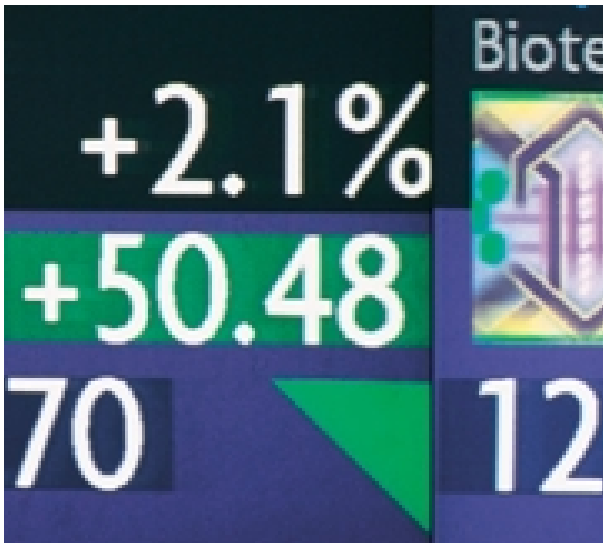
Nitty-gritty detail on business operations is a must for analysts and vital to portfolio managers in comparing companies. Essentially, the information they want enables them to evaluate performance and gain insight on how the company is likely to do, at least near-term. It includes order rate, inventory, shipments, new and lost contracts, receivables, SG&A and more, appropriate to each company.

Investors and analysts want performance results reported separately by businesses, product groups, markets and geographic regions. The reason is to have a basis to better understand future results. Which businesses are the largest and most efficient, for example, and which are making the greatest sales strides, contributing the most and least to profitability? Investors also want to see expansion plans laid out by businesses, including capital expenditure figures. The data help investors evaluate management's investment decisions. Is the company investing in its best-growth opportunities or pouring money into a low-growth or losing operation?

One industrial producer measures each of its 15 major product groups by return on asset targets. But, it doesn't make the numbers public. If it did, investors may be favorably impressed by the results, and the company likely would see its valuation increase.

Shelley Taylor & Associates, a research firm, asks some 75 professional investors each year to identify the most important information obtainable from companies. Making the top 10 list are:

- Statement of cash flows
- Future prospects and plans
- Segment analysis by business activity
- Segment analysis by geography
- Short- and long-term debt
- Objectives vs. results
- Planned expenditures
- Business strategy
- Contingent liabilities
- Product and service information



The answers clearly show the high level of interest portfolio managers have in understanding company plans to grow in the future, how each business unit is performing, and the more intangible factors that drive success, namely strategic plans, objectives, management characteristics and cash flow generating capabilities.

Selecting Communications Vehicles

Companies have an arsenal of communications vehicles available to provide information. The list includes printed materials, videos, electronic information services, meetings and, of course, the telephone.

Printed Materials

Printed materials are the foundation of a communications program. Required reading includes Securities and Exchange Commission (SEC) disclosure documents, namely proxy statements; 10-K, 10-Q and 8-K reports, plus such voluntary materials as annual and quarterly reports, corporate profiles, newsletters and fact books.

Proxy statements are high on investors' reading lists because of the required performance charts and executive compensation information. They provide an excellent opportunity to describe the company's strategies and programs. In fact, it can be argued that a discussion of fundamentals and growth initiatives is absolutely necessary to explain the performance charts and to justify executives' compensation. The SEC requires companies to include a statement from the board of directors or audit committee explaining how the board structures compensation for top executives. Investors read this description with high interest to evaluate the level of compensation against the company's level of performance.

Through the efforts of the SEC, the Management Discussion and Analysis (MD&A) report in 10-K and annual reports has become more meaningful and is read seriously by investors. Bland, boring, by-the-book MD&A reports can arouse investors' suspicion that a company has something to hide. In the MD&A, companies are required to cite and explain material events that occurred during the year and to flag possible material developments. These can include material contracts likely to be won or lost, or breakthrough technology promising high market impact, as examples.

Annual reports that are overly promotional and self-serving tend to backfire. At least a half dozen surveys over the last several years verify that the annual report is the single most important information document published by a company. Investors rely on these reports for financial information, focusing on the financial statements, footnotes and MD&A. But surveys indicate that most investors are disappointed by the lack of quality information in the front section of

Major Communications Vehicles			
Printed Materials	**Electronic Information Services**	**In-person Meetings**	**Telephone Contact**
■ SEC disclosure documents ■ Proxy statements ■ 10-K reports ■ Annual reports ■ Quarterly reports ■ Press releases ■ Newsletters ■ Letters from CEO	■ Database services like Business Wire or PR Newswire ■ EDGAR system ■ Internet — company Web sites, Nasdaq Web site, video or Webcast conference calls ■ E-mail	■ One-on-one discussions ■ Group presentations	■ One-on-one calls ■ Audio conference calls ■ Video or Webcast conference calls

reports and companies' tendency to be overly promotional in this section. Investors want a good strategic discussion in the CEO's letter, an honest description of problems and how the company is resolving them, and an analysis of how the company is doing against its competition.

Quarterly reports are crucial to investors — as long as they arrive promptly. The old printed version that arrived midway through the next quarter is a dinosaur in our electronic age. Investors also like the report to be accompanied by a letter from the chairman or CEO. Companies are abandoning the traditional printed quarterly report, opting instead to make the quarterly news release available to investors, through mail or fax-on-demand services and by posting it on their IR Web site. In this way, all investors have immediate access to the information — institutions and individuals alike.

Electronic Information Services

Putting the information into electronic databases extends the company's ability to reach investors, analysts, brokers and prospects — and to do it in a timely manner. It also gives individual investors with computer access the opportunity to receive information at the same time professional investors obtain it.

Much information is available online today. Investors can receive news releases through Business Wire or PR Newswire, PrimeZone or popular databases. The various SEC filings now made by

companies through the SEC's EDGAR system are available through a number of database services, including the SEC's own Web site (www.sec.gov). In addition, the Nasdaq Web site (www.nasdaq.com) provides investors with a direct link to EDGAR.

Companies are encouraged to set up their own Web sites or have it done for them through one of the growing number of outsourcing services. Among these sources are CCBN.com, Shareholder Direct, PrimeZone, Stockmaster, PR Newswire and Business Wire. A survey by the National Investor Relations Institute indicates that over 90% of public companies have Web sites that include an investor relations section. An IR Web site is rapidly becoming a standard communications vehicle for reaching the investment marketplace. Many companies also participate in one or more of the IR super sites, created to provide information to investors. These sites attract investors (individuals and institutions) because of the convenience of studying numerous companies at one cyberspace location, and thus, enable companies to reach a wider audience. Sites include InvestQuest, StockSmart, Red Chip Register, PrimeZone, Business Wire, PR Newswire and others.

Investor relations Web sites often include stock quotes; historical stock prices and charting capabilities; SEC filings; pertinent news releases; the annual report; a corporate profile; financial overview; events calendar; and feedback capabilities. Companies increasingly are broadcasting conference calls and financial presentations on the Web, especially since the passage of the SEC's Regulation Fair Disclosure (Reg FD). Some companies provide consensus earnings estimates. Companies also are providing the names of analysts and sell-side firms providing coverage. And a few companies are including analysts' research reports. Lawyers tend to argue against reproducing coverage, or even consensus estimates, believing it runs the risk of entangling the company in the content of the report should there be a lawsuit. Most companies do not include research reports on their Web site because of that concern.

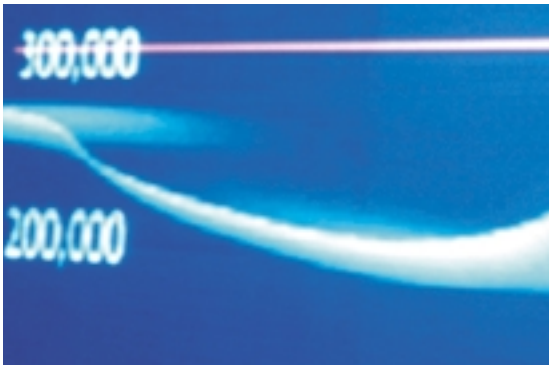
The key with company IR Web sites is to keep the content current, encouraging investors to return to the site time and time again, and to make navigation of the site extremely user friendly.

Companies are also linking with investors through e-mail. Many companies today have extensive e-mail lists of sell-side analysts, buy-side analysts and portfolio managers, retail and institutional brokers, and individual investors. Increasingly, quarterly financial results releases, statements, and announcements of conference calls are being sent via e-mail as the use of facsimile for these purposes begins to decline.

Increasingly, companies' quarterly conference calls to discuss financial results, plus other calls to cover major news such as an acquisition, are being carried on Web sites. In fact, a number of Nasdaq companies have led this trend, especially those engaged in Internet, computer and other high-technology fields. Traditionally calls were transmitted over the telephone and were limited

to sell- and buy-side analysts and institutional portfolio managers, however, Reg FD now requires that all interested investors have access to this information. Webcasting of conference calls can be a cost-effective solution.

Moving calls to the Web expands the audience to include virtually everyone with access to a computer. This opens the door to individual investors, retail brokers and the media, who are flocking to the calls. Large cap companies report having thousands of people on their conference calls. Today, companies are combining telephone and Web access, letting telephone participants ask questions and either allowing the Web audience to be in a listen-only mode or to ask questions through e-mail exchange.



Companies also can broadcast their calls on their own IR Web pages or use one of the webcast conference call providers. In the latter case, the calls are broadcast live or delayed on the provider site. Leading providers today include StreetFusion, Street Events, Investor Broadcast Network, Business Wire V-call, PR Newswire, broadcast.com and Yahoo Finance. (Their names also are their Web site addresses.)

Street Fusion, Street Events and Investor Broadcast Network publish on their Web sites the dates companies release their earnings and hold their conference calls. Street Fusion and Street Events also are leading providers of schedules of various brokerage firm events, including industry conferences, meetings and road shows for initial and secondary public offerings. The schedules are designed to help institutions plan their busy schedules, avoiding conflicts. With a heads up on upcoming broker conferences, Investor Relations Officers can contact the firms in efforts to be included on the program.

The Internet also is spawning a plethora of investor chat rooms, raising serious questions for companies about how to deal with information contained on various message boards and chat rooms. Leading chat rooms include the Motley Fool, Yahoo Finance, Silicon Investor, America Online, Microsoft, Prodigy and others. These forums provide opportunities for people to post information about companies, engage in dialogue, and even spread rumors and misinformation. There are numerous instances of inaccurate information and false rumors being spread across chat rooms, either to boost or drive down stock price, depending on intentions.

Efforts to find the sources of false information are intensifying, several lawsuits have been filed by companies and several criminal cases have been brought by the government. Companies can go to court to force chat room providers to reveal the identities of people spreading false rumors

or posting negative or inaccurate statements. These providers also are expressing a willingness to remove postings that are not true. Corporate executives have real reason to worry about statements that drive down stock price resulting in lawsuits against the company.

Legal counsel advise most companies not to participate directly in chat room discussions. Instead, companies are monitoring chat rooms — either directly or through a monitoring service — for negative statements and postings that may be impacting stock trading and price. Companies have a number of choices of acceptable ways to respond. One is to refer people to accurate disclosures covering the subject in question in company releases and SEC filings. Another is to suggest that people send the IR representative a separate e-mail or phone the company to discuss the issue. This creates an opportunity to have a dialogue out of public view. The risk is that the content of the discussion or e-mail will be posted on the message board or chat room. Companies believing that a false statement is material and/or that it is causing market prices to move can issue a press release.

In-Person Meetings

Despite the focus on electronic communication, face-to-face meetings with companies remain the preferred choice of professional investors. Investors learn from observing executives giving presentations. They learn from the manner in which tough questions are answered. They learn from having other smart people in the room asking tough questions.

Meeting formats run the gamut from large group presentations at broker conference and analyst societies to one-on-one discussions. The trend is for senior executives and IR professionals to meet with smaller groups of analysts or investors, or with the analyst and portfolio managers of one institution. Investors believe more is learned in these more intimate environments. These sessions focus on discussion, giving investors opportunities to ask their own questions rather than passively listening to a presentation that may or may not reveal new information.

Telephone Contact

Even with all these methods of communicating, the telephone is still the most popular way of exchanging information between a company and investor. Some days, the investor relations professional never gets off the phone. Telephone contact is highly efficient for both parties. It also provides a unique opportunity for the investor relations person to add value to the process, helping analysts and investors better understand the company.

Telephone contact has spread to audio conference calls, which are used most often by companies to discuss quarterly financial results with analysts, investors and brokers. Virtually everyone likes these forums because of their efficiency and thoroughness in providing information. Video

conferences are starting to take place as technology advances. E-mail dialogue also is increasing. It overcomes the constraints of busy days and hectic travel schedules interfering with the ability to make or return phone calls.

A complete list of communications vehicles also includes:

- Advertising and media coverage to reach individuals, institutions and analysts
- Direct mail to brokers
- Electronic distribution of quarterly reports
- Special programs for tailoring Internet, video and audio communications to a variety of audiences

Administering the IR Program

The last component of the investor relations program involves administering the function efficiently. Most investor relations departments tend to be small — one- or two-person staffs. Even some large companies have just one or two professionals; others have four or more.

The modern investor relations office is computer-driven. Various outside database services are making it possible to accomplish an amazing amount of work. Virtually all the information needed to perform the IR function can be obtained electronically today, and virtually all the information to be distributed can be prepared, produced and sent through computers.

The research obtained through computers enables investor relations to improve message and information flow, better understand how the market is behaving toward the company, prepare presentations and reports, and work with management on advancing the IR program.

Extending Investor Relations Globally

Companies are conducting communications programs aimed at capturing investors outside the United States. Investors in Canada are integrated into most companies' domestic investor relations efforts. Brokerages and institutions in Canada are included in identification and targeting programs. They participate in conference calls and receive materials regularly. Companies frequently include meetings in Toronto, Montreal, Vancouver and other locations on trips to see institutions, brokers and analysts.

European institutions are a prime market for American companies as well. The same is true for Asian capital markets. Investors everywhere have the same essential need — good information on companies. This applies to a European investor looking at a U.S. company or a U.S. institution considering a European company.

When investing overseas, institutions tend to prefer companies they can follow easily. This starts with the company having a base following of brokerage firms. Offshore institutions, especially those in Europe, work closely with U.S. brokerages to gather research, obtain recommendations and execute transactions in the stocks. Larger companies tend to be favored. Offshore investors look for well-known U.S. companies with good reputations and familiar products in familiar industries. They also like companies with global operations and a presence in their own countries for establishing direct contact.

Mid-sized and smaller companies certainly can attract offshore institutional investors. Always interested in good investments, these institutions will attend meetings to hear corporate managers. Overseas fund managers frequently follow certain industries closely, selecting the strongest companies on a global scale. When technology, biotech, banking and other industries are doing well in the U.S., shares of these companies are being purchased in Europe, Asia and elsewhere at the same time.

Most European and Asian institutions are inclined to be longer-term investors.

Companies intent on placing stock beyond North American borders are advised to meet with investors face-to-face in the leading financial centers of the world. Investors will want to meet and get to know senior management. With smaller companies, the presentations need to be made by the top echelon of officers — chairman, CEO, president or CFO. But investor relations professionals should be part of the group.

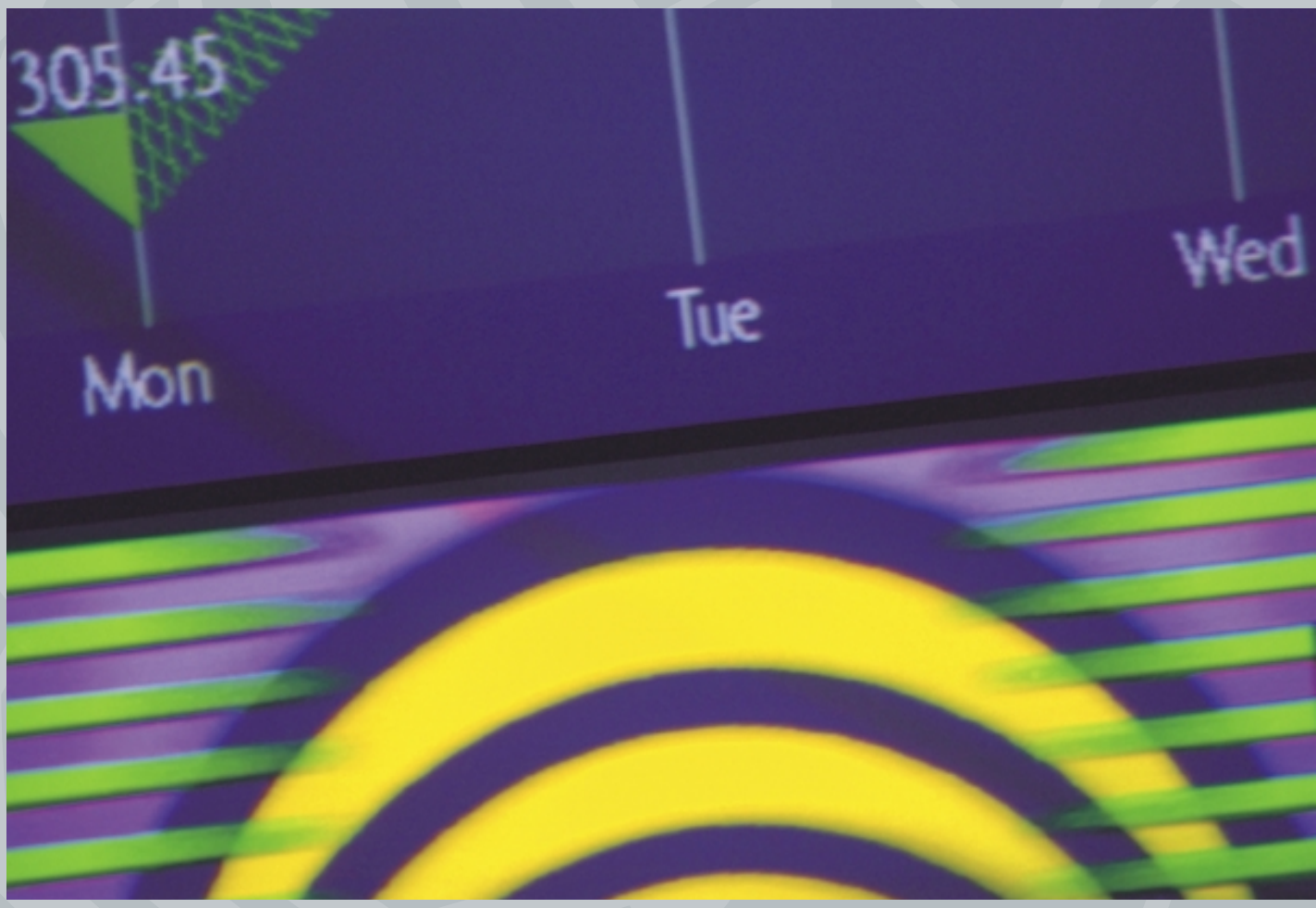
It's the investor relations people who will continue to provide information through the mail, electronically, over the telephone and in follow-up personal visits. Companies must assure overseas investors that ongoing contact will be maintained — a steady flow of information and direct contact with the company.

When starting to establish contacts with offshore investors and analysts, companies tend to work with their investment bankers or international investor relations consultants. Each has its advantages. Investment bankers have strong contacts, based on long-term relationships, and can attract audiences for meetings or to arrange appointments.

Investor relations consultants bring the same capabilities to the process as investment bankers, but can offer a broader range of contacts since they're not limited by the bank's customer relationships. Careful research is advised when selecting an investor relations resource. They are not equal in contacts and capabilities.

Major institutions in Europe prefer one-on-one meetings with corporate executives, especially once a relationship has begun. The biggest institutions may attend general presentations to begin their research on a company, but it's also true that these investors tend to shun the large meetings.

Chapter 4



The key is making sure that investor relations has the opportunity to be effective.

Staffing the Investor Relations Function

The investor relations function is managed by investor relations specialists who also speak for the company. The IR specialist typically handles telephone contact, leads or takes part in conference calls, gives presentations to brokers and often to analysts and portfolio managers. He or she is the chief spokesperson to the investment marketplace at numerous companies today, with senior executives being the main speakers at major events, such as investment society and brokerage-sponsored meetings and "investor days" hosted by the company.

In most companies, CFOs and CEOs are part of the investor relations team. These senior executives also make presentations at conferences, host meetings with institutions, participate in quarterly conference calls with investors, take telephone calls, and conduct one-on-one discussions. Analysts and portfolio managers spend considerable time judging the quality of management, by tracking performance, evaluating executive decisions and strategies, and by their impressions at face-to-face meetings.

Most corporate IR staffs consist of one or two professionals and an administrative assistant. Probably under 10% of U.S. public companies have three or more professionals on their IR staff. However, IR departments tend to have budgets large enough to accommodate a number of key outside resources, including consultants, writers, suppliers of valuable data, and outsourcing of certain activities such as maintaining a Web site.

IR on the Organization Chart

Because it merges so many disciplines, investor relations doesn't fit neatly into an organization chart. Various companies have placed it under the auspices of the chairman, chief executive officer, president, chief financial officer, chief counsel or an executive in charge of corporate communications.

There isn't any right place; the key is making sure that investor relations has the opportunity to be effective.

Rationales can be built to have investor relations report to the CEO, CFO or senior officer with corporate communications and public affairs responsibilities. The current trend, however, is to have investor relations be part of the chief financial officer's responsibility, viewed as part of financial management. IR is a "numbers" function — understanding the numbers since the company is judged by financial results — as well as a communications function.

In making sure the job isn't reduced to reporting just the numbers, the investor relations specialist needs to be closely linked with functions responsible for operations and strategic planning. Operational results drive the numbers. Developing a level of expertise on each piece of the business is crucial to telling the company's investment story comprehensively.

To link investor relations and strategic planning is a win-win for the company. By virtue of the alliance, strategic planning gains a window to Wall Street to help develop competitive analysis information and to measure market response to major plans and programs. Investor relations benefits by having access to the company's strategic direction and initiatives to realize it. "Greater understanding of the strategic plan should allow the investor relations person to improve the company's P/E ratio relative to peers," says Timothy P. Cost, an IR expert who has practiced and managed both investor relations and strategic planning at a number of companies.

These close internal alliances are valuable not just for understanding current operations and plans but for mapping the company's future. Investors want to understand what the company has done for them lately, but they are primarily interested in figuring out what the company is going to do for them today, next month, next year, three and five years from now. Knowledgeable investor relations people play a vital role in helping to shape those messages.

The IR function can also report successfully to the CEO — that sends the message that the CEO is serious about IR, supports it and participates in it. This reporting relationship tends to open doors for the IRO inside the company, leading to better knowledge of the business. Or the function can report to a senior officer in charge of all the company's communications functions. Because many companies view investor relations as the most important of the communication functions, the senior officer in charge of the combined communications activities often has an investor relations background.

Though the investor relations function grew out of public relations, it should not report to public relations, marketing, advertising or sales promotion. This reporting relationship most likely will handicap the investor relations person's ability to work effectively. It puts the function under a promotional umbrella, and investor relations is not a promotional function. It sends the wrong signal to investors, suggesting to them that the company's main interest is promotional rather than informational. In addition, public relations and marketing have too narrow a scope for investor relations and can remove the IR specialist from senior management and critical information flow.

A few companies have investor relations reporting to the chief legal counsel. That's acceptable provided the attorney is sufficiently enlightened to understand the importance of having a proactive communications policy and an open door to information, which is typically not the strategy of the corporate legal counsel.

At some companies, the investor relations function is carried out by a senior officer, such as the CFO, treasurer or CEO. This is especially the case at smaller companies that don't have the budget to hire a full-time IR specialist. Even so, it is critical that the function be given a high priority. Many market observers believe that investor relations can have a greater impact at smaller companies that have little Wall Street analyst following and are less known to institutional investors. Successfully working to attract analysts and institutional shareholders can have substantial impact on valuation and stock price. Many small companies are undervalued because of a lack of good information flowing through the capital marketplace.

Regardless of where investor relations responsibilities fall within a company, investors expect to get some information from the CEO, other information from the CFO, and some from both (as indicated in the chart below). In that regard, it is critical for the IR function to have open and complete access to these individuals.

Information Sources

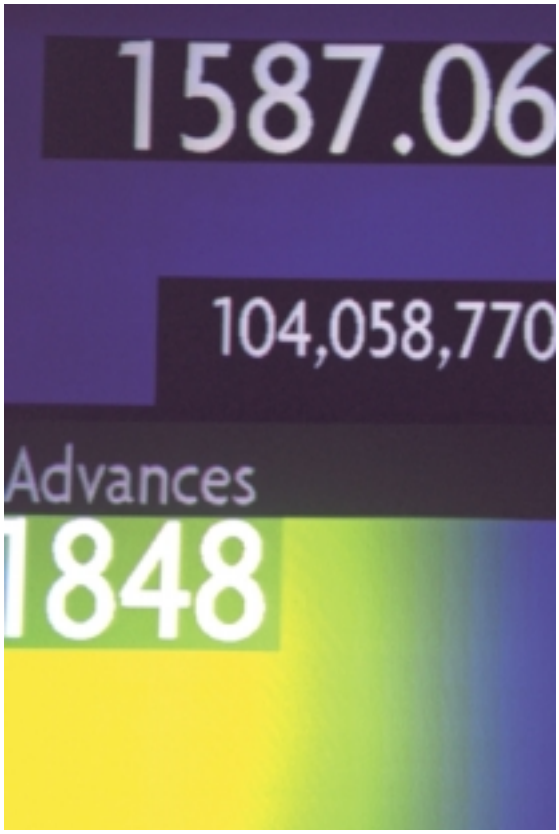
CEO	Shared	CFO
Primary leader — CEO/ operations management	Shareholder accountability and interface	Primary leader — financial management
Primary interface with full board	Board-level accountability and interface	Support for worldwide operations with financial information designed to aid decision making
Primary leader — long-term strategy development	Fiduciary responsibility for SEC	Primary interface with audit and/or finance board committees
Primary accountability to implement company's strategies — short- and long-term	Understanding of operations and financial impact of decision making	CEO support with analysis for long-term strategy
Primary leader — customers	Short- and long-term strategic decision making	Sounding board for CEO ideas/partner

Making the Investor Relations Function Effective

Where investor relations falls in the organization is important to this function gaining the respect it deserves, but equipping the function to be effective is the most important consideration. That means giving Investor Relations the respect and resources needed and seeing that high-caliber people are doing the job.

This process starts with making sure the investor relations officer has the ability to speak substantively for the company. He or she not only has to have full access to information but must be part of the inner circle participating in discussions that yield in-depth insights and understanding. The company will fare much better with investors when investor relations officers are knowledgeable enough to speak with authority and not simply messengers carrying the company's party line.

Qualified, well-informed investor relations people are in the best position to speak for the company because they are trained in both proactive communication and in handling difficult encounters. Qualified IR people are less likely to speak out of turn because of their training and experience. They understand their audiences — investors and analysts — better than anyone else. They know and understand the methods these professionals use to get information, the way questions are asked, and how best to respond. They are the company's resident experts on investment process, investor behavior and how best to deal with the players in the market.



The key for management is to be certain the investor relations person is well-qualified. Perhaps more than anything else, the chief contact with investors needs to be smart and relaxed in potentially confrontational situations. The IR person is dealing every day with very bright people who are asking very difficult questions.

Qualities of the Investor Relations Professional

Investor relations combines communications, finance, operations, strategic planning, economics, investment analysis and management. The highly-qualified investor relations officer needs to know a lot about each of these areas. And he or she needs to know how to secure information to fill in any gaps.

IR people benefit from having a host of qualities — being energetic, tough-minded, goal-driven and confident. The confidence is needed for standing up to demanding, aggressive and smart analysts and investment managers. Corporate executives aren't always so easy to deal with either.

High energy is a must for the IR professional. Days can be tough: traveling and conducting meetings, answering difficult questions on the phone, debating inside the company over the best way to handle a situation, preparing for conference calls and the like.

Being driven to accomplishment is important as well. The investor relations function can easily lapse into a daily routine of taking care of mechanical duties — responding to shareholders, answering the phone, putting out releases, setting up meetings. That's lots of reactive work, but little proactive work to help improve valuation or the company's reputation.

In fact, early on the investor relations officer and management should decide what is to be accomplished — set realistic goals about the quality of information to be disseminated and about how to identify the right investors for your company, have an impact with the investment community, and improve the company's valuation. The investor relations officer must have a set of goals for the IR function.

Essential IR Capabilities

There is no single education leading to the position of investor relations professional. In fact, IR professionals in practice today bring diverse backgrounds to the role, combining education, job experience and talent. Generally, they all have strong interpersonal, written and verbal skills as well as an understanding of finance, operations, corporate strategies and responsibilities.

Some of the capabilities IR professionals should bring to their jobs include:

- Working knowledge of the capital market process and investor behavior. Some schooling provides this, but it really comes from being on the phone with analysts and investors, having in-depth discussions of company operations and the investment market, setting up meetings, participating in meetings, making presentations on behalf of the company.

- Familiarity with creating an investor relations office. This requires understanding the technology required to implement essential activities. Vendor services today can make information dissemination and retrieval and administrative tasks highly efficient.
- Background and training in finance and the responsibilities of a public company. Investor relations officers need to understand the financial structure and process of the company, how to interpret a balance sheet, and how to "crunch" the numbers. This knowledge is essential in working with virtually all analysts and most portfolio managers. Investor relations professionals can gain this knowledge through education and/or on the job. Many IR people today have an MBA in finance. However, many others have come to their current positions through communications and other fields, mastering financial requirements along the way. Some investor relations people also bring experience as operating managers to their positions.
- Background in planning and preparing communications messages and materials. This starts with developing the operable message and information base. It includes preparing presentations, press releases, annual and interim reports. The investor relations professional must understand how to position the company, build the story, and continue to tell it as each new chapter unfolds. He or she should have the writing skills to prepare the messages and materials and know when to seek these skills from an internal communications department or outside resources.
- An understanding of the role of market research in supporting an investor relations program. Only through market research will companies know how much is known about them, the attitudes and perceptions of key players in the investment process, and what actions are suggested to maintain good relationships. This research can be benchmarked, and it should be ongoing.
- Ability to be a manager and to interface well with various constituencies, both inside and outside the company.

Support from Outside Resources

Companies can get help for their investor relations function from trade associations and from The Nasdaq Stock Market. For example, the National Investor Relations Institute offers publications and seminars, operates a bookstore, has local chapters, and maintains an advisory group to answer any IR question. In addition, Nasdaq sponsors and co-sponsors educational investor relations programs. Nasdaq also provides its listed companies with a proprietary service, Nasdaq Online℠, offering extensive market information on such subjects as charting

stock performance, sorting out the factors embedded in stock price, identifying a company's shareholders, and identifying institutions most likely to be interested in a company based on how they construct their portfolios.

Outside investor relations services are also available to supplement in-house IR efforts.

Selecting the service that's best for a company starts with identifying your company's needs. Companies with a full-time investor relations professional might go outside for specialized support in any of these areas: market intelligence, institutional targeting, building sell-side analyst contacts, writing presentations and annual reports, and conducting research to gain analyst and portfolio manager feedback. This specialized support can come from a single consultant or a full-service agency.

Smaller companies with a less-experienced investor relations person, or an executive handling the investor relations job on a part-time basis, probably look for more generalized support from outside sources. Experienced outside services can help a company determine the appropriate communications platform, write presentations and other materials, arrange meetings, interview analysts and investors to gain an objective perspective, and target compatible potential investors. Consultants also can advise companies on the best technology-based products and services to use in running the IR office.

One caution. Some agencies with special capabilities may try to sell you on emphasizing these in your investor relations program. The capabilities may be just what you need, may be useful but not essential, or may not satisfy your fundamental needs at all. Make sure the agency has what you want and is being objective in its recommendation. Agencies should be chosen to fit specific needs, such as developing appropriate messages and an information platform, shareholder analysis, institutional targeting, or better understanding market behavior. An agency's ability to demonstrate a proven record of success should be mandatory.

It may not be advisable to have a consultant speak on behalf of the company. Analysts and investors need to be confident they can have direct access to the company whenever it is desired.

Chapter 5

Companies are advised to see disclosure as good communications, and design a consistent communications process.

Disclosure: The Foundation of Investor Relations

Disclosure. Disclosure. Disclosure. It is a major focus of investor relations. Adequate disclosure is a concern of senior executives and lawyers. They may fear the company will get into trouble for saying too much or the wrong thing. The wrong disclosure can trigger a lawsuit. Not enough disclosure can trigger a lawsuit. On the positive side, effective disclosure contributes to achieving full valuation. And companies can protect forward-looking statements against lawsuits under the "safe harbor" law enacted by Congress at the end of 1995.

Disclosure has two important dimensions:

- Voluntary disclosure — a process of consistent information flow that helps make and keep the investment community well-informed. Companies are advised to see disclosure in this way, as good communications, and design a consistent communications process.
- Required disclosure, which is set in a regulatory/legal framework and has boundaries to follow. There is mandated disclosure in the form of documents required by the SEC when a company goes public: prospectus, 10-K, 10-Q, 8-K reports, and proxy statements.

Voluntary disclosure contains guidelines on how best to provide information safely that have resulted from laws, rules and court cases.

For companies concerned about whether they can have a proactive communications program and avoid legal repercussions, the answer is yes. It takes a good understanding of the disclosure regulations including the Securities and Exchange Commissions Regulation Fair Disclosure (Reg FD), court-related precedents, procedures for releasing information, and the appropriate content of information. Experience helps in knowing how to provide information in various forums — and how to refrain from words and actions that can create problems.

Economic Value of Disclosure

For encouragement that a proactive disclosure process is in the best interests of a company, look to the study mentioned earlier, by Stanford Professor Mark Lang and Michigan Professor Russell Lundholm. It showed that providing good consistent information attracts sell-side analyst coverage and encourages analysts to rely more on the information coming from the company.

"More forthcoming disclosures cause the analysts to place more weight on the common firm-provided information, thereby increasing the consensus in their forecasts," the study noted.

The professors also concluded that extensive analyst coverage attracts a larger pool of informed investors and potential investors with more accurate expectations of future results: "They (the analysts) have greater consensus in their expectations, and their expectations change in a smoother manner over time. All of these attributes may serve to reduce the firm's cost of capital."

Dr. Baruch Lev, professor of accounting and finance at New York University, has been studying and analyzing the effect of companies' communications with investors for a long time. Dr. Lev concludes that the benefits of disclosure outweigh the risks, and even the costs, should a company get sued. The exceptions are small companies with little or no income stream that can't afford a costly settlement or prolonged court trial.

One study he conducted covering 800 companies of all sizes indicated that the companies increased market value by $85 million on average by disclosing such qualitative strategic developments as technological advances, new products, business alliances and capital expansion programs. On the other hand, a parallel study of 276 lawsuit settlements in 1990-1991 showed the average paid by companies to be $3.8 million. Later studies have shown the settlement numbers to be rising but not approaching the market value to be gained.

Dr. Lev also encourages early disclosure of potentially negative news — quarterly earnings below the analysts' consensus forecast, for example. His studies indicate that there's less of a stock price decline following a negative preannouncement than when the company waits to actually report the results. He cites a study indicating a 2.4% drop in price at the time of the preannouncement, with virtually no decline when the results are reported. In contrast, average declines are steeper when companies only release the actual results.

According to Dr. Lev, companies should have a defined disclosure policy and set of procedures. "A disclosure policy is a complex, multiple-objective and multi-benefit activity that may be aimed at: correcting investors' misperceptions and stock price undervaluations, enhancing the stock's liquidity, or changing shareholder mix. Disclosure may also decrease the firm's cost of capital and enhance its growth and ultimately maximize shareholder value."

Reasons for Voluntary Disclosure

At a conference of the National Investor Relations Institute, Dr. Lev gave five reasons to conduct a proactive voluntary disclosure program:

- It reflects favorably on the quality of management, showing up in share price. "If the management doesn't say anything, the investors will think it doesn't know anything," he stated.

- It increases liquidity. Disclosure helps create more consistent stock price and trading volume because of the consistent flow of information. It can help a company maintain a stable shareholder mix by creating more longer-term investors.
- It can enhance a company's reputation. Reputation is important to investor confidence and share price and can affect cost of capital. Explained Dr. Lev, "The market's lack of information leads to undervaluation, which raises the cost of capital."
- It can help narrow the gap between bid and ask price. Lack of information is a major cause of a wide spread. "Market Makers and specialists worry that the investors are more informed than they are," Dr. Lev noted.
- It can decrease litigation or the fear of litigation. Good information eliminates surprises, prevents information gaps among investors, and helps avoid misunderstanding or misperception.

Professional investors support company efforts to be forthcoming because the orderly, consistent dissemination of information can achieve uniform behavior in the markets. This is particularly important to smaller companies and those participating in fast-paced, fast-changing industries, such as computer technology and biotechnology, where there can also be a lot of uncertainty.

Some investment managers say there is value in building a disclosure program around communicating the longer-term strategic purpose of the company. Full value is more likely to be achieved when investors can see how a long-term strategy is playing out. They like to know what the outcome will be if this happens or that doesn't happen.

Material Information: Complex But Defined

Before setting up a disclosure policy, program and procedures, it is helpful to know these facts. Disclosure falls into two parts, structured and unstructured. Structured disclosure is covered in the 1934 Securities Act, administered and enforced by the Securities and Exchange Commission, which was established with the enactment of the 1933 and 1934 Acts. Structured disclosure means that information must be provided in a precise manner, which is stipulated in various mandated documents, such as the 10-K, 10-Q, 8-K, prospectus, proxy, registration statements, audited financials, and management discussion and analysis in annual and 10-K reports.

Unstructured disclosure is addressed in the 1934 Securities Act under Rule 10b-5, which deals with implicit disclosure obligations under general antifraud provisions. Unstructured disclosure means that, within certain guidelines, information can be provided at will, using appropriate communications vehicles such as annual and interim reports, letters to shareholders, press releases, ads, speeches, investor meetings, teleconferences, telephone conversations, online databases and Internet Web sites.

Conflict in efforts to disclose typically occurs for two reasons: (1) investors claim they were misled or misinformed by inaccurate information or by the absence of necessary, accurate information; (2) would-be buyers, holders or sellers of shares claim that everyone did not have access to important information at the same time, that "insiders" had the information first.

Key notions that come into play here are the definitions of material information and the definition of an insider. The working definition of material information is from the 1976 *TSC Industries versus Northway* court decision, which was reaffirmed in the 1988 *Basic v. Levinson* U.S. Supreme Court decision. It says information is material where there is a "substantial likelihood" that a "reasonable investor" would find it important in the "total mix" of information.

The definition is drawn a little tighter in the U.S. Supreme Court's commentary in the *Basic v. Levinson* case: "There must be a substantial likelihood that the disclosure of an omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."

Examples of Material News

Product News	Business News	Financial News	Management News	Labor News
The acquisition or loss of a significant contract	Quarterly and annual earnings	A call for redemptions of securities	A change in control or a significant change in management	A significant labor settlement or dispute
A significant new product or discovery	A merger, acquisition or joint venture	The public or private sale of a significant amount of additional securities		Plant closings or layoffs
	A stock split or stock dividend	The purchase or sale of a significant asset		
	Earnings or dividends of an unusual nature	A significant change in capital investment		
	A tender offer for another company's securities	Establishment of a program to purchase a company's own shares		
		A decision to take a write-off		
		A major change in accounting treatment of financials		

The Association for Investment Management and Research (AIMR) has written a definition of materiality: "Information is material if its disclosure would be likely to have an impact on the price of a security or if reasonable investors would want to know the information before making an investment decision. In other words, information is material if it would significantly alter the total mix of information currently available regarding the security."

Regarding equal access to information, an insider is someone who has material information and thus cannot trade on it or pass it along to someone else to trade on it.

Typically, insiders include corporate managers and employees, outside IR consultants, lawyers, accountants, investment bankers and vendors, such as printers preparing stock offering documents. Insider trading scandals of the late 1980s often involved outside advisers.

Key disclosure situations where material information is likely to exist involve sales/earnings results; forecasts of results; possible mergers, acquisitions, joint ventures or other alliances; divestitures; executive management changes; a CEO, chairman or other key officer who is seriously ill or is in serious trouble; instances where the company is in trouble, about to be cited or indicted for some violation; significant technology or product development; major accounting practice changes; and major change in order or inventory flow.

Handling Rumors

Disclosure affects the entire communications process and the specific vehicles used to communicate — releases, speeches, reports, meetings and phone calls. One of the stickiest types of disclosure to handle involves rumors about a company and its performance.

A few companies have gotten into trouble over how they handled rumors, leading to court decisions and a body of court case law that now guides companies on how best to handle rumors and pending material deals. The laws emerged during the merger/acquisition (M&A) period of the 1980s, when rumors ran rampant.

Rumors on pending deals can catch a company in the middle. You don't want the stock price being buffeted by rumors. Typically, the acquiring company loses value, and the company being acquired gains value — which usually is not in the best interests of either company.

There are good reasons not to reveal a deal until it's done. Premature disclosure can change the stock price and affect the cost of the deal or even sour the deal. When engaged in M&A discussion, companies have learned that the best practice regarding rumors about a possible merger or acquisition is to say nothing — to give a "no comment" or say "we don't comment on rumors." There is no obligation to comment on a rumor unless the company is responsible for it or has made earlier statements about a pending deal. Otherwise, a "no comment" response is acceptable, according to securities laws and the courts.

Landmark court cases have established the precedent for not revealing plans until they are completed. They also have shown the risk in saying the wrong thing — for example, "the company knows of no significant corporate developments at this time" if M&A discussions are underway.

Two such cases involve Carnation and Heublein. A Heublein spokesperson said the company wasn't aware of developments to account for unusual stock activity. A Carnation spokesperson said he wasn't aware of any developments. In both situations, negotiations were occurring, and in both cases, the companies were sued, though they were not held liable by the courts. The courts decided there wasn't a duty to disclose until an agreement was reached in principle. These cases have set the precedent for when most companies announce mergers or acquisitions.

In *Basic v. Levinson*, the Supreme Court indicated there is no "bright line test" to help companies decide if certain information is material. The court said preliminary negotiations could be material under certain circumstances, establishing a "probability and magnitude" test. Probability suggests the seriousness of the discussions, while magnitude involves the seriousness of the deal. In effect, the court said consider making a disclosure when the CEO or board is involved, the companies are big, and the premium is substantial.

The Basic case also reaffirmed a company's right to remain silent as long as it is not involved with the rumor. "Silence, absent a duty to disclose, is not misleading," the Supreme Court said.

From legal, regulatory and court interpretations of the Securities Acts Rule 10b-5, lawyers for companies have developed a set of guidelines for the companies to consider concerning disclosure of possible material information.

- There is no general duty to disclose material information simply because it exists. However, material facts must be disclosed in required documents such as the 10-K and when the company is trading in its own securities.
- There is no duty to disclose merger or acquisition negotiations until they are complete. Disclosure practice, supported by the courts, suggests disclosing deals when they are firm, namely when an agreement in principle has been reached.
- There is no general duty to respond to rumors. However, the company must respond to rumors when it is the source of them or a participant in some way.
- There is a duty to update material information released previously.
- There is a duty to correct a previous statement if it is shown subsequently to be inaccurate at the time it was made.

- When a company chooses to communicate in a situation involving material information, it must be accurate and complete in the information provided.

Avoiding Selective Disclosure

In discussing the risks of selective disclosure, the purpose is to show companies how to avoid some land mines in conducting an effective communications program.

It is critical that IR professionals avoid selective disclosure — giving material information to one person or a few people but not others. Potentially risky are phone calls with analysts or investors, one-on-one meetings or small group sessions, and conference calls. Actively promoted conference calls on the Web can qualify as full disclosure under Reg FD but not under all marketplace rules. Media coverage of the conference call content can widen disclosure, even be seen as fulfilling disclosure requirements. At minimum today, Web-based calls deflect concerns about selective material disclosure occurring during the call.

New material information provided in any of these situations must be widely disseminated through a press release. In fact, the prescribed method of disseminating material information, spelled out by the SEC, Nasdaq and the other stock exchanges, is for material information to be fully described in a press release sent to the major wire services, at least one New York newspaper and newspapers serving the company's headquarters location. In addition, Nasdaq requires that a company notify MarketWatch℠ by phone (800-537-3929) or by fax (240-386-6047) at least 10 minutes before releasing material news to the press.

This means providing the release at least to Dow Jones/*The Wall Street Journal*, Reuters, Bloomberg, Associated Press, *The New York Times*, and your local papers. The company can't be responsible for whether the release is used, of course, but depending on the importance of the announcement some coverage is certainly likely.

Most companies send important releases through one or a combination of electronic services — PR Newswire, Business Wire, PrimeZone, First Call or Bloomberg. These services disseminate the release to an extensive list of financial and business press and wire services, plus any and all other media requested by the company. The release also is received in most of the major brokerages and investment houses, and it appears in virtually all of the electronic databases available to investors today, such as Dow Jones News Retrieval.

Selective disclosure can be accidental or it can be intentional. Corporate or investor relations managers in phone discussions with analysts or major investors can let something material slip out when responding to probing questions. The same thing can happen in a meeting or on a conference call. Companies are well advised to have someone in the room with an ear tuned to hearing an inadvertent material revelation.

In an intentional disclosure, a company spokesperson may be trying to give an edge to an analyst or investor. It may be a favored analyst, with market power, who has done well for the company. It may be the biggest shareholder. The spokesperson may feel intimidated and forced into providing a material answer. But he or she shouldn't be, for three reasons:

- **Illegality.** Under Reg FD, the SEC can bring action against the company and individuals for providing material information selectively.
- **Risk.** If the company gets caught giving out nonpublic material information, a competing analyst or a shareholder may find out and be annoyed. One of them could seek recourse, for example, by tipping a reporter, whose story then puts the company in a negative spotlight.
- **Futility.** The analyst or investor can't use the information anyway. Under AIMR's Standards of Professional Conduct, the analyst can't provide the information to an investor or take any investment action based on the information. Investors can't make investment decisions while the information is still private. Knowing these rules, professionals don't want to receive nonpublic material information.

However, analysts and investors are quite interested in converting pieces of non-material information into material conclusions, using the "mosaic" process. The process says analysts and investors are free to do all the research and analysis they want in coming to material conclusions. The SEC is comfortable with the mosaic concept. It doesn't want to stifle the efforts or limit the intellectual power of specific analysts and investors in gathering good information, applying sound judgment, and making wise predictions of a company's future performance.

For this reason, disclosure of nonmaterial information to selected analysts or investors is acceptable and even encouraged. It's okay for companies to participate in the work of an analyst or investor to gather the best possible nonmaterial information.

The SEC's approval of this type of disclosure is apparent in the requirement of companies to file 10-K and other reports but not to have to supply them all directly to every shareholder. In effect, investors need to exercise initiative to gain the information contained in these documents.

Regulation Fair Disclosure: A Communications Challenge

Reg FD was approved by the SEC on August 10, 2000 and went into effect on October 23, 2000. It updates and expands the process of meeting disclosure requirements, dating to the 1933 and 34 Securities Acts, in response to technology's impact on market behavior and information availability.

The intent of Reg FD is that good information should be available in a timely manner to the investment community at large. This means full and fair disclosure of material information

distributed as widely as possible, so individuals have access to it at the same time as financial analysts and institutional money managers.

In summary, Reg FD states that when a publicly traded company discloses material nonpublic information to certain securities market professionals and security holders, it must make public disclosure of that information. The timing of the required disclosure depends on whether it was intentional or unintentional. An intentional disclosure must be made simultaneously to the public. If, on the other hand, the disclosure was unintentional, the company must publicly disclose the information "promptly" — within 24 hours or before the next market open, whichever is later. Public disclosure can be made by filing a Form 8-K or "another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public."

At the center of Reg FD are the press release, SEC 8-K filing and phone or Webcast conference calls. Releases are front and center in the disclosure process. Releases should be issued and broadly distributed covering any material information, disseminated ahead of any discussion, whether a meeting, conference call, phone conversation or e-mail.

SEC 8-K filings to cover new material events are increasing in number. CFOs, attorneys and accountants routinely make SEC filings and are growing more comfortable in using this method, providing the information under item 9 of the 8-K. Companies making 8-K filings are helping to broaden the audience for these documents by making them readily available on their IR Web sites.

However, press releases are still more likely to reach a wider audience in a timely manner, since they quickly reach media, analysts, portfolio managers and the many online data sources of investor information.

Widespread dissemination of releases made possible by electronic delivery goes a long way to satisfy the SEC's intent to get material, market moving news to the entire investment community on an immediate basis. Releases sent by companies through a commercial wire service such as PR Newswire, PrimeZone and Business Wire are carried in their entirety, versus snippets appearing on the Dow Jones Broadtape and in the papers the next day, reaching analysts and money managers directly, plus the myriad of sources monitored by investors by the minute — Bloomberg, Dow Jones, Reuters, First Call, CNBC, CNNfn, new Web media and hundreds of online databases.

Inadvertent or unplanned release of material news during a discussion requires a follow-up news release within 24 hours or before the market next opens, whichever is later. The choice is designed to cover disclosure occurring over the weekend. Just posting the release on the company's Web site does not meet disclosure requirements, at least not at this time.

Material information provided during a conference call constitutes full and proper disclosure, provided the company announces the call in advance to widen the audience and makes it available through a live webcast. This provision protects companies giving new material information during the call — whether pre-planned or revealed during a discussion. The SEC advises companies to use "push" technology to alert the market of the pending call, send e-mails, post the session on its Web site and such popular online forums as StreetFusion, StreetEvents, Investor Broadcast Network and BestCalls.

Regulation FD applies to corporate people who maintain investment market contacts as a major or primary responsibility. Essentially, this means it covers senior executives, board members, investor relations and corporate communications people. Excluded from the rule are communications with rating agencies, customers and suppliers, and advisers in a position to have a duty of trust or confidence and a need to know. Included are attorneys, investment bankers and investor relations consultants. Attorneys advise companies to have written confidentiality agreements with all appropriate parties.

A controversial aspect of the regulation is the exclusion of the media. In theory, a company can provide material information selectively to a reporter or editor. This can be troublesome to companies, leading advisors to urge companies to be even handed in the disclosure of information — material and non-material. It clearly is not in the best interest of a company to be part of a situation that gives the media an advantage over analysts and investors in learning about and reporting on new material information.

There also is a risk in arranging exclusive interviews with certain media, requiring them to embargo the information until it appears. The possibility that the information can leak out selectively is real.

It is important to remember that the media and analysts compete to break information, with the media gaining ground steadily. Providing material information to the investment community and media simultaneously appears to be the most prudent course of action for companies.

Foreign companies are excluded from Reg FD, at least at this time. It is likely that foreign companies with ADR (American Depositary Receipt) programs could be included in the future.

Impact of Reg FD on the IR Function

At introduction, the initial response to Reg FD was strong and divided — among companies, analysts and investors. A predicted "chilling" effect on disclosure occurred even before the rule even went into effect, but began to ease as companies developed new formats for releases and conference calls and became more comfortable with filing 8-Ks to report material news. More companies are providing revenue and earnings guidance in press releases and conference calls, and webcasting conference calls is on the increase.

Trends are emerging. One is to provide guidance at the start of each quarter, then either not discuss financial performance during the quarter or use the guidance as a framework for further discussion that is non-material. A variation involves updating the information at a midpoint of the quarter, either in a release or conference call or both. The release and call enable the company to provide updated material information. Another alternative is to update the initial quarterly guidance if necessary, namely the material information has changed, creating the need or opportunity for a material update.

Companies continue to honor the quiet period, which typically falls at the end of the quarter and the first part of the next quarter, lasting until financial results are reported. Quiet periods are the time when a company has a firmer knowledge of financial results, but hasn't completed its audit. During this time, the company makes no comment on results and provides no additional guidance. Under Reg FD, we could see this period starting earlier near the end of the quarter.

In response to Reg FD, the number of companies pre-announcing earnings results that differ from analysts' consensus expectations has risen significantly. The increase began with the third quarter of 2000, possibly in anticipation of enactment of the rule.

More likely, three circumstances contributed to the increase.

- One is concern over violating Reg FD through selective material disclosure.
- Another ties to studies indicating companies that pre-announce an earnings shortfall end up with less stock price impact versus the negative impact of totally surprising the market.
- It also can be argued that companies are obligated to let the market know as soon as they realize any miss in results.

Many observers believe Reg FD will motivate companies to focus more of their discussion on qualitative factors, elevating the value of that information in analyzing companies and making buy/sell/hold decisions. Similar advantages from the rule accrue to buy-side analysts, portfolio managers and individual investors relying more on non-financial information to make their decisions. Overall, the depth, quality and value of research will likely get stronger on both the sell and buy sides.

After initially drawing back on attending broker-sponsored conferences and holding their own meetings, many companies are returning to these activities, recognizing their importance in the full disclosure process.

Companies can continue to make presentations and answer questions without providing new material information. These sessions continue to add important value to analysts, investors and brokers as they build their mosaic in reaching material conclusions. An increasing focus in these sessions on strategies and other qualitative information and less on discussing the numbers is fair game and continues to enrich the research process.

Expanding Role of Conference Calls

One way to alleviate concerns about selective disclosure is to webcast conference call sessions. Before long, it is likely that virtually every company hosting a conference call will expand coverage to the Internet. This enables individual investors, brokers, the media and others to hear the call live. Some companies are allowing these Web users to submit questions through e-mail. The calls include presentation of slides and are archived to let other investors and analysts to tune in later.

Brokerage firms are falling in line, making arrangements or allowing companies to webcast their presentations and breakout sessions at broker conferences. Some brokerages even are webcasting the entire conference.

The trend is sure to pick up. Opportunities to reach individual investors, attract institutions and analysts, and meet Regulation FD disclosure requirements are likely to convert most companies to the conference call format as a communications medium.

And, while conference calls, actively promoted in advance and webcast live, fulfill the new disclosure requirements, companies still are urged to issue a release in the event of an inadvertent material disclosure.

Revisiting Reg FD as It Applies to Relations with Analysts

Corporate dialogue with sell-side analysts has been made ever more delicate by Reg FD. Indeed, continuing the dialogue remains in the best interest of both parties, helping analysts accurately analyze companies and helping companies improve the information flow through the investment marketplace.

Of ongoing concern are analysts' earnings estimates that are not consistent with internal forecasts — whether higher or lower. In working with the Street, companies must be careful not to make a forecast and not to directly comment on an analyst's estimate. Both are material events

and must be disclosed broadly through a release or 8-K filing. Not allowed is suggesting that an analyst's estimate is too high or too low, or the company's range is from X to Y cents a share.

Before Reg FD, conventional advice was to suggest that the analyst review the assumptions in his or her earnings model. Discussing assumptions with the company was common practice, called "walking the Street up or down" as the case might be. This practice violates Reg FD. The SEC considers these discussions to be part of the guidance process. According to the regulation, any material guidance must be published in a way that makes it widely available to the investing public.

The new rule also suggests that companies not review analyst reports, especially forecasts. Reviewing them, even for factual accuracy, can be interpreted in a lawsuit as being "entangled" with the content and/or forecast, or even "adopting" it. As such, companies will be less likely to comment on information in research reports, except to correct fact-based errors.

Managing Expectations and Earnings Forecasts

When disclosing nonmaterial information, it's important to manage expectations of everyone interested in the company. As noted elsewhere, a timely, consistent flow of valuable information is probably the best way to manage expectations. It is designed to keep everyone fully informed in making recommendations and buy/hold/sell decisions.

On the most-fully-informed chain, brokerage analysts come first. They are paid to be the experts on the industries and companies they follow; their job is to forecast companies' sales, earnings and other key financial measures of growth. How well they do depends on a number of factors, including the quality of information they receive and are able to extract from companies.

Obviously, they feel they can make more accurate forecasts based on good information and a solid understanding of the company. When a company's actual earnings are close to the analysts' consensus forecasts, stock price is hardly affected. When the earnings are below the analysts' consensus forecast, there's almost always a stock price decline.

Companies that know their earnings are going to be less than the market anticipates are wise to get the information out a few weeks early, before the actual results are reported. Market disappointment will most likely cause the price to fall, but studies show the overall drop isn't as steep as when the market is hit with the reported results.

The pre-announcement also helps a company build a case in the event of a lawsuit. The company can show it was timely in releasing the information as soon as it knew financial results were going to be below market expectations or below results of earlier time periods.

Some companies are nervous about dealing with analysts making forecasts. Should companies comment on the forecasts or even on research reports? Most lawyers suggest not commenting on either forecasts or analysts' reports. In a lawsuit, the plaintiff's attorney may argue that the company endorsed a forecast by commenting on it. If a company feels compelled to comment on analysts' reports, however, in the interest of maintaining good relationships, it should limit the comments to the facts contained in the report, lawyers suggest.

But what about the analyst whose forecast is out of line with the opinion of other analysts and with the company? An inaccurate forecast can affect trading patterns and price. It can produce an embarrassed analyst who decides to stop following the company, decreasing coverage. It might also lead to litigation if the analyst can make a good case that his or her estimate was influenced by information from the company.

Lawyers strongly advise against correcting the forecast in any direct way — like telling the analyst he or she is out of the ballpark, indicating the forecast is too low or high, or providing a better range. These types of comments are tantamount to the company making its own forecast and would need to be released to the public.

The way lawyers and IR professionals recommend dealing with out-of-line forecasts is to engage the analyst in a discussion on the assumptions that produced the estimate. By reviewing the assumptions, questions can be asked and nonmaterial information provided that enables the analyst to reflect on the estimate more closely.

...a timely, consistent flow of valuable information is probably the best way to manage expectations.

The volatility in stock price that is possible when a company doesn't meet analysts' quarterly earnings forecasts has many concerned. Some people suggest that the focus on short-term earnings forecasts contributes to volatility as investors sell stocks quickly and in large numbers. Certain investors are likely to buy shares in strong companies after the price falls, before the market realizes growth prospects are still positive, and the stock recovers. Brokerage firms benefit from the activity by gathering commissions from all the transactions being conducted. Investors with short-term earnings-based models contribute to higher trading as they buy into earnings growth/acceleration companies and sell out their positions in a hurry when earnings below consensus estimates are reported.

Pressure to meet analysts forecasts has the SEC concerned that companies are engaged in "earnings management," either creating reserves for down quarters or participating in questionable accounting practices designed to boost earnings. A number of accounting fraud cases have surfaced in recent years and the SEC has widespread investigations under way, studying the financial statements of dozens of companies to review a range of practices.

The SEC's concern about "managing earnings" has caused the commission to take a longer look at the definition of materiality. In August 1999, the SEC issued a Staff Accounting Bulletin on materiality, reminding companies that they are legally responsible for keeping books and records that reflect transactions and assets accurately. The SEC statement is aimed at addressing directly the issue of accountants and lawyers deciding what is material and immaterial in maintaining the books.

The SEC Bulletin exhorts companies to consider whether a "reasonable investor would consider the item to be important" rather than relying on traditional quantitative measures used by most companies to date. The traditional rule most companies have applied is that results that account for less than 3% to 5% of a company's reported earnings are immaterial. The Bulletin states that instead of using the threshold routinely, companies consider the qualitative factors impacting the situation.

Safe Harbor for Forward-Looking Information

Can and should companies make earnings forecasts? How far should companies go in providing forward-looking information?

Most companies don't make earnings forecasts, but they do provide forward-looking or qualitative information that gives investors and analysts a better understanding of the company. Larger companies tend to be followed by a number of analysts who are filling the market with information and predicting future performance. These companies prefer to let the analysts do the forecasting, trying to help manage the expectations accurately.

The situation is different for smaller companies, with little or no real analyst coverage and broker sponsorship. Forecasts can help these companies gain attention and send a message that the future looks bright. This can attract broker, analyst and investor attention, creating a buying interest.

The risk, however, is that the estimates will prove to be off the mark, causing a number of negative ramifications. The disappointment will probably be reflected in a stock price decline. The situation may necessitate a pre-announcement of the anticipated shortfall, depressing the price. Now the management is getting attention for negative, instead of positive, reasons. Corporate credibility is at stake.

The good news is that companies wanting to make sales or earnings forecasts now have more protection through the Private Securities Litigation Reform Act of 1995. The Act provides a safe harbor for forward-looking statements and also makes it more difficult for lawyers to file suits on behalf of shareholders claiming to have lost money because of something the company said or didn't say.

Companies of all sizes are taking advantage of the safe harbor. It provides a measure of protection for any forward-looking statement, enabling companies to talk more about future strategies and actions aimed at enhancing shareholder value. To invoke the safe harbor, companies must include reasonable assumptions supporting the forward-looking statement (see example on next page). Statements considered to be forward looking include projections of sales, income gains or losses, earnings gains or losses, capital expenditures, dividends, capital structure and other financial items, plans and objectives of management for future operations, strategic plans and initiatives, new products or services, efforts to penetrate markets, and statements of future economic performance.

Framers of the law intend the cautionary safe harbor language to be linked with the forward-looking statement and to be easily accessible to investors. Safe harbors need to combine two pieces of information: The first is a notification that the written material or verbal presentation contains forward-looking information and that actual results could differ; and the second involves including appropriate assumptions to support the statement. That means the disclaimer would appear in a release covering financial results, for example. The assumptions should appear in the release as well, and it also can include references to more detailed assumptions in such documents as the annual report, 10-K, 10-Q and 8-K reports.

The law also enables companies to protect qualitative and forward-looking information given in presentations, at meetings, during conference calls and regular telephone calls. The speaker would need to invoke the safe harbor, saying, in effect, that the discussion will or might include forward-looking information and that results could differ, then refer to the company's more extensive cautionary assumptions where they appear (annual report or 10-K, for example).

Wording of Safe Harbor Statements

Information released by a company is protected by the safe harbor law if:

- The information is identified as forward-looking and includes meaningful cautionary support or references to readily available data.
- The statements were made without knowledge they were false. In a lawsuit, the plaintiff would have to prove actual knowledge of falseness.

The plaintiff's bar is testing the adequacy of safe harbor claims, by being willing to file suits and have them go to court. While the number of suits filed fell in 1996, the first year of the new legislation, it grew to 235 cases in 1998. Most cases continue to be settled, rather than going to court. The focus has shifted somewhat from missed earnings forecasts resulting in lower stock price triggering suits to more accounting fraud cases and alleged insider trading before announcements of lower earnings.

Several studies of the outcome of the legislation have taken place and a number of cases have reached court rulings. However, no cases have reached the precedent-setting level yet, by virtue of rulings from appeals courts or the U.S. Supreme Court. One study shows that 60% of shareholder fraud suits filed in 1997 and 1998 were dismissed versus 38% of cases in 1990 and 1991. The study was conducted by SEC enforcement advisor David Levine and University of Michigan law professor Adam Pritchard.

For a while, plaintiff's lawyers were taking cases to state courts, including a number that were dismissed by federal courts. This loophole was thwarted with the 1998 Congressional Act, which had the effect of returning the cases to federal jurisdiction.

Several cases helped set patterns and create the basis for precedent. Suits in North Carolina and Florida were dismissed. In another case, a judge ruled that a company's efforts to invoke the safe harbor to start a conference call, with references to printed documents for assumptions, was valid. On the other hand, a judge ruled that Boeing's cautionary language wasn't sufficient.

A Ninth Circuit court ruling made in the summer of 1999 involving SGI (formerly Silicon Graphics) can have precedence. The case involves the "pleading with particularity" standard that is called for in the 1995 Congressional law. A lower court dismissed an alleged insider trading violation, ruling that the trading activity was in line with company officers' historic patterns.

The circuit court ruling provides an answer to the meaning of pleading with particularity and a direction for future court decisions. The court affirmed that the "required state of mind" must be a "fraudulent intent," and it must be shown that the company action constitutes "deliberate or conscious recklessness." Such was not the situation with SGI, according to the court ruling. Based on this outcome, the plaintiff's bar may seek a hearing from the U.S. Supreme Court. Meanwhile, it is likely that more cases will be dismissed or settled at less cost to companies.

From the lessons to date, attorneys strongly urge companies to invoke the safe harbor and to exercise skill in making it meaningful. This includes following the procedures carefully, making sure safe harbor statements are included in releases, documents and given during presentations when forward-looking information is provided, and having a good set of assumptions readily available to investors.

Congress and the SEC encourage companies to make the cautionary statements specific to the forward-looking information being provided. The more specific the language, the more meaningful the disclosure is likely to be.

Boilerplate safe harbor language is less likely to pass muster. Early on, some companies said too little and were too general with their disclaimers, while others covered every possible thing that could happen.

The following is an example of safe harbor language from a conference call conducted by 3Com, given by Eric Benhamou, Chairman and Chief Executive Officer, on March 23, 1999.

> "The information in this transcript includes forward-looking statement about: sales growth, expense levels, financial and operating performance; the deployment of emerging converged network technologies, such as hand held computing, IP telephony including LAN telephony and Voice-over-IP, broadband access including cable and xDSL and home networking; the company's ability to reduce cost and time to market from siliconization; development or marketing of new products with partners; trends in market place demand; product mix; integration of acquired technologies; and changes in investments in various lines of business and resulting benefits, including stronger position in higher growth markets; and as such is subject to the risks and uncertainties including, but not limited to, quarterly fluctuations in results, the timely availability of new products, the impact of competitive products and pricing, and the other risks detailed in the Company's SEC reports, including 3Com's Form 10-K for the year ended May 31,1998 and Form 10-Q for the quarter ended November 28, 1998. Actual results may differ materially."

Cirrus Logic incorporated the following safe harbor language in a press release shortly after the legislation was passed:

> "Except for historical information contained herein, the matters set forth in this news release are forward-looking statements that are dependent on certain risks and uncertainties including such factors, among others, as new orders received and shipped during the remainder of fiscal Q3 and Q4; the timely ramp up of new audio (CS4236) and graphics/video (CL-GD55446 and CL-GD5462) products, which could be subject to various delays, including software release delays, new bugs not yet seen, and customer qualifications; the final determination of appropriate inventory reserves based on the outlook at the end of each quarter for the products in inventory; the actual operational results including operational spending; completion of a bank line of credit currently in negotiation; and the risk factors listed in the company's Form 10-Q for the quarter ended September 30, 1995. (See Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations.)"

At first glance, the cautionary statements may seem negative, but each has a flip side detailing drivers of improved performance and growth. These statements are the basis of an effective presentation and can go a long way in helping analysts and investors better understand the company, leading to a full valuation in the marketplace.

Congress and the SEC don't intend for a company to cover every conceivable future caveat. "The intent is to look at the total mix of information," said Louis M. Thompson, Jr., President of the National Investor Relations Institute. "Failure to include that particular factor that ultimately causes a forward-looking statement to not come true doesn't mean the statement is not protected by the safe harbor."

This has since been borne out in a court ruling in the U.S. District Court for the Middle District of North Carolina in the *Racheedi v. Cree* Research case. A risk factor that caused the company to miss its projection was not listed in the cautionary statement that included other risk factors. The judge ruled that in the total mix of information, investors were warned of the risk that the forward-looking statement might not prove accurate.

While not specifically addressing the need to update information covered in a safe harbor communication, lawyers and investor relations people conclude that updating is wise. Stale information can cause bad investment decisions. The National Investor Relations Institute takes the position that it is in the best business interests of a company to update forward-looking statements that change in a material way. Lawyers argue that there is a duty to update, even under a safe harbor, since the new law doesn't specifically state that there is no duty to update.

Smaller companies and those in biotechnology, high-tech or other rapidly changing industries have been hit especially hard by lawsuits, typically triggered by a fall in stock price after financial results are reported. These companies can be seen as vulnerable because of the uncertainties that are integral to their fields.

Changing Legal Requirements

Several roadblocks have been put in the path of lawyers racing to the courthouse to file suits. The "discovery" process by plaintiffs' attorneys to build a case can be held up by a judge while the company prepares its plea for dismissal.

As indicated, plaintiffs' lawyers must "plead with particularity." This higher pleading standard requires the plaintiff to specify each statement alleged to be misleading or to demonstrate that material information was omitted, causing the statement to be misleading. This requirement should discourage attorneys from rushing to the courthouse to file a lawsuit, with the intent of pursuing a settlement, based on a company's falling stock price.

A certification requirement should discourage law firms from using "professional plaintiffs" identified in advance. In the past, sometimes the plaintiff didn't even know a lawsuit was being filed using his or her name. The law now requires the lead plaintiff to file a certified statement

with the complaint showing that he or she has reviewed the suit and authorized filing it, didn't buy the stock at the direction of counsel to participate in the suit, is willing to serve as lead plaintiff, and wasn't paid a "bounty" to be the lead plaintiff.

Who serves as the lead plaintiff has been changing as well, motivated by the law. Traditionally, it has been an individual investor in most cases. Increasingly, it has become an institutional investor. Under the law, the court has 90 days to appoint a lead plaintiff once a lawsuit has been filed. The idea is to pick an investor with a major stake in the outcome as a way of improving the quality of representation. The lead plaintiff then selects the law firm to represent the class suing the company.

Institutions as lead plaintiffs add influence to the suit and can encourage other institutions to support the effort. However, many institutions aren't pleased with seeing companies in their portfolios being dragged through the expense and time of defending themselves. So institutions are being deliberate in deciding to take up the cause, focusing on substantial cases, usually involving alleged fraud, insider trading or steep price declines. In most lawsuits to date, institutional lead plaintiffs also are leaders in activism and corporate governance issues. Institutions are seen as doing a better job of prosecuting lawsuits and can make it more difficult to settle them.

The legislation also places limits on attorneys' fees. They are fixed by the court to a "reasonable percentage of the amount of the recovery awarded the class." An added wrinkle: The amount will be disclosed.

Can the winner collect legal costs from the loser? Maybe, say lawyers. There are sanctions, which keep that door open.

Merits of Having a Disclosure Policy

Companies are encouraged to have a disclosure policy, complete with guidelines. NIRI suggests one approach in its Standards and Guidance for Disclosure:

- Designate a Disclosure Policy Committee, consisting at minimum of the general counsel or outside counsel, chief financial officer and/or treasurer, chief investor relations officer, and chief corporate communications officer.
- Designate authorized spokespersons.
- Commit to keeping authorized spokespersons fully apprised of company developments.
- Instruct all employees who are not authorized to speak for the company to refer calls to authorized spokespersons.
- Have a policy on reviewing analysts' reports. Lawyers caution companies against reviewing

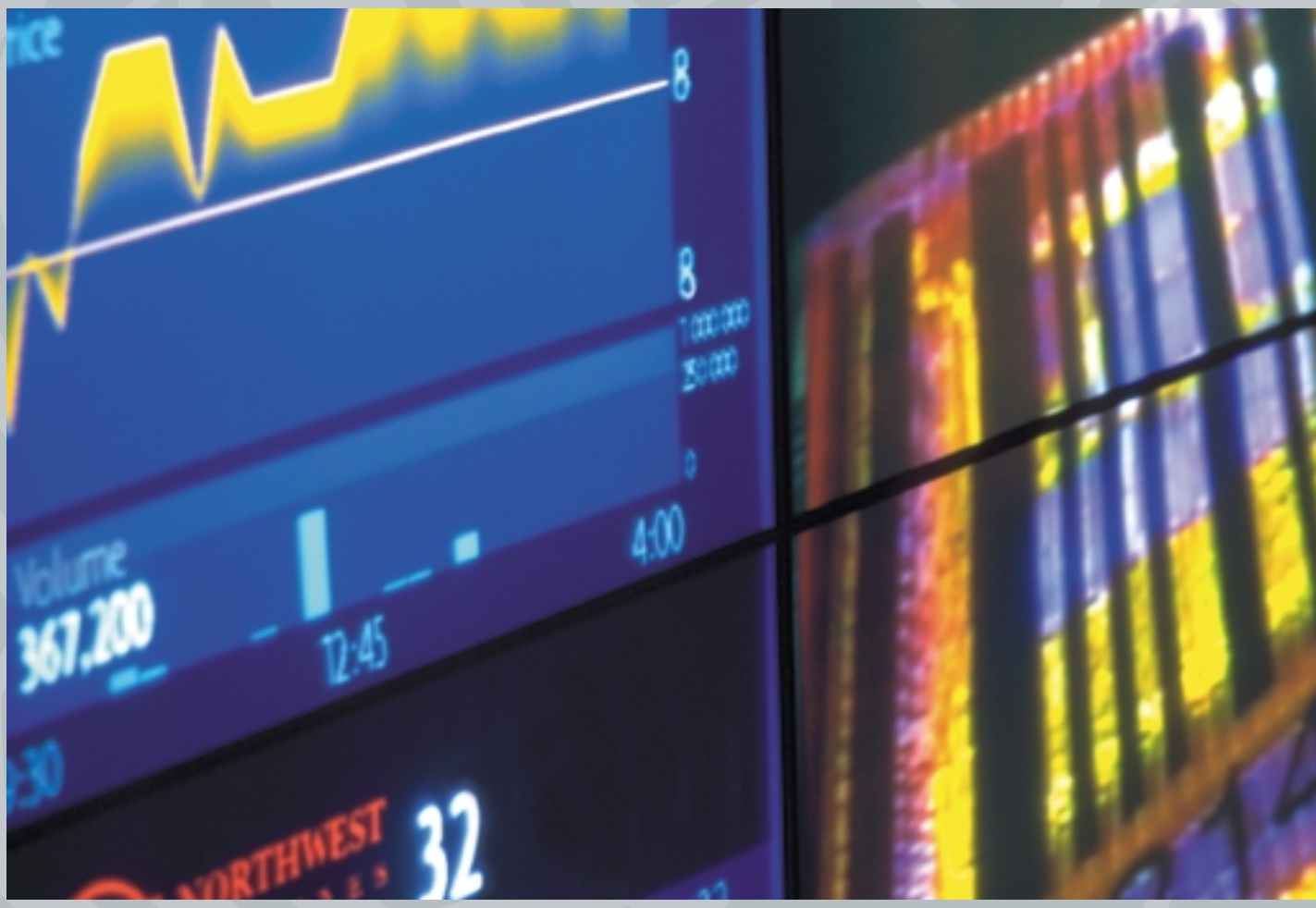
reports out of a concern of becoming "entangled" in their comments. If the company does review reports, stick to correcting errors in fact and don't comment on forecasts. Provide your corrections in writing.

- Have a policy on responding to market rumors. Court precedent suggests not commenting on rumors and not commenting on deals until an agreement has been reached in principle. Exceptions occur when the company is involved in the rumor or already has commented on the deal.
- Have a policy on commenting on analyst earnings estimates. Most companies don't officially comment on estimates but try to use a consistent flow of good information to help analysts arrive at accurate forecasts.
- Have a policy on providing forward-looking information. Companies are being encouraged to use the safe harbor as a way of providing more qualitative information to analysts and investors while providing protection against lawsuits.
- Have a policy on providing fair distribution and access to corporate information. In particular, don't "blackball" an analyst because you don't like what he or she is writing or saying about the company.
- Have a policy on the conduct of analyst meetings and conference calls — who can participate in the question/answer session versus who can only listen.
- Have a policy regarding media participation in analyst meetings and conference calls. The trend is for companies to include media in a listen-only mode. As more companies broadcast their calls on the Internet, greater access is provided to media and individuals.

Lawyers at the securities law firm of Fried, Frank, Harris, Shriver & Jacobsen, Washington, DC, add a few more ideas to the list:

- Always tell the truth.
- Get bad news out early. It helps cushion the blow. Try to avoid surprises.
- Have a policy that specifically covers the content of information that will be provided and the depth of information in each case.
- Keep a file on all the communications pertaining to a subject or issue. Include company statements, media clips, analyst comments, etc., both written and verbal.
- Always debrief the spokespersons after the situation to determine if any material information was inadvertently provided.
- Make sure internal documents support what was said.
- Continually assess the market's perception and understanding of the company. You can then issue communications to clear up misperceptions or to enhance understanding. Assessments help you anticipate issues and prepare to deal with them.

Chapter 6



Valuation is a process for determining worth.

Understanding Valuation

Companies that understand how they are valued by investors have two important advantages over other companies. They have the basis for focusing communications on the specific pieces of information that affect their valuation; and they are able to measure how business strategies are likely to influence or improve their valuation.

Valuation is a process for determining worth. Essentially, it is two-dimensional, applied by investors to determine the worth of a company's securities, and applied by companies in determining the returns from investments designed to improve value.

Institutional investors also think of valuation as the fair price of the stock based on the company's fundamental strengths and growth prospects. Institutions use their models to estimate the value of the stock, then compare their valuation to that of the market to gain a better sense of whether the price is likely to rise, fall or remain the same. Institutions want to buy shares of companies likely to have their stock prices increase, thus achieving their expected return. So valuation becomes an analysis of whether the current price indicates the stock is under, fairly or over valued.

Many if not most investors follow a certain valuation process in calculating the value of a company's securities. The fully valued price of the stock is used as a guide to making investment decisions.

Corporate efforts to improve value constitute the second dimension of valuation. Companies are using valuation techniques similar to those employed by investors to make decisions on their investments. Is the business growing through acquisition, new production facilities, a move into global markets, an emphasis on technology in developing new products? Well-defined valuation methods help the company evaluate whether returns from the new investment will be greater than costs, thus adding value.

The goal of companies is to take actions to increase revenues, improve earnings and generate higher levels of cash flow. Most valuation approaches used by investors today calculate earnings or cash flow. Steadily increasing levels of earnings and cash are the critical measures that enable companies to sustain growth.

Companies participating in high-growth product lines, services or markets can reinvest their earnings to sustain or accelerate their growth rates. These companies frequently borrow more money or issue more shares to raise additional capital to take full advantage of their business opportunities. Typically, that means using the capital to strengthen research, increase productivity, expand sales and marketing, open new markets domestically or overseas.

Companies in more mature markets generating large amounts of cash have little opportunity for additional growth from reinvesting in their existing businesses. But they can pay substantial dividends or repurchase shares as ways of rewarding shareholders. Or they can find new ways to grow — by creating new applications for their products, for example, or expanding into global markets, or making smart acquisitions.

Capital investments, then, are aimed at generating higher levels of cash flow, either from making existing assets more productive or by buying (through acquisitions) or building new assets that earn returns above the cost of the investment.

How Investors Use Valuation

Investors tend to view valuation either broadly, as an entire investment approach, or narrowly, as a specific model.

Valuation is highly quantitative. The investor is adding up the numbers — the company's ratios (price to earnings, book, cash flow, sales, etc.); its returns (on equity and assets); and its price and volume history. In these investment approaches, valuation is one major input into the decision-making process.

Most professional investors today have valuation approaches that are relatively complex. Some use one simple formula, such as a dividend discount model or CFROI (Cash Flow Return on Investment), but most combine a host of inputs into a complex model that screens and rates the company by numerous factors.

If the investor tends to be quantitative, investment decisions are made on the basis of all this data. Active investors use the data as an important part of their fundamental analysis; it becomes their screen to determine the companies to investigate further.

A common model used by investors and companies has its principles rooted in the discounted cash flow (DCF) model as a basic valuation approach. Investors using this method believe that a company's economic performance is the major measure of its strength and ability to grow. In

contrast, earnings measures are flawed based on accounting conventions. DCF is a method for calculating the present value of future cash flows in an effort to price the intrinsic value of a company.

Through the years, many more models have emerged, as investors continue to seek better ways to predict the future — and as they try to improve their returns by creating better tools for blending market behavior and corporate performance.

These models use data and patterns of market behavior to attempt to determine: (1) how a company will perform in the future; and (2) how the market will price the company's stock. Current investment approaches and valuation methods are continually being fine-tuned, with new variations back-tested for their accuracy in forecasting stock prices.

Some popular offspring and variations of the discounted cash flow theme emphasize earnings, dividends, cash, asset utilization and other proxies. Familiar to almost everyone are the ratio models — for example, price/earnings, relative price/earnings, price/book, price/cash flow, price/sales.

Two Categories of Valuation Models

In their work, the people at BARRA, a Berkeley, CA firm that consults with institutional investors, say valuation models in general fall into two categories — those capturing an investing pattern and those built on a cause-effect relationship.

Pattern-based models "recognize a phenomenon," says BARRA, "a pattern in historical returns that exhibits a surprising persistence." Investors are far more interested in exploiting the pattern than explaining it. For many Nasdaq companies, the "small cap effect" pattern is a positive model used by investors. The model analyzes historical patterns as the basis to predict when small cap stocks will be more favored by the market, thus achieving returns above market averages. Institutions using the model begin to invest in smaller companies when they see the pattern turning positive.

Reversal models are probably the leading pattern-based group. Evidence supports the notion that stock performance reverts to the mean. In other words, those stocks outperforming the market can be expected to under perform in the future and vice versa. Company fundamentals mainly drive the reversion, but market behavior can also play a role. Specific models calculate various time horizons for the reversions — one month, two months, six months, a year and more.

Earnings momentum models are hybrids of pattern and causality models. The pattern-oriented investor is observing the pattern of consistent earnings growth, while the causality-motivated investor is basing confidence in continued acceleration on fundamental analysis. Momentum investors look for strong indication that the upward trend will continue and try to determine how much longer it will last. They want to be sure other investors will continue to pay a premium as the stock price keeps going up.

Moving to the causality side, investors applying these models "are developing a rational, logical sequence of steps," according to BARRA, that leads to conclusions on the company's current and future value. There is a cause-effect relationship. Key tools in cause-effect models are ratios and growth rates, and estimates of future growth. These models are used primarily by active investors who are conducting fundamental analysis and are working closely with companies as sources of information.

Growth, Value and Income Investment Styles

Active investors tend to fall into three groups — growth, value and income. Investors in all three schools look for revenue and earnings growth; strong cash flow; healthy margins; high returns on assets, equity and investment; and good prospects for continuing improvement.

Cash flow and growth are important to income investors. They ensure continuation of the dividend, at hopefully higher yields. Most income investors require a threshold dividend yield or payout spread. Yield is dividends divided by current stock price, while the payout ratio is dividends divided by the price/earnings ratio. When screening companies, income investors compare the company's dividend yield and payout against the current market average. The company must be near or above the average to qualify for investment consideration.

Average dividend yields fell in the decade of the 1990s, thanks to the strong economy and the stock market emphasizing opportunities to grow. Companies with high growth opportunities opted to reinvest earnings in expansion rather than pay higher dividends. Yields fell as earnings and stock prices rose even though the amount of the dividend was the same or higher.

Growth investors want to be sure that revenues, earnings and cash flow trends will continue. They like to see earnings reinvested in high-growth opportunities. Companies of choice tend to have low yield and payout ratios, high price to book and price to cash flow ratios. A healthy economy and bull market emphasized growth stocks in the 1990s, encouraging use of earnings models as a measure of that growth. Some of these models require high growth earnings (25% or more), while others require earnings acceleration, namely higher earnings from the previous quarter. The latter group has been dubbed "momentum" investors.

Value investors look for good companies that are currently under appreciated or not recognized by the market. The company's stock may be priced below its true value, even below historical pricing levels. The companies themselves may be cyclical companies, recovering from problems or ready for a turnaround. Or they may simply be neglected companies.

A basic way investors measure under valuation is by the company's current price/earnings ratio. A ratio that is low compared with the market (Standard & Poor's 500 Index is generally regarded as the market) and its industry peer group suggests that investors don't have high expectations for the company.

Another basic measurement is market capitalization. Investors may buy only large cap stocks, setting a minimum size requirement — $1 billion, for example, or as high as $5 billion. Or they may prefer small cap and mid cap companies.

Industry position is important to many investors. The company must be an industry leader or quickly moving up the charts. A company that's losing position, especially in a fast-growing, highly competitive industry, is going to have a tough time attracting professional investors.

Quality ratings matter, too. Investment grade bonds may be a requirement for some investors. Others will accept companies with B or B- ratings. Liquidity is of interest to all investors, but especially the biggest institutions, who want to be confident they can buy more shares easily without pushing up the price or can sell their positions with little market impact. Institutions buying shares of smaller companies are concerned about liquidity. For this reason, they may spend more time researching and analyzing small companies. Thus, a good IR program helps provide the information and opportunity to dialogue with management to convince investors to buy shares.

Typically most important is the quality of management. And management is judged on returns — how well they deliver on promises to improve the company.

While investors are pursuing growth, value or income strategies, most also are interested in achieving highest total return. At the extremes, growth investors are focused mainly on price appreciation and income investors on dividends. But total return is what leads them to superior portfolio performance results. Total portfolio return is the average return of all the stocks in the portfolio.

Proliferation of Models

Specific valuation models become tools to help investors find growth or value companies or to take advantage of perceived patterns. Models being used extensively today by professional investors probably number around 20, with innumerable variations and refinements.

Valuation Technologies, an institutional style analysis firm that works closely with BARRA, identifies these valuation models: dividend discount, normal earnings to price, predicted earnings to price, cash flow return on investment, cash plowback, economic value added, estimate change, estimate revision, earnings momentum or acceleration, historical alpha, relative strength, residual reversal, neglect and sector momentum.

The firm also offers suggestions on the key ideas to communicate to institutions using these models in their investment disciplines.

Dividend discount. Measures the intrinsic value of a stock by calculating the present value of expected future cash flows. The model typically projects a stream of annual dividends and then calculates the annual rate of return required to equate the current price with the present value of the forecast dividends. The annual return may then be adjusted for the riskiness of the stock.

The model compares current price with expected growth rate — sometimes called Growth at a Reasonable Price. Even if your company is not paying a dividend, it may rank high on dividend discount if earnings are growing fast enough to support a substantial future dividend, and your company is priced attractively. Compare the long-term growth in your business with current price. Past growth rate and projected rates are of interest. Compare with peers, others in your industry, or with the market as a whole.

Historical earnings to price ratio. Compares past or reported earnings with current price. Discuss P/E based on last year's or trailing 12-month reported earnings. Compare with P/E of peers. BARRA says reported earnings don't reflect a company's long-term profit potential. So investors substitute an expression of normal earnings based on historical trends and forecasts. They use a trend line of the last five years of earnings and a one-year forecast.

Forecast earnings to price ratio. Compares expectations of earnings with current price. Discuss predicted P/E based on sell-side analysts' consensus estimates of next year's earnings. Compare with P/E of peers.

Cash plowback. These are earnings reinvested in the business. High reinvestment of earnings often indicates management faith in the future growth of the business, while a low reinvestment rate indicates a strategy of returning cash to investors. Discuss the portion of earnings you are

reinvesting. If you have a high cash plowback, indicate how you are investing these funds and why you expect good returns from these investments.

Yield. Compare current annualized dividend with current price. High yield companies are favored by value investors, while low or no yield companies are desired by growth investors. If your company pays a high yield, discuss dividend policy, history of your dividend, dividend coverage. Compare your company with its industry and peers. If your company pays a low or zero dividend, discuss growth and how you are re-investing earnings. Has your company bought back shares, returning funds other than through paying dividends?

Earnings estimate changes. Compare reported earnings to previous predictions. Tracks increases in consensus earnings estimates because stocks with rising estimates in recent months tend to outperform the market. Stocks with increasing estimates one month are likely to continue the pattern.

Estimate revision. Compare reported earnings to previous predictions and how recent price movement reflected those surprises. It combines two factors: recent earnings estimates and the stock's actual return for the period, the latter to make sure the market is reacting reasonably to the difference.

Earnings momentum. Indicates trends in earnings. High earnings momentum indicates a company that has grown faster than average, while low earnings momentum corresponds to lower than average growth. The past trend may include future earnings growth. If earnings growth is above average, indicate plans to keep growing. If growth is below average, discuss plans to improve growth. The model digests the last two years of earnings growth and analysts' forecasts for the next two years in picking stocks with the highest forecasts above current earnings.

Value/Growth reveals whether the market views your company as a value company or as a growth company. A high value/growth indicates a value company, while a low value/growth denotes a growth company. Value companies, those with high value/growth, have a high ratio of book value to market price, allowing the investor to purchase assets at a low price. Low value/growth companies (high growth) are priced high, to reflect the expectation of above average growth. If your company is a value company, discuss the company's assets and dividends; how liquid are the assets and/or prospects for increasing growth.

If you are a growth company, discuss growth trends, analysts' predictions of growth and your company's strategy to achieve growth.

Cash flow to price model. Used as both a model and a variable in other models, this is typical cash flow to price ratio over the past five years. It is calculated as the average price flow per share divided by the average year-end closing price. It is a good measure of relative value.

Economic value added. Measures cash return on investment above the weighted average cost of capital. Among the model's most visible supporters is Stern Stewart & Co.

Cash flow return on investment. Emphasizes cash flow as opposed to earnings and adds back such items as research and development in the investment category. HOLT Value Associates is among the model's chief developers and proponents.

Historical alpha. Looks for trends in price over a five-year span, comparing price growth with changes in market level. These managers are concerned with long-term trends.

Relative strength. Looks for trends in price over the most recent one-year span, comparing price growth with changes in market level. These managers are concerned with medium-term trends.

Residual reversal. Looks for trends in price over the most recent one-month span, comparing price growth with changes in market level. These managers are concerned with short-term trends. Discuss recent news that may have overly impacted price, either positively or negatively.

Size is a combination of market capitalization and assets. Indicate total market capitalization (price times shares outstanding), total assets, sales, earnings. If you have several classes of stock, indicate the total value.

Neglect is size relative to your industry and extent of analyst coverage. High neglect indicates that your company is small for its industry, and has low analyst coverage, whereas low neglect companies are large and well covered. Indicate your plans to grow, attract more analysts and get your story told.

Sector momentum. Look for recent trends by sector. Sectors are based upon the BARRA 55 industry codes. An investor buying stocks with high sector momentum is seeking stocks in sectors that have done well in the previous month. These investors are sometimes called sector rotators. Indicate the industries in which your company is active.

Is your company a "pure play," or are its business holdings diversified?

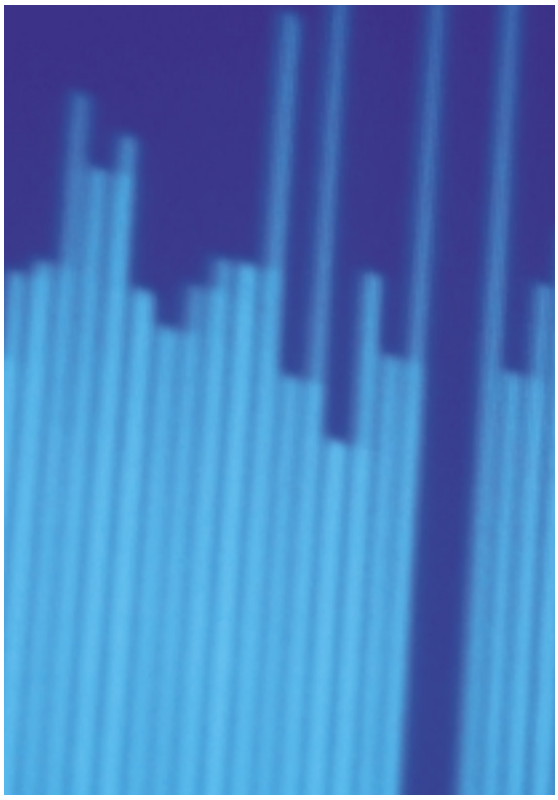
This model builds from historical evidence that sectors continue to out or under perform the market in the near term. The model captures this effect and assigns each stock a score based on the relative recent performance of the sector.

Trading activity. A high value indicates substantial trading and investor interest for a company of your size. Discuss number of shares traded, exchange listing, number of Market Makers, number of institutional investors, indications of an active investor relations program.

Factor Models

Also gaining popularity among professional investors are factor models, which seek to capture the inefficiencies of the market. These models exploit short-term market inefficiencies by identifying and ranking the factors accounting for the largest inefficiencies.

Professor Robert Haugen of the University of California is among a growing number of professional investors who have developed a factor model to capture market inefficiency. His premise is that expected returns can be better predicted by a model that identifies and properly weighs all key factors. His model has some 50 factors in five groups — covering risk, liquidity, the effect of current pricing, indicators of growth, and technical historical factors.



Professor Haugen has identified the most powerful factors, according to his model. They include: one-month excess return, 12-month excess return, book-to-price ratio, earnings-to-price, cash flow-to-price, two-month excess return, trading volume to market capitalization, return on equity, variability in cash flow yield, trading volume trend, six-month excess return, and return on assets.

Factor models are proliferating. BARRA and DeMarche Associates have been using them for years — BARRA as a consultant in helping investment firms manage their portfolios, and DeMarche as a consultant in helping pension fund and other plan sponsors select investment managers. The models described in the previous section are key components in various factor models used by institutions. A given institution may use three of the models (or factors), eight, 15 or some other combination, giving each a weight according to the firm's analysis of the relative impact of the factor on market or company performance.

Growing Interest in Non-Financial Factors

Valuation also relies heavily on factors harder to quantify, such as the quality of management, strength of the strategic plan, value of R&D, a company's success in gaining market share, customer relationships, a good record of environmental citizenship, and many others.

These are vital factors because they determine whether a company will increase revenues, reduce expenses, improve returns and score gains in other key measures of financial performance.

While hard to quantify, the importance of non-financial factors is recognized by investors, especially those practicing fundamental investing methods. Most fundamental investors rank quality of management as the number one value driver at companies. Also high on the list are new products, R&D and market position.

Several studies in recent years reveal the importance placed on qualitative factors by institutional investors. A study of some 275 portfolio managers and analysts by the Ernst & Young Center for Business Innovation showed that 35% of the investment decision by portfolio managers, on average, is based on non-financial factors. The percentage was higher in industries where there is more uncertainty, such as technology, and lower in more stable mature industries.

When asked to rank the 10 most important factors in making investment decisions, sell-side analysts placed seven non-financial factors on their list, while portfolio managers had eight. The financial drivers to make the lists were earnings, cash flow and segment data. Key non-financial factors were market growth, new product development, market share, expenses, capital spending, R&D investment, R&D productivity and strategic achievement.

The study also highlights the potential value of investor communications. Companies have an excellent opportunity to improve their valuation by communicating more effectively the importance of various non-financial factors.

Value of Understanding Valuation Models

The message for companies and their investor relations officers is clear. With a good handle on investment process and investor behavior, companies have a well-defined road map for: (1) determining strategies and initiatives that can improve value, and (2) focusing communications on information that can contribute to improving value by better educating the investment community.

The payoff for strategic investor relations is helping to create a shareholder mix of longer-term holders, who support the company through good and bad times, and short-term holders, who

buy and sell based on their valuation models. By knowing different models, management can anticipate the moves of investors — value investors moving out as the price rises on improved earnings, for example, and growth investors moving in because they expect the new growth pattern to continue. Before the trend takes hold, the company can be targeting growth investors.

The net result also can be an increase in trading volume based on demand. Generating more trading volume helps attract institutions.

Tying communications to valuation methodologies can create a higher plane for communications, one that more closely relates information from the company to investment decisions. At the same time, it makes the information more useful in building better relationships with investors.

Knowing the models helps companies better understand the information investors and analysts will want. It serves as the basis for supplying both the numbers to satisfy the models and the information that helps investors appreciate the qualitative factors.

The New Economic Metrics

Companies increasingly are turning to economic performance metrics to strengthen their operations and to improve valuation. At the same time, more institutional investors are using these metrics to help value companies. This, in turn, is encouraging companies to describe their metrics methods and to report the progress being made in implementing them to investors. Investors can then better appreciate corporate efforts to improve value.

Two methods growing in use by companies and being better understood and applied by investors in their portfolio management are economic value added (EVA) and cash flow return on investment (CFROI).

Popularized by Stern Stewart and Company, EVA integrates operating income efficiency and balance sheet management into a single measure while linking accounting results to stock price results. EVA is net operating profit minus an appropriate charge for the opportunity cost of capital. As such, it measures true economic profit, according to Stern Stewart. True economic profit is the amount of after tax earnings once the cost of capital has been applied. It may be a positive or negative amount.

By taking capital costs into account, EVA shows the dollar amount of wealth created or destroyed by each business unit and the company as a whole. "If shareholders expected a 10% return on their investment, they achieve that expectation only to the extent that their share of after-tax profits exceeds 10% of equity capital," says Stern Stewart.

CFROI also is designed to cut through historical accounting data distortion and inflation in comparing a company's CFROI against investors' cost of capital. It is being popularized by BCG (Boston Consulting Group) and HOLT Value Associates. BCG helps companies apply CFROI to their operations. In addition to working with companies, HOLT is providing its valuation assessments of companies to around 800 portfolio managers at nearly 200 institutions worldwide and is helping companies understand how these institutions use the metric in their valuation processes.

CFROI is calculated as a real internal rate of return, not a ratio. This provides the basis to compare the company's CFROI directly to the investors' discount rate (i.e., cost of capital). Cash flow is the foundation of the CFROI calculation. The basic measure of a company's performance is earning a cash return on its capital. Accounting returns fail, HOLT says, because they reflect the past and many accounting conventions.

In contrast, CFROI compares cash flow to all the company's owners from the assets employed, marked up to current dollars. CFROI adjusts asset composition and produces an inflation-adjusted, or real return, that is a percent per year internal rate of return, rather than a ratio.

CFROI reflects both short- and long-term evaluations. The short-term calculation is based on translating analysts' forecasts of earnings per share to forecasted CFROIs one year into the future. The long-term calculation captures the amount of today's value attributed to existing and future investments. The present value of net cash receipts from existing assets is separated from the present value of net receipts from future investments. A life cycle approach is used to fade CFROIs to market average returns, based on competition and maturing businesses. HOLT argues that separate calculations are more accurate than the traditional practice of blending existing assets and future investments in perpetuity assumptions.

A life cycle approach enables a company or investor to calculate the company's past life cycle to use in gauging the plausibility of a forecast. Since CFROIs and growth rates are real variables, past and future are directly comparable.

HOLT's valuation work shows that companies with returns at or below the cost of capital should focus first on improving returns on investment through such efforts as contracting unprofitable assets, significantly reducing operating costs, and moving into higher margin more profitable products and markets — essentially changing the business mix.

Programs to grow assets through acquisitions and new investments earning more than the discount rate (cost of capital) also increase valuation. For each company, HOLT can calculate the increase in stock price that should result from improving CFROIs and from growing assets on a percent-by-percent basis.

Linking Valuation and Targeting

A good understanding of valuation also serves as the basis for targeting investors, especially institutions. Targeting as a proactive, marketing-oriented activity is being done by many companies of all sizes. Managers who do targeting are concluding that the market isn't efficient for their stock — that all investors don't know everything there is to know about their company.

Targeting seeks to identify the institutions most likely to be interested in a company because of compatibility between the investor's style and the company's investment characteristics. For example, some likely matches are growth investors and growth companies, earnings acceleration investors and companies with higher earnings every quarter, or income investors and companies that have a dividend yield above the market average.

There are several ways to analyze institutions in finding the best potential matches. The company can learn about their investing styles through one of the directories available (see Chapter 12) or from consultants who keep close tabs on these styles.

The company can also analyze the 13(f) filings of institutions to see which institutions have positions in other companies in its industry, or in companies with similar financial characteristics — market cap size, dividends, etc. Every institution holding $100 million or more in equities must make a 13(f) filing of their positions in each company with the SEC each quarter. A number of vendors provide the data, showing institutional holdings in your company and others. Through Nasdaq Online, Nasdaq-listed companies can view a list of their institutional holders and those of their peers.

In addition, a company can make use of targeting services that analyze institutions' portfolios in attempts to gain insights into fully understanding the institutions' investment styles. These vendor/consultants believe that first-hand analysis of the stocks and number of shares is the key to understanding the performance characteristics of the companies represented in the portfolio. They calculate the average P/E ratio of stocks in the portfolio, for example, in determining that an institution is mainly a value player. Or they compile dividend yields or the average growth rate of companies in the institutions' portfolios.

Providers of these services also are helping companies estimate the number of shares a particular institution might buy. This is done by analyzing share positions in other companies with comparable characteristics, then considering the total amount of money being invested in equities by institution. Results of the analysis may spur managers to target institutions holding more shares in their industry or in their financial peers than in their company.

Some consultants are linking valuation and targeting data to help companies zero in on prospective shareholders. They analyze an institution's portfolio to relate the principal investment characteristics of the portfolio to specific investment models. Share positions and buying patterns also are studied to determine the amount of the portfolio invested in each valuation model. Software is used to analyze the primary factors driving each model and to relate the factors to company characteristics in determining the models that correlate closest to company characteristics. Institutional targets are selected on that basis.

Targeting is designed to help companies develop appropriate communications messages and information sets for each investor group. A company can increase its appeal to growth investors by describing the factors driving its growth, for example.

Targeting also has strategic value. Managers can influence the makeup of their investor base by understanding the relationship between the company's financial characteristics and the investment approaches of their shareholders. Companies can focus messages on specific shareholders, encouraging them to buy more shares. Companies can change, modify or add business strategies and initiatives designed to attract certain types of institutions. Companies can anticipate which investors might leave as fundamentals change, and they can begin communicating with other investors who will be drawn to the company.

Part II

Implementing the Practice

Chapter 7

Information blossoms into knowledge, which helps build investor confidence and trust.

The Components of the Communications Program

There are two parts to the investor relations process. The first involves really knowing the landscape. You can do this by thoroughly understanding the investment marketplace, from how the capital markets work through how investors behave, which tells us how stocks are priced and what we can do to influence that process.

The second part involves implementing the investor relations program. Through information disseminated to investors, analysts, brokers and others, we establish relationships. The information blossoms into knowledge, which helps build investor confidence and trust. Companies then nurture these relationships, reaping a fair value for their investment securities.

The tools to provide information and build these valuable relationships are communications methods and vehicles that fall into three categories:

- Printed materials, including SEC filings, press releases and statements, annual and interim reports, corporate profiles, fact books
- Oral communications — meetings, conference calls, telephone contact
- Electronic communications — using databases, online services and the Internet

Getting More Value from SEC Filings

As mentioned in Chapter 3, SEC filings are a vital part of the communications mix for a company. Investors are highly interested in gaining information from the prospectus; 10-K, 10-Q and 8-K reports; the proxy statement; and any other key securities offering filings.

Because SEC filings are compliance documents requiring certain disclosures, investors look to them for valuable, unvarnished information about the business, its products, markets and competition. They can evaluate management from these documents by learning more about the backgrounds of officers. They get detailed financial data, including performance data. Ultimately, the information helps them assess the level of risk involved in their investment.

In addition, investors read the Management Discussion and Analysis section of the filings and annual report to learn about material events and developments, and possible material developments, that must be disclosed in that section.

Proxy statements also are valued sources of information to investors. Since 1992, companies are obligated to show how management compensation is determined and to specifically link pay to corporate performance and shareholder value. The Board of Directors or the compensation committee must demonstrate their accountability for performance and responsible compensation practice through a detailed, written description of how compensation is based on performance. The proxy statement also must include a chart comparing financial results against the market and an appropriate peer group.

Some companies are taking the opportunity to use the proxy to communicate corporate strategy and key initiatives to investors. Companies can show how the strategy and major implementation initiatives are producing the results being reported.

Although typically prepared by lawyers and accountants, these documents can benefit from a review by a professional writer. The reports also should be edited by the person responsible for investor relations to ensure the content has value, the information is consistent with other communications, and the writing is easy to understand.

Making Annual Reports Powerful

Companies sometimes get confused about the primary audiences for an annual report. Ideally, the report should be useful to several groups — investors, employees, customers, suppliers, business leaders and interested parties such as the communities where the company has major operations. The question becomes whether one report can be prepared to satisfy all these audiences.

The answer is yes, while focusing the report on the primary audience — namely investors. Companies should make sure the primary beneficiary is the investor. Investors expect this as the report is a financial disclosure document prepared for them. There are other venues available to reach customers or employees. All audiences benefit from an informative annual report that discusses business strategies and how well the company fulfills them.

Surveys show that investors consider the annual and interim reports to be among their most important sources of information. It typically ranks among the top four sources of information — the others being meetings with management, research from institutions, and research from brokerage analysts.

Analysts and investors also are quick to criticize the quality of annual reports, however, expressing a strong interest in having them contain more of the information they need and value. Reports are often considered to be self-serving, promotional, vague and lacking solid

information. Investors don't seem to mind the reports' upscale design; in fact, they agree that companies need to portray a progressive and professional image.

The lessons to be gleaned from these surveys:

- Writing should be straightforward and fact-based.
- Graphic design should communicate a tone of professionalism, being progressive, prudent, enthusiastic and exciting. Flamboyant graphics are acceptable for a highly visible entertainment company, while more conservative graphics may be best for a financial institution.
- Financial information should be easy to find and easy to read. Key financial facts should not be buried in footnotes, worded in a confusing way, set in very small type, or obscured by color backgrounds.
- Financial data for working valuation models should go back 11 years preferably, with changes from year to year shown in percentages. A six-year summary is better than five, and three years of financial highlights are better than two years.

Letter to Shareholders

The letter to shareholders from the top officers is the most frequently read part of the annual report and provides the best opportunity to communicate the company's investment story. Investors are looking for a strategic discussion about the company. The letter should describe the company's vision, strategic direction, important initiatives to carry out the strategies, and progress in these initiatives.

All of this information is put into the context of reporting on the year's results and what they mean in the near term. Key pieces of information include:

- Significant new technologies and products
- Market penetration, share gains and new markets
- New production capacity
- Efforts in cost reduction and management efficiency
- Major new contracts
- Acquisitions
- Partnerships
- Divestitures
- Management changes

A letter of value to shareholders also includes a discussion of setbacks, challenges and problems. Companies may be reluctant to do this, but dealing with issues realistically boosts investor confidence. Issues might involve declining market share, lost business, serious competitive threats, downturn in the economic cycle, and so on. The letter provides management with the opportunity to discuss the issues insightfully and to offer its course of action leading to solutions.

Traditional financial reporting also covers revenues, net income and earnings per share, return on shareholders' equity, and report on dividends. Depending on their industry, some companies now report on their total shareholder return for the year — the percentage gain that results from price gains and dividends. They are even comparing their returns to their peers and the market.

In financial reporting, providing information in a valuation framework is most useful to investors. The process begins by explaining the top line, providing the sources of revenue and showing growth or decline by business product or market. For example, "Sales are up 12%, accomplished by a 16% increase in business A, a 13% increase in business B, and a 7% increase in business C, while business D experienced a 3% decrease because of slow markets."

A discussion of net income, earnings and profitability becomes a verbal analysis of the profit and loss statement. It can be valuable to investors and useful to companies to discuss expenses and how the company is working to manage them better. This discussion can cover research and development; selling, general and administrative costs; cost of goods sold; interest and debt expense; depreciation, depletion and amortization.

It is not the technical discussion that appears in the financial section of the annual report. It is a strategic discussion in the letter to shareholders about how the company is improving its financial picture — how it is controlling and reducing costs to improve margins and profitability. Better computer systems for administrative management, more efficient warehouses, new production equipment, continuous improvement programs and similar programs are appropriate in this discussion.

How the company plans to reinvest its retained earnings to improve shareholder value can be the next part of the discussion. For most younger companies, the money will be reinvested in ways to strengthen and increase sales, cash flow and earnings — through continuing R&D, new products, expanded marketing and sales efforts, new or improved capacity, a new alliance or acquisition. The focus is on describing capital expenditures and other investments that create opportunities and take advantage of growth to build a stronger company.

Bigger, older companies with consistently strong cash flow often improve shareholder value by increasing the dividend or buying back shares. They have fewer growth opportunities than younger companies.

Regardless of size, companies respond to investor interests by providing ratio and return information in the letter to shareholders. Ratios are a little tricky because they are subject to market behavior and can change — like current stock price to sales, earnings, cash flow and book value.

But returns are measurable indicators of performance that are influenced and controlled by a company's managers. Return on assets and return on equity show the company's ability to manage its physical operations and its capital effectively. Setting up a report card is a good idea. Give your return targets, then describe how you're doing, and what you're doing to meet them.

Some companies measure themselves on economic value added (EVA) and cash flow return on investment (CFROI) metrics today (see Chapter 6). While these are economic performance indicators, not accounting measures, they are used more and more by institutions today to value companies. EVA is especially useful in managing business operations. It forces companies to calculate the cost of every business expense against returns. CFROI helps companies link their economic performance to equity market practice. Essentially, it compares the company's CFROI with investors' cost of capital.

Companies paying dividends should announce both the dividend and the amount of increase. They benefit from letting investors know their dividend policy, providing yield and payout ratio targets. The policy is likely to be viewed as good news. A modest payer will have more money reinvested in projects that are likely to return rates above the cost of capital; a modest or medium payer will be contributing to the total return equation; and a high payer will be encouraging income investors to be shareholders.

Whether they appear in the letter to shareholders or the report's financial section, segment breakouts of financial and operating information by businesses or major product lines are wanted by investors. Product/market companies can provide this information readily. For companies with multiple businesses or product groups, investors look for breakouts of

revenues, earnings, margins, R&D spending and capital expenditures at a minimum. Numbers amplifying on how corporate initiatives are being carried out are also desirable.

Editorial/Operations Review

Investors say the least read part of the annual report is the editorial or operations review section that follows the letter to shareholders. Investors' bias is that companies tend to get overly promotional, extolling their virtues and omitting information important to the investment decision.

Companies have an opportunity to turn this section into something of great value to investors and themselves. It could contain a discussion of the company's key value drivers, for example, or its competitive advantages. These might be technology, product, marketing, production or management based. Manufacturers might describe how their technologies produce distinct competitive value for their customers. Companies in service industries might describe their extra efforts to provide exceptional customer service.

Companies can choose to use this part of the report to provide a meaningful operations review, detailing financial and operating results of individual businesses or product groups. This type of report positions the company in its industry and markets, providing a thorough competitive analysis covering product capabilities, market share and cost.

Financial Section

In the financial section of the report, shareholders and analysts want clarity, completeness and easy accessibility to important information. Management knows the financial aspects of the business that drive results and the financial details that are important in really showing how a company is doing.

If you're not sure of the financial information critical to analysts and investors, ask them. Also ask them about the best ways to report the information. If that seems to be too direct, analyze their reports on companies to see what is being emphasized. Study annual reports of industry peers given high marks by the investment community for their content and communications methodologies.

Investors desiring to wrench all the information value they can from an annual report scrutinize the balance sheet to understand the company's assets and liabilities, define what a company owns and owes, get a sense of working capital, better understand the debt and leverage positions, and determine assets. They study the income statement to measure profitability and focus on cash flows — in, out and in terms of ratios.

They read the footnotes carefully to check on accounting policies, the acquisition picture, debt and borrowing arrangements, lease commitments, the state of the pension fund, possible legal problems. They gain an historical perspective; track quarterly results; analyze the relative strengths and weaknesses of each business through the segment analysis, along with the company's confidence in the future of each operation through R&D and capital spending commitments.

Management Discussion and Analysis

The management discussion and analysis serves as an excellent opportunity for the company to analyze the business from a financial standpoint. How does management really see this company? Here is where management should comment on three key aspects of the company's financial position: results of operations, capital resources and liquidity.

Investors are looking for companies to follow SEC guidelines in discussing material events that occurred during the year and explaining situations and developments in the future that can be material, such as the gain or loss of material contracts.

Interim Reports

Interim communication is seen as critical by analysts and institutional investors. Their desire for continuous information heightens as investors become increasingly short-term oriented. Portfolios of professional investors are being modified every day, with large trades occurring around the clock.

With the pace of investment decision-making quickening, analysts and portfolio managers are becoming even more demanding of interim information that includes financial results and key operating data. Quarterly reporting remains the standard, but the information provided continues to expand. Analysts, in particular, are demanding quarterly segment breakouts, for example.

Companies are responding. Clearly, more companies are providing quarterly segment data. And some companies are reporting sales figures or other financial information monthly. Whether there is a pressure to do this depends on your industry.

More investors and analysts are getting detailed information faster, thanks to computers and fax machines. Faxing and e-mail have become the norm for releasing quarterly financial results. But computers, online services and the Internet are enabling companies to reach millions of people.

Institutions and individuals alike can have the same information at the same time. It is becoming standard for companies that distribute interim reports to shareholders to include both registered and beneficial shareholders.

With companies able to achieve broad scale dissemination of detailed financial results, the traditional printed quarterly report is disappearing. The number of companies still producing them is declining, mainly because copies are costly and not very timely, arriving well into the next quarter.

In reaching rank-and-file shareholders, companies are replacing printed interim reports with special letters from the chairman and copies of the press release. While some companies still mail printed reports, most maintain fax and or e-mail lists of interested parties to effect rapid transmission of key information.

The Internet is becoming the distribution point of choice for most investors to receive major releases, especially quarterly earnings releases. Companies are placing releases on their IR Web pages and making them available to investors on the numerous databases now serving the market. The major wire services used by companies to disseminate releases all have their own Web sites for corporate releases and contracts to supply the information to the many database services used by investors — institutions and individuals alike. These major services are PR Newswire, Business Wire, Canada Newswire and Prime Zone.

Resources for Releasing Information

Wire Services

Business Wire	212-752-9600	www.businesswire.com
Canada Newswire	416-863-9350	www.newswire.ca
First Call	617-345-2280	www.firstcall.com
PR Newswire	212-596-1540	www.prnewswire.com
PrimeZone	800-307-6627	www.primezone.com

Corporate Profiles and Fact Books

Another useful information tool is a corporate profile. Sometimes called fact sheets, these typically are two-page (front and back) or four-page capsulized annual reports. They:

- Summarize the business
- Furnish key financial data
- Give stock price information
- Provide key ratios and returns
- Cover important recent events
- Describe the company's essential strengths, value drivers and competitive advantages
- Identify the Market Makers
- List the investor relations contacts

The profiles are used mainly to tell the company's story to retail brokers, who, in turn, often supply the profiles to their customers. In a way, they become the centerpiece of a direct mail effort. The profiles also can be given out at financial presentations and meetings, including the annual meeting, and can be provided to prospects and others who request information.

Many companies reproduce them in investor publications, such as *Research, BuySide, Investor Direct, Registered Representative* and *Better Investing* (NAIC publication), either as inserts or advertorials, thus making them part of a media visibility program.

Also being added to the information mix are fact books for professional investors. Fact books tend to be produced by bigger companies with complex operations. They consist mainly of finance data and some text explanations. Their purpose is to help analysts and detail-oriented portfolio managers better understand these companies.

Sending and Receiving Vital Information

Advanced communication enables companies to move news faster than ever, mainly through electronic dissemination services that also provide the widest distribution possible. Virtually all public companies today put their news releases — their basic communications tool — on either PR Newswire, Business Wire or both. PrimeZone started up in 1998, offering a competitive service. Canada Newswire Ltd. and Canadian Corporate News serve Canadian and U.S. companies. The releases can be sent to the basic media group that fulfills disclosure requirements or

an expanded group covering virtually every publication and media outlet of any size and consequence. Through these services, the releases go directly to most brokerage firms, many institutions and most databases used by investors. PR Newswire and Business Wire say they disseminate corporate releases to over 100 online information providers, including all the major ones.

First Call, a service started by brokers to send their research to institutions, now handles releases, statements and other materials from companies. First Call is widely respected by investment professionals, so subscribing companies are assured that their information gets directly to analysts and institutions. Companies also can use First Call to collect the data being sent by analysts on themselves and their competitors. You have access to the same information on yourself and peers that institutions and other analysts are receiving. There's one catch — the service can be expensive.

Multex Systems, Inc. was launched in 1997 as an information service to institutions and investors, providing brokerage-based research, analysts' earnings forecasts and other useful information. Multex offers Corporate Register, enabling companies to include information for a fee on the Multex Web site. Bloomberg has a similar service, providing broker research to investors and enabling companies to disseminate information to the investment community.

Obtaining information can be just as important as sending it. Electronic services useful to the investor communications process are extensive and growing. Key ones provide access to market activity and identification of the major players in the investment community.

Companies are gaining increasingly sophisticated online information on brokerages and institutions. You can find brokers specializing in certain industries, for example. You can pinpoint the analysts following your industry. You can identify institutions with investing approaches ideally suited to your company's investment characteristics.

You even can learn how investors use their research on companies' stock price and volume patterns in making decisions. Being able to compare pricing and volume patterns among a peer group provides important clues into the reasons for certain market action and into predictions of future behavior. The ability to better understand and anticipate investor behavior also results from comparing ratios of the industry and peer group. And much is to be learned from knowing and comparing total shareholder return among companies.

These comparative analyses serve as the basis of meaningful insights. Are your company's ratios below those of your peers? How does the price compare? Why is trading volume less than a competitor with a similar number of shares available? The answers can guide a company in

making comparative evaluations to diagnose the reasons and in taking actions to correct situations as needed.

Studying this data also enables a company to project market behavior. If your price/earnings ratio is below your peer group, your performance is better and your industry is moving into favor; trading in your company's stock could increase. You can support positive momentum with a targeted, focused communications program.

Companies can obtain analysts' forecasts of earnings and their consensus conclusions. The information is essential in efforts to manage expectations. Investor relations officers should know the earnings forecast for the next quarter, full year and year after that for each analyst following the company, plus the consensus numbers.

The goal is to have all the analysts in a tight circle, with their estimates in line with reality. By watching their forecasts closely, the company can continue to provide nonmaterial information that serves to keep the estimates realistic. Mainly, the company is trying to avoid unrealistically high estimates that need to be lowered, risking a drop in stock price and loss in confidence. Key suppliers of analysts' earnings forecasts include I/B/E/S, First Call, Zacks Investment Research, and Nelson Information Earnings Outlook. In addition, Nasdaq-listed companies can obtain analysts' forecasts on any public company on any major U.S. market through their proprietary Web site, Nasdaq Online.

Meetings Remain the Best Forum

There is no substitute for face-to-face meetings with analysts and investors. Companies can look great on paper and disappoint in person. Or they can look mediocre on paper and reveal their real potential in dynamic discussion.

Senior managers need to deal with the reality that investor contact is a critical part of their job description. Active investors, the ones who matter and who are more likely to be longer-term shareholders, will insist on getting to know you and the management team. Meetings are opportunities to impart your vision, enthusiasm, commitment and abilities — as well as to discuss your company's nitty-gritty strategies, initiatives and numbers.

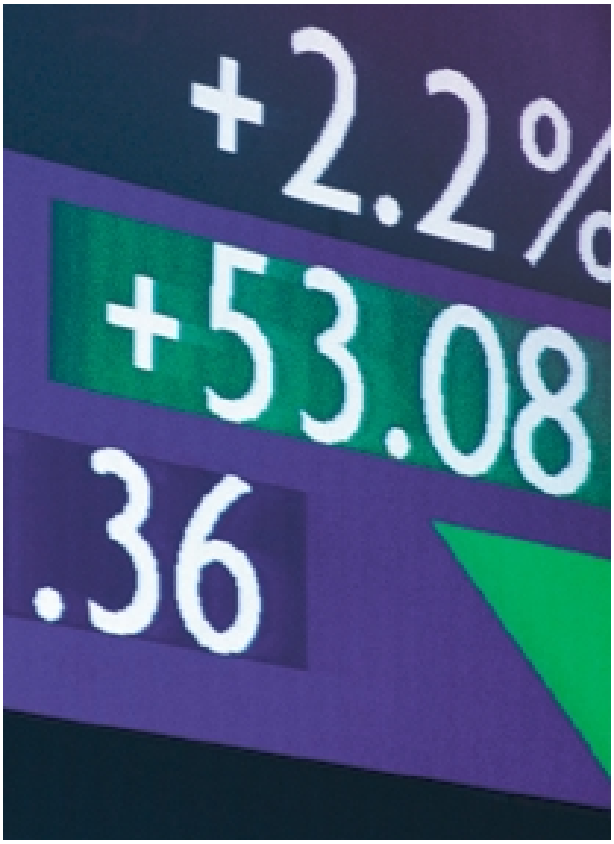
There is no substitute for face-to-face meetings with analysts and investors.

Who does the talking? The smaller the company, the more important it is for the chief executive officer to talk about the company's vision and strategies and to be questioned by investors. The

buck stops with him or her. The chief financial officer is certainly a welcome part of the communications team and so are the president, chief operating officer and heads of business units. Investors want not only the vision but the grand plan, the financial strategy, and a thorough understanding of operations.

Experienced investor relations officers can tell the story. Many do it as well or better than senior executives because they know what investors want to hear. They also know how to balance the interests of the company and investors, giving enough but not too much information. Investors are comfortable taking the story from well-qualified investor relations professionals.

AIMR Meetings



Meeting opportunities are extensive. There are forums set up by professional groups and by the company itself. Companies can send executives to address the various chapters of the Association for Investment Management and Research (AIMR). New York has the biggest chapter, offering separate venues for large and small companies. Exposure of the company's presentation ranges beyond the meeting — it's broadcast on an institutional investor network and other TV outlets, receives database coverage, and becomes a transcript and video that companies can use in their own marketing. It also is available on the Internet.

Because most sell-side analysts are at large brokerages located in New York, many industries have splinter groups that meet regularly and are receptive to presentations from companies. These include airlines, automotive, banks, chemicals, computers, construction, consumer products, diversified companies, electronics, environmental controls, health care, insurance, machinery, media, motor carriers, metals, oil, paper and forest products, real estate, textile and apparel, and utilities. Boston has chemical, electronic, petroleum and utility groups, while Chicago is home to consumer product, financial institution, science, transportation and utility splinter groups.

AIMR chapters are located throughout the United States and Canada, and companies can reach financial markets of all sizes by soliciting AIMR speaking opportunities. AIMR members include a combination of brokerage analysts and institutional analysts, portfolio managers, traders, and members of institutions' powerful executive committees who set and guide the investment approach of firms.

Brokerage Firm Conferences

Many brokerage firms sponsor conferences where companies are invited to make presentations and answer questions. Typically, the conferences focus on a specific industry, but some are general in nature. The audience consists largely of institutional clients, other institutions the firm is trying to attract, their own brokers, and high-net-worth individual investors. In other words, the audience is prime for the companies. Much networking takes place during these events — some companies have even found joint venture and merger partners.

To be included as a presenter, identify the brokers sponsoring conferences in your industry, make contact through the analyst covering your industry, and push to be on the program. A handful of brokers are breaking new ground by carrying their industry conferences on the Internet.

Several organizations run conferences for fees. *Equities* magazine (516-248-1871) holds such a conference each year in New York. Discovery Expo (949-724-0444) holds conferences in New York, Boston and San Francisco. These forums attract a combination of portfolio managers, sell-side analysts, brokers and individual investors.

The Wall Street Forum (617-523-1234) holds live meetings at the former Harvard Club in Boston, typically attended by members of the Boston Analysts Society, and carried live worldwide over the Internet. The Forum says that some 27,000 analysts and portfolio managers globally have passwords to participate in the meetings. Schedules of presentations are promoted in advance. Questions are asked by members of the live audience and Web audience through e-mail. Companies can keep the presentation on the Forum's Web site for up to 90 days. They also receive a video of the session for extended use.

Broker forums also are plentiful. Some cities have organized broker societies. The National Association of Stockbrokers (619-455-7422) holds weekly luncheons in a number of cities. Cities with individual groups include Philadelphia, San Diego, Toronto, Hartford, Indianapolis, Boston, New York, and Cincinnati. Most organized broker groups ask the company to pay for lunch or dinner for everyone in attendance. Some companies question the value, while others

see it as a small price for the opportunity of addressing a group of influential brokers. Your viewpoint depends on how aggressive you want to be in building a following among retail brokers.

Company Meetings

Companies can set up their own meetings, and many do. They can be with: analyst or broker groups or institutional shareholders; targeted institutions not currently holding shares; or one analyst, broker or institution (as long as no material information is given out).

Though these meetings can be large or small, the trend is toward smaller meetings as companies target their messages more effectively. A company might hold a meeting with a half-dozen institutions in a city, combining a mix of current holders and prospects. Or it might set up a meeting with just one institution, where the institutional analyst and portfolio managers take part in the discussion.

What constitutes a great meeting, and why do companies sometimes fail to do the job? Even after decades of holding meetings, companies still are faulted for failing to provide the important information. Investors don't want a detailed history or lengthy, technical descriptions of products. They don't want to hear all the numbers — they can get them in the prospectus, proxy, 10-K or annual report before or after the meeting.

What they do want is a forthright, comprehensive and insightful discussion of strategic direction and major initiatives. They want to thoroughly understand the company's strengths and advantages, and they want to hear how management assesses itself against competition. They want the company to be willing to discuss its challenges and offer realistic solutions. They want to be confident that management has a full grasp of its technology, industry, competitors, challenges and opportunities and has a sound plan to maximize the results of those opportunities. They want a demonstration that management is willing to answer questions thoroughly and honestly.

Telephone Conversations

In the daily rollout of the investor relations program, much of the contact that takes place between companies and market players occurs over the telephone. Once companies have shown their interest in being proactive, phone conversations become the main vehicle for exchanging information. They allow companies to learn a lot about what's happening in their industry and with specific competitors from analysts and even portfolio managers. The analysts and investors, in turn, get the nonmaterial information they seek to understand the company better.

For many investor relations professionals, telephone conversations are the most important aspect of their job. The telephone serves as an instrument for research, selling and relationship building. How responsive companies are to incoming calls — and how aggressive investor relations officers are in initiating calls — makes a difference in the attitudes and knowledge levels of analysts, institutional shareholders and prospects.

These conversations can move analysts and portfolio managers from having superficial knowledge of the company to becoming true experts. No material information needs to be provided in building relationships of this caliber. Periodic exchanges provide small pieces of information, while regular discussions create insights that elevate analyst and investor understanding of the company.

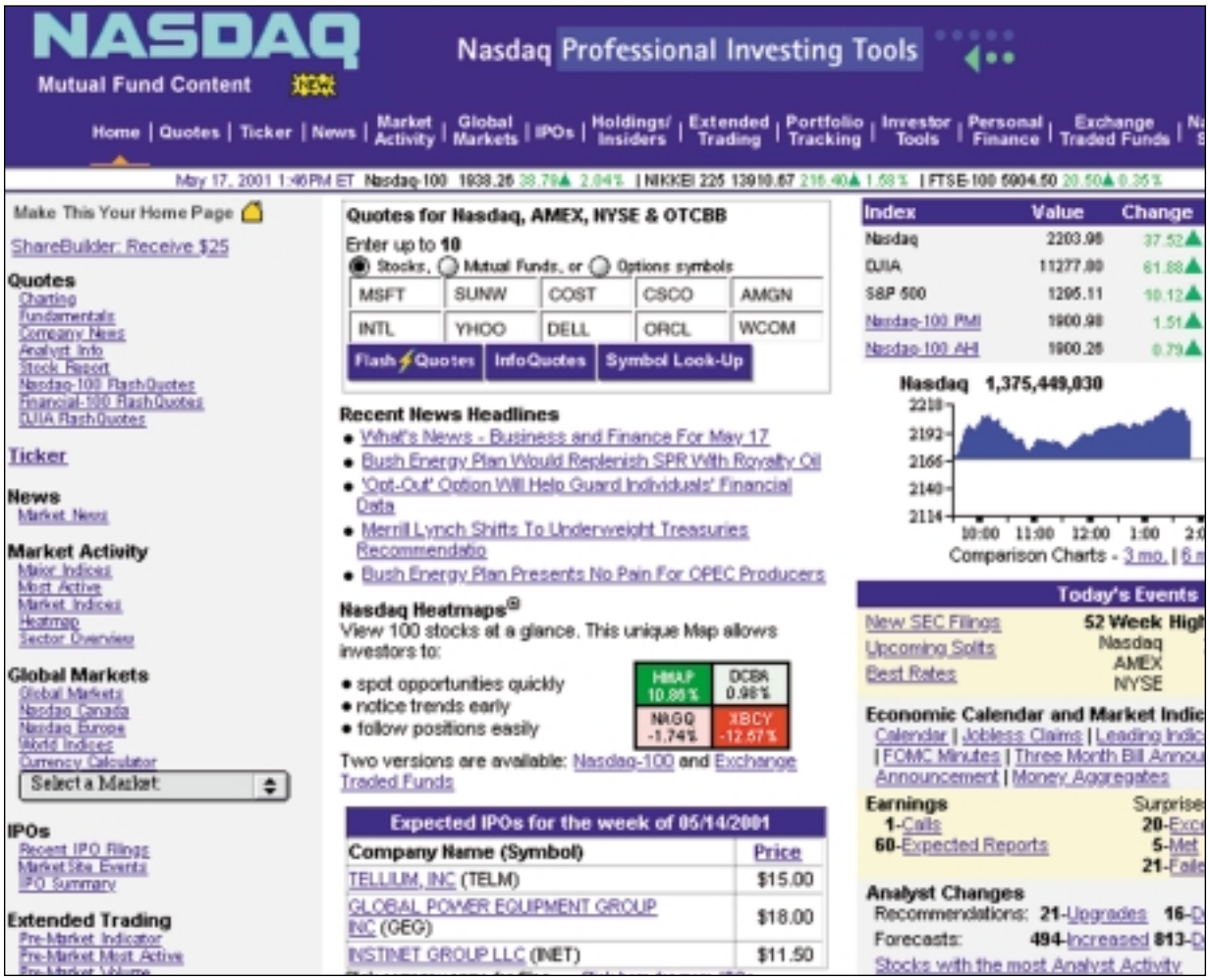
The telephone also serves as an excellent learning and marketing tool for companies. Benchmark and follow-up interviews help investor relations people better understand the investment community's knowledge level and attitude toward their companies. Meetings are planned and people are contacted to attend. Efforts to get an analyst interested in covering the company or a portfolio manager interested in investing are carried out via the telephone. Often, it is the persistence of the investor relations officer that results in an analyst deciding to follow the company or a portfolio manager looking into the investment potential of the stock.

Internet Web Sites and More

Virtually every company has an investor relations Web site, attracting individuals and, increasingly, sell-side analysts and institutional portfolio managers. Surveys show that professional investors are beginning to depend on the Web for information, a trend that is likely to continue growing.

The key to that growth is the quality and timeliness of information available to investors. The virtues of convenience, speed and value of information are the cornerstone of Web communication.

Companies are working to improve the quality of information by including content of highest appeal to investors and by making sure new information is available on Web sites promptly. Key information to provide on IR Web pages includes real-time stock prices, historical stock prices and trading volume, the ability to chart this data, earnings and other significant news releases, corporate profile, annual and quarterly reports, fundamental and historical financial data, an events calendar that includes dates of releasing financial results and meetings, listings of Market Makers and analysts providing coverage, earnings estimates, SEC filings, answers to frequently asked questions, conference calls and financial presentations live or replays, links to the transfer



Averaging over one million unique visitors per day, nasdaq.com is one of the top sources of financial information on the Internet. This comprehensive online resource brings information once available only to investment professionals to everyday investors.

Features include quotes for stocks, options, and mutual funds for all major markets. Plus, access to personal portfolio tracking, performance charting, stock and mutual fund screening, analyst information, timely U.S. and international market and individual company news, and more.

agent and registrar, links to other data sources, and e-mail capabilities to request information, ask questions or make comments. Companies that list on Nasdaq can link their IR Web sites to Nasdaq's financial data.

Companies must make the basic decision to maintain a Web site themselves or to outsource the responsibility to one of a growing number of providers. Offering the advantage of specializing in the practice, these outsource firms have agreements with a number of key suppliers to provide various services, such as stock quotes, financial data and analyst coverage.

Among providers of IR Web data and outsourcing services are CCBN.com, offering IR Eye (617-531-2999), Merrill Corp. offering IR Edge (877-647-3343), Business Wire with its Corporate IR.com (888-381-9473), PR Newswire offering vIRtual IQ (212-596-1542), PrimeZone, providing IR Connect (800-307-6627), Shareholder.com (800-990-6397), Corporate Communications Center (214-871-2941), and Quote.com (650-428-5000).

Participating in Internet locations widely used by investors, analysts and brokers serves as another way for companies to build visibility with the market. Numerous databases operate to provide information to investors, especially individuals but also including institutional users. Available information covers about everything an investor can use — daily market results and commentary; performance of various indexes; analysts' forecasts for every company; financial data covering the market, industries and individual companies, providing key ratios and returns, market capitalization and more; a range of information on specific companies. Investors can use these sites to tailor the information they obtain, designating certain data and stocks in literally managing their portfolios.

Companies can choose to include information on these sites, paying fees for the service. InvestQuest is a site geared around the information companies want to provide — an investment profile, releases, annual reports, SEC filings, stock quotes and charting, access to conference calls and presentations, e-mail capabilities. Other sites similarly cater to companies and as such, function as investor relations supersites, known to be convenient sources of information for investors on a high number of companies.

The investor audience for information in cyberspace has grown rapidly. Through the Internet, online services and investment software, investors are comfortable gathering information through technology. Surveys indicate that high percentages of analysts, portfolio managers and brokers have PC access to information and a wide range of online services. Most have e-mail capabilities, too.

The easy availability of qualitative and quantitative information on the computer makes it a compelling way to access data. Investors, analysts, brokers and traders can gather financial data

from numerous sources and in many formats, including spreadsheets. They can watch the market as a whole by indexes, countries and regions, and by the companies in their portfolio, getting price, volume and other data. They can keep up with breaking financial, economic and world news. They can listen to companies' conference calls and view the "slides" in a presentation.

E-Mail Capabilities

E-mail is becoming a significant communications channel between companies and the market. At first, most users of e-mail were individual investors requesting specific materials or asking questions. But now e-mail is rapidly becoming a medium for analysts and portfolio managers to maintain contact with investor relations officers and to receive important press releases immediately upon their dissemination. Investor relations officers continue to build their e-mail "address books" of analysts and portfolio managers as well as brokers and individuals.

Some companies are encouraging professional investors, analysts and brokers to accept e-mail as the primary method of information dissemination in place of facsimile.

E-mail enables investors to ask questions, make comments and order such materials as annual reports or direct stock purchase plan enrollment forms. Since people automatically leave a return address when sending an e-mail, the e-mail capability also identifies investors and provides a count of investors going to the company's site for information. So companies not only can measure total usage, but they can gauge which specific material on the Web site is of most interest to investors.

Microsoft serves as an example of a company offering a wide variety of company information online to investors. Its Web site provides investors with current 10-Q and 8-K reports; annual reports for the last two years; financial and other pertinent releases, including those on products and business developments prepared by the public relations department. It shows current and historical stock pricing, from the present back to the company's IPO in 1986, as well as stock splits and the closing price before and after each split.

An IR calendar gives dates for announcing quarterly results, filing SEC documents, and holding the annual meeting and other important investor meetings. A frequently-asked-questions file covers dividends, the DRIP, stock splits, headcount, how to transfer shares, how to contact the IR department, and more.

Microsoft provides extensive financial data and gives investors the capability to manipulate it on the Web site, using Excel or PowerPoint software. The company identifies its key financial value drivers and presents them in a manner that allows investors to chart the information in various

ways. The charting can be applied to numbers throughout the company's financial statements, including cash flows, profit and loss, and balance sheets.

Microsoft also maintains an active e-mail communications program, with several staffers answering questions and, when necessary, obtaining answers from others in the company. Through its e-mail program, it has built an extensive list of investors' e-mail addresses. The company also conducts scheduled "chat" sessions after announcing quarterly results, answering questions posed by investors who access the site. Transcripts of the conference calls and Q&A sessions are added to the Web site.

Electronic Fulfillment Services

E-mail capabilities and the Internet are enabling companies to fulfill a multitude of shareholder services more efficiently. The Internet is reducing costs and saving IROs' time through the convenience of using the company Web page to answer routine questions, fill literature requests, send shareholders to the transfer agent or registrar, or enroll investors in dividend reinvestment or direct stock purchase plans.

Indeed, many of these services also are being handled through outsourcing firms. The last few years have seen the emergence of new services from outside providers designed to not only simplify and reduce costs of providing shareholder services, but to enhance companies' opportunities to attract new shareholders, for example, through such programs as direct stock purchase.

Chapter 8

Analysts have considerable influence because they are advising institutions with investment responsibilities for billions of dollars.

Building Relationships with Analysts, Brokers and Investors

A well-rounded communications program is based on building relationships with the analysts and brokers constituting the sell side and the institutions and individuals making up the buy side.

Role of the Sell Side

Some people say the influence of brokerage analysts is declining and, while that may be true, their influence remains extremely important and will stay that way. Even the largest institutions, with their own research staffs and substantial computer capability for gathering information, still use sell-side research.

Buy-side analysts and portfolio managers use sell-side research in several ways. The research becomes their initial homework when they look at a new company. It is an integral part of investors' body of research as they approach an investment decision. Institutions are likely to check the opinion of each analyst following a company to see if there is a strong consensus. They probably will talk to the analysts with the strongest positive and negative opinions. Certain analysts have the trust of specific buy-side analysts and portfolio managers because they have been right in the past and have built credibility with that institution.

Mid-sized institutions with limited in-house research capabilities rely more on the sell side for ideas and research. The smallest institutions, with no inside research, consider the sell side to be their most important research resource. In absolute terms, then, analysts have considerable influence because they are advising institutions with investment responsibilities for billions of dollars.

Bigger institutions probably consider a broker's ability to buy and sell large blocks of shares without disturbing price a more valuable function than research. Institutions select certain brokerages to execute buy and sell trades because of their trading ability or the quality of their research. Brokerages make their money on trading, of course. While brokerages sell their research for fees, most provide it in return for transaction business.

Brokerage research is important to individual investors as well. Some brokerage firms focus their research and sales primarily or exclusively on the institutional market; some serve both the institutional and individual investor segments; and some specialize in the retail sector.

Types of Brokerages

The universe of brokerages divides into national wire houses, regional firms and boutiques. The big brokerage houses typically do extensive research, are armed with large institutional and retail sales forces, execute transactions, underwrite new securities issues, and function as investment banks. Some vary in their emphasis and specific activity, specializing in research, for example, or the institutional or retail markets, trading, underwriting or deal making.

Big brokerages include: Merrill Lynch, Salomon Smith Barney, Goldman Sachs, Morgan Stanley Dean Witter, Credit Suisse First Boston, Bear Stearns, NationsBanc Montgomery Securities, BT Alex Brown, CIBC Oppenheimer, Lehman Brothers, Donaldson Lufkin & Jenrette, Prudential Securities, PaineWebber, Warburg Dillon Read, J.P. Morgan Securities, BancBoston Robertson Stephens, A.G. Edwards, SG Cowen.

Firms with large broker networks that emphasize retail broker business include Merrill Lynch, Salomon Smith Barney, Morgan Stanley Dean Witter, Prudential Securities, PaineWebber, Edward Jones, AG Edwards, American Express Financial Services, Fidelity Brokerage, Charles Schwab, Bear Stearns, and Raymond James.

There are many high-quality regional firms serving institutional clients in securities analysis and trading, conducting deals and underwriting for local companies, and often operating sizable retail brokerage businesses. These firms frequently build a reputation for providing research expertise on their local companies in winning institutional business and retail clients. Many Market Makers are regional firms with a strong knowledge of the companies and industries in their area.

While stocks and bonds are important sources of income, large and mid-sized brokerages typically sell a wide range of financial investing instruments, including mutual funds, annuities, money market accounts, and others. The competition for investors' dollars requires being able to offer the full array of investment products.

Boutique firms tend to specialize in one or two aspects of the investment process. The firms providing research are most important to investor relations officers.

Given this landscape of national, regional and boutique firms, companies need to know how to build analyst coverage. The largest firms are likely to have at least one analyst covering each major industry, with some industries meriting more than one analyst because of their size. Other firms assign an analyst to a group of several smaller related industries — for example, companies in the distribution business, where fundamentals are similar.

Depending on their size, regional brokerages may have a few specialists covering industries with a strong local presence, but their analysts tend to be generalists. Regional and local brokerages like to focus on local companies they can get to know well, taking advantage of proximity and shared community involvement. Regional analysts often become the best source of research and analysis on a local company.

This demographic analysis suggests that, in building analyst coverage, smaller companies start with local regional brokerages, then move to regional brokerages specializing in their industry, then to the industry specialists at the national wire houses. Boutiques also should be investigated to see if they specialize in your industry.

There is plenty of good research material available today to help identify brokerage firms, learn more about them, and get the names of chief contacts. Directories and online databases profile firms, provide the names of research directors, industry and generalist analysts. You can see if regional firms in your area have an industry specialist. If not, your best bet is to contact the firm's research director. If your company is to be covered, the assignment will come from there.

Directories also profile the national and boutique firms, listing virtually all the sell-side analysts at each firm, including industry specialists. Resources include Nelson Information (914-937-8400), Carson Group (212-707-0605), and Zacks Investment Research (312-630-9880). Analyst and broker lists are available from Thomson Financial Investor Relations (212-509-5100) and Vickers Stock Research (516-423-7710). Nasdaq-listed companies also have ready access to analyst information through Nasdaq Online.

Armed with this information, companies can now decide which analysts to target and how best to approach them. The top analysts covering any industry are members of the *Institutional Investor* magazine all-American team. They are judged the best by their customers, institutional analysts and portfolio managers. These sell-side analysts are probably the toughest to sell because they are already following a set group of companies. A way to get their interest is by being a source of information about the industry itself. They always want to improve their industry knowledge and insight, and your help might lead to them covering your company.

Some leading analysts have assistants, and an initial contact with that person may prove fruitful. The assistant may start to do research and help you make your case. The assistant also may be allowed to follow certain companies separately, and he or she could become a major analyst someday.

By identifying companies being followed by industry analysts, you can figure out the best ways to reach an analyst while providing a wealth of information on the industry. You can determine

the information relevant to the analyst, his or her "hot buttons" and biases, and how the research and analysis are constructed. This base of knowledge helps you determine the best information to use in approaching the analyst.

Getting Analysts' Attention

There is no single route to approaching an analyst. You can start slowly by putting the analyst on a distribution list for materials. Or you can send a letter of introduction, then follow it up with a phone call. The letter should include key printed materials, such as a corporate profile, annual report, 10-K or copy of a recent presentation. The letter should give two or three key reasons why the analyst might consider following your company. Possibilities include consistent performance, improving fundamentals, a franchise position in your markets through technology, your growing importance in the industry.

Or you can be a little bolder and call the analyst to introduce yourself or seek an appointment. You can invite a group of analysts to a meeting, seek to address an AIMR chapter and splinter group meetings. You can arrange a trip to New York, where most national brokerages are located, for face-to-face meetings or to a nearby city with several important regional firms.

An active effort to build sell-side coverage will include all these methods of making contact. Still, the effort is likely to meet with mixed interest. It will take persistence to be successful.

You must be able to give the analyst a reason to cover the company, and an improvement in fundamentals tops the list.

The quality of information also will play an important role. The communications focus should be on fundamental strengths; competitive advantages; creating a clear understanding of the technology, products or services; showing effective cost and margin management; describing the financial condition and financial results.

You must be able to give the analyst a reason to cover the company, and an improvement in fundamentals tops the list. Analysts won't start to follow a company with faltering fundamentals and prospects. They need to be shown a story that indicates growth. A key role of an analyst is to create interest in a company so investors will buy shares to generate commissions.

The first phone call to an analyst, whether "cold" or in follow-up to a letter, is an important selling opportunity for an investor relations specialist.

For the call following a letter, if the analyst has read the letter, along with the enclosed materials, you should have the basis of a discussion. If the analyst hasn't read anything, you can use the

letter as a way to open up the conversation, then send the material as a follow-up. If the analyst doesn't want to talk, you can offer to send the letter and materials again before calling back. Hopefully, the next time you call, the analyst will be ready to talk. The process should tell you what's ahead in cultivating this relationship. The door may be closed for now, open enough to allow further contact, or open wide to start a relationship.

The conversation can be a valuable learning experience. It may tell you why the analyst isn't interested in the company. It may tell you what the company must do to generate some interest. It may give you insight into how the company stacks up in the industry. It may tell you that the company's fundamentals are fine but that there isn't enough stock available to make the analyst's effort worthwhile. It may tell you that the improved performance has to continue for awhile longer to show a track record. It may tell you the company needs to be more forthcoming with information to give the analyst comfort that there won't be any surprises down the road.

Following face-to-face meetings, additional contact is essential. The analyst can be added to your list to receive releases and reports. A letter thanking the analyst for attending the meeting and inviting him or her to stay in touch is certainly a good idea — as are continuing phone conversations.

This contact process can lead to the analyst including the company in industry reports and beginning to position the company in the industry. Or, it can lead to covering the company and issuing a report containing a recommendation to buy. At this point, the analyst is following the company, participating in conference calls, asking questions over the phone, talking to the firm's institutional and retail sales reps and large clients, and issuing "morning notes" comments that are read by clients and much of the investment universe. These notes are distributed to the market through First Call.

In building analyst relationships, companies often wrestle with the issue of how much information to provide. The first step is minimum required disclosure — learning what the analyst absolutely has to know to be comfortable following the company. Then the company has to decide if it can provide all that information. Management may view some of it as proprietary or irrelevant. In the latter case, you can try to show the analyst why the information isn't really important.

With information seen as proprietary, analyze the situation more carefully. Are other companies in the industry providing this information? Is it essential to the analyst in being able to make accurate forecasts and valuations? To gain coverage, the company may have to provide the information, but then must release the same information to the general public under Reg. FD.

Consistency is essential when supplying pertinent information. Companies can't turn the faucet on when the flow of information is positive, then shut it off when the numbers or trends aren't

favorable. In the same vein, knowing what is and what isn't material is important. If inventory is a material number, you can't supply it only when the picture is favorable.

Companies can build their rapport with analysts by volunteering good information beyond the minimum requirement. No one knows more about your company than you do. You know what drives your growth, enables you to control costs, be the low-cost producer, have the best technology, continually increase market share. Sharing these insights can help analysts better understand the true value of your company.

Reaching Retail Brokers

Brokers are the company's direct link to individual investors and sell stocks plus an extensive array of financial products. Some operate as financial planners. Their customers represent all the demographics — men and women of all ages and occupations with discretionary incomes ranging from modest to grand. High-net-worth individuals may have their brokers and investment advisors managing millions of dollars in investments.

Unless they specialize in equity and bond accounts for a handful of wealthy people, most brokers don't have the time to do the definitive kind of research conducted by analysts and fund managers. So they want the corporate story in highlight form. Their prime information interests are the company's core business, its major technologies and products, market position and financial performance.

Essentially, brokers want to know:

- How the company is making money
- How it rewards shareholders
- Sales and earnings growth
- Efforts to improve margins and control costs
- Competitive advantages and investments that will preserve growth

Public image also is important to brokers. They know that a company's high and favorable visibility, its reputation for having good products, delivering customer service and supporting its communities all help sell stocks to individuals.

Companies can reach brokers in several ways. They can run ads in broker trade and individual-investor-oriented publications like *Research* or *Registered Representative* — or in the general business/financial press. They can secure media coverage in these same publications. *Research*

magazine runs advertorials to grab broker interest, then reprints the stories for brokers to give their customers in helping to sell the company. The magazine also runs corporate fact sheet-type profiles and includes response cards for brokers to order quantities of the corporate materials. *Investor Direct* also publishes advertorials and profiles. It is written for individual investors.

Companies can hire outside vendors to conduct direct mail programs, or they can create appropriate materials and run their own mail campaigns, buying lists from Thomson Financial Investor Relations, *Research* magazine, *Registered Representative*, Select Information Exchange (SIE) and other sources. They can sort from a universe of names, picking brokers in certain cities or with certain firms. These mailings can serve as introductions to the company or as a way for brokers to order your reprints for use as sales tools. SIE claims to have lists of brokers from main line and small independent firms, one-person shops, discount brokerage, mutual funds and banks totaling 280,000 names.

Broker lists also are a good source for names of people to invite to meetings. A popular format for the meetings is to give a presentation after the market closes, then follow the meeting with a cocktail reception where discussion can continue. Another approach is to address the various broker societies in cities across the country.

Companies can improve the odds of gaining attention by working directly with a brokerage firm. This can be as basic as arranging a meeting through the local manager of a specific office. You are likely to be heard if the industry analyst is following your company and has made a buy recommendation or, when the firm isn't following the company, if the manager believes you have a good story to be shared with their sales force.

A successful meeting format is for the company to buy box lunches as an encouragement for brokers to join the group. They have lunch, listen to the presentation, ask questions and take away your corporate materials. The presentation can be made by the investor relations officer, CFO, president or CEO.

Since the most effective meetings usually are with brokers of firms recommending your stock, the investor relations goal is to attract analyst coverage and to have the analyst help you arrange the meetings. In situations like this, brokerages often invite the CEO, CFO or IR officer to give an audio or video presentation over the firm's broadcast system. The presentation may be mandatory for brokers and scheduled into their day. Or it may be voluntary, part of an ongoing series of scheduled meetings with companies, live or carried over the firm's internal broadcast network.

While considerable effort can go into a broker communications program, it can be difficult to measure the degree of success — especially when the objective is to "build relationships with brokers."

But companies can measure the results of specific communications efforts. With advertorial magazine placements, you can find out the number of brokers ordering reprints and the number they order.

Following meetings, companies can call brokers in attendance to evaluate their interest and see if they are actively putting the company into their customers' portfolios. You can also watch your trading and shareholder lists to gauge how a specific campaign may have played out in a certain location.

If you've built a "mailing list" of brokers who've responded to your direct mail or attended a meeting, you can call these brokers from time to time to assess their continuing interest.

Brokerage firms are important Market Makers, of course. Efforts to maintain good relationships with these firms by providing valuable information are essential to the investor relations process.

Institutions as a Prime Market Group

Conventional wisdom today says that institutions drive the stock price of most companies — by trading more frequently than individuals and by trading larger numbers of shares.

From an investor relations perspective, this is beneficial. Companies can make contact with institutions more readily than with individuals. There are fewer institutions, obviously, and virtually all of them can be identified, even the smaller ones. The investor relations professional conducts relationships with institutions purely on a business level.

After all, institutions are professional investors making business decisions in the best interests of their clients, with a fiduciary obligation to achieve highest returns.

Increasingly, institutions view companies as viable, direct sources of information. Institutions are evaluating the quality of corporate information on a company by company basis. They are quite willing to take information from knowledgeable investor relations people on a daily basis. But they also insist on meeting with top officers periodically and when information requirements mandate it.

When the information flow is below par, institutions will still invest in companies that are sound investments based on information from SEC filings and other public information. And they will invest in smaller companies with breakthrough opportunities created by technology or a new idea that's catching on fast. In fact, they will rush to get in early, so they can enjoy the rising stock price ride.

Chances are, however, that institutions won't invest in smaller companies with average or above-average performance when those companies are not providing enough information for an accurate assessment of their operations. Institutions need assurances of certainty in performance and minimal risk of negative surprises.

Institutions need assurances of certainty in performance and minimal risk of negative surprises.

Good information provides these assurances and helps companies build quality relationships.

The first proactive efforts of companies to communicate with institutions involve meeting with institutional analysts at presentations sponsored by their professional societies, then inviting them to company-sponsored meetings. Soon the buy-side analysts become an integral part of the communications process. Companies now dispense information directly to portfolio managers and get to know them on a broad scale. And they understand institutions' investment approaches, making it possible to tailor information to their needs and to target compatible investors. This, in turn, leads to companies' ability to better serve shareholders by giving them good information.

It also helps companies have more influence on their shareholder mix. It enables a company to follow strategies and conduct programs that will attract certain types of institutions. Companies now can anticipate the types of investors who will become shareholders and then plan appropriate communications. Chapter 6 describes in detail the valuation approaches of institutions and the targeting programs of companies.

So the communications process for institutions has two dimensions: satisfying the information needs of current institutional holders; and reaching out to new institutions, knowing who to target and what information to use in appealing to them.

While companies still give presentations at analyst societies and brokerage conferences, the methods for reaching institutions are becoming more personalized. With greater understanding of institutions' specific investment approaches, corporate managers are now pursuing smaller and one-on-one meetings where they can really contribute to the discussion.

Companies typically make one- or two-day trips to various cities to meet with institutions whose investment approaches closely match the company's financial characteristics. The company holds breakfast or luncheon meetings with small groups of fund managers and buy-side analysts. It also schedules sessions with one institution that involve meeting with several portfolio managers at the firm.

Other ways of communicating with institutions: (1) faxing and sending all news releases and relevant statements to commercial wire services so they can be accessed immediately and made available quickly through online databases; (2) putting SEC filings on online databases; (3) establishing company Web sites containing any information you consider important.

Individual Investors: An Important Part of the Market

An estimated 78 million individuals in the United States invest in equities either directly or through mutual funds. They are a very diverse group, no matter how you define them in terms of age, income, assets and education level. Of course, the 80/20 rule that applies to most industries also is in effect in the investment sector — a small proportion of individuals (20%) accounts for the heaviest number of trades (80%), and they are more upscale than the investor population as a whole.

Additional research reveals that individuals tend to put half their stock investments in companies where they or another member of their household works. Investors cite savings through work as a "major" source of retirement income.

Increasingly, individuals are taking responsibility for their financial growth and retirement, not relying on pensions or social security. The motivation to grow a substantial nest egg, accumulate wealth and improve their life style, combined with the excellent economy and strong bull market, has prompted millions of individuals to expand their knowledge of investing and build the confidence to manage their own portfolios. Increased use of discount brokers and online trading are evidence of this growing knowledge and self-confidence.

Investors have become more proactive in setting financial goals and monitoring their investments. They are accessing research and doing their own portfolio management through the Internet, databases and software. They are buying more shares directly, often using discount brokers or the Internet to reduce commission fees. They belong to organized groups of investors, applying professional money management techniques to achieve higher returns, which they are achieving.

While in the recent past day traders have grabbed the headlines, it is the serious investors doing their research and using the Internet to execute transactions at lesser cost who are interested in knowing more about the fundamentals and growth prospects of individual companies. These investors are best reached through Internet online databases, Web sites geared for investors and corporate investor relations Web pages. These are described in detail in Chapter 7. Much of this activity is taking place after hours, from home after the normal workday.

It is important to contrast these careful, thoughtful individual investors from the day traders who many perceive as using the market as a gambling casino, often executing dozens of trades in one day in efforts to capture gains from daily market activity and from using chat room/message board manipulation to move prices. As recent evidence has shown losses from this activity, the fervor over day trading has been tempered somewhat.

The challenge for investor relations professionals in reaching individuals is that there are so many of them, and they're so spread out. They defy efficient marketing programming. Nonetheless, smart companies can serve this important market segment in several ways:

- By working effectively with brokers
- By communicating directly with these investors through various electronic sources
- Through dividend reinvestment and direct stock purchase plans
- By meeting these investors directly through their investment clubs and associations
- Through targeted direct mail programs
- By mailing or faxing information to individuals
- Through certain print and broadcast media
- Through the Internet and e-mail

Broker programs. The most efficient way to reach individual investors is through brokers. Programs can be organized and measured, as explained in detail earlier in this chapter. In addition to various types of meetings, they include direct mail campaigns using articles and fact sheets as customer reprints.

Electronic communication. Online databases and the Internet are revolutionizing the way individuals receive investment information, manage their portfolios and execute trades. Financial releases available electronically give individuals and professionals access to the information at the same time. SEC filings, annual and quarterly reports are available on the same timely basis. Individuals are now tuning in to live conference calls, gaining information at the same time as analysts and portfolio managers. These information resources also are serving to bring companies and individual investors together. Companies are talking with their individual shareholders through "webcasting" and e-mail.

In addition, individuals can tap into numerous computer services that enable them to be more knowledgeable investors. And they have an abundance of investment management software available for purchase. They also can subscribe to Telescan or join the computer groups of the National Association of Investors Corporation (NAIC) and American Association of Individual Investors (AAII). Telescan has a highly sophisticated information resource/investment management package, offers access to companies, and continually updates and refines the materials.

DRIPs and DSPPs. Companies are reaching out to individual investors through dividend reinvestment (DRIP) and direct stock purchase plans (DSPP). These plans enable shareholders to reinvest their dividends and make cash payments to increase their holdings without paying brokerage commissions and fees. They even get discounts from some companies. Companies actively promoting these plans report that over half their individual shareholders are DRIP participants.

Now companies are offering individuals the opportunity to buy shares directly, bypassing brokers and their costs. In the first few months following SEC approval of the concept, more than 100 companies of all sizes and in many industries introduced direct stock purchase plans. By mid-1999, about 700 companies had programs to allow direct purchase, and the numbers have continued to grow. A company doesn't need a dividend reinvestment plan in order to have a direct purchase plan. But the direct purchase/dividend reinvestment combination is a powerful incentive to attract individuals and encourage them to increase the amount of their holdings systematically.

These opportunities to develop a closer rapport with individuals and increase their overall holdings come at a time when brokers are whittling away at a company's registered shareholder base. Requirements to settle security transactions within three days encourage investors to leave their accounts with their brokerages to facilitate completion of the transaction. The trend works well for brokers because it ties up the account and makes it more likely that they will handle any future transactions instead of some other firm chosen by the investor.

But this also means the investor is no longer registered with the company or identified as a shareholder. Instead, the account is in "street name" with the broker. The trend has continued to grow, leaving companies able to identity fewer and fewer of their shareholders, compelling companies to communicate with shareholders indirectly, since mailings go through the brokerages and their fulfillment agents. That can cause delays in arrival of information, including proxy materials, and create uncertainty as to whether the shareholder ever received the mailing.

Companies can deflect this move to "street name" by using electronic book entry registration, eliminating the issuance of stock certificates. Shareholders receive statements of their positions. Electronic book entry is now available and being used by numerous companies. It can be set up in-house or through bank transfer agents — its speed, along with the elimination of certificates, expedites transactions within the three-day requirement. On request, investors still can obtain certificates.

Companies are increasing their holdings among individuals by using direct purchase, dividend reinvestment and other plans to appeal to certain "affinity" groups. They are aggressively marketing the benefits of share ownership to such affinity groups as employees, customers, suppliers, professionals in their industry and citizens of the communities where the company is located.

Employee Ownership Programs. Companies clearly recognize the value of attracting their own employees as shareholders. Employee Stock Plans (ESPPs, ESOPs) and other plans encourage investment. Stock options are being granted to a broader range of employees; a substantial number of companies now offer them to every employee. Companies actively promoting employee stock ownership have seen a substantial increase in the number of employees with stock and the number of shares being held. Communications programs to help educate employees about the market are on the rise. Employees who appreciate the role of investors are more inclined to support corporate initiatives aimed at improving shareholder value.

Investor clubs and organizations. Investor clubs are an excellent way to reach individual investors. The National Association of Investors Corporation (NAIC) is the grandfather of investment clubs, helping to set them up in cities and towns across the country. It also sponsors

Investor Fairs® that bring companies and investors together. NAIC teaches individuals how to invest and to manage portfolios, following the principles of fundamental analysis. It promotes long-term, systematic investment in growth companies.

NAIC offers tools to help its members, including conferences, publications, computer programs, investor club meetings, investment profiles and a monthly magazine. Companies can participate in NAIC programs through magazine and corporate profile activities, by sponsoring booths and making presentations at fairs, and through the group's low-cost dividend reinvestment plan. The American Association of Individual Investors (AAII) also is a leader in educating individuals on stock investment. Its education program, considered comprehensive and highly professional, is achieved mainly through publications, conferences and seminars, where members discuss their experiences and successes. Companies can't participate directly in AAII activities.

Fax and mail. With many individual investors receiving information by fax today, companies are establishing so-called "fax-on-demand" capabilities, either directly or through an outside service like PR Newswire, Business Wire or Direct Report Corporation. Investors call a toll-free number to request a company's release; those without a fax machine can receive the release through the mail. Companies are advertising availability of the fax service through their own communications media. PRN and Business Wire also are actively marketing the service through publications read by individual investors.

Of course, people with Internet access can obtain information from company Web sites, download and print the materials. They also can use the Web to request materials from companies or their transfer agent. And there's always the mail for sending releases, quarterly reports, corporate profiles and other materials to registered and non-objecting "street name" shareholders.

Many companies today have a toll-free number that investors can call for information. They might request an information kit, current news release, annual report, DRIP or DSPP enrollment form and prospectus, or other information. Some companies also have recorded messages that give investors the latest information. A few companies even set up times for conversations between the investor and an investor relations professional via a toll-free number.

Media visibility. Many companies also believe in the value of media visibility in attracting individual investors to a certain stock. *Barron's* and *Individual Investor* magazines, for example, carry investment profile-type stories. Articles conveying positive things about companies in virtually any media outlet can lead an individual to buy shares. So could any of the television programs devoted to evaluating companies as investments.

Television has become a media center of financial and stock market information. Investors can watch the market ticker minute-by-minute, gain frequent reports and commentary throughout the day and analysis after the market closes. Company news is reported right after it is released. Interviews with corporate executives occur regularly. Company moves and prospects are being analyzed on the air by analysts and portfolio managers. Such networks as CNNfn and CNBC are leading the way. One end result: a better educated individual investor.

Many print media outlets also run annual report sections. Since companies pay a fee to have their report described and made available to readers, it is an opportunity for both the media outlet and the company. The outlet collects some revenue; the company collects some investor prospects. Costs vary by publication; those with strong stock investor readership profiles typically cost more. Companies can measure results of the program by the number of people requesting annual reports, though it's nearly impossible to know how many of them bought shares.

Certain media have sections for companies to pay for coverage of their news releases, with the most popular subjects being quarterly and annual financial results. Companies also use these services to make major announcements — about mergers, new products and executive changes, for example. Publications providing these services mainly reach individual investors, but some, like *Barron's* Current Corporate Reports, also are read by professional investors.

Quite a number of media outlets also offer response cards for readers to obtain information from companies, including annual reports or complete investor information kits. These kits may contain current releases, annual and interim reports, article reprints, copy of a recent financial presentation, fact sheet and other materials. Kits also are being disseminated online.

Companies also are turning to advertising in selective publications read by individual investors, institutions, analysts and brokers to create visibility, shape an image, and build investment interest. These campaigns function as part of a communications process that enhances a company's reputation, provides information and eventually convinces investors to become shareholders.

Attracting Market Makers

Companies listed on The Nasdaq Stock Market have a network of competing Market Makers trading their shares. This broker-dealer network primarily helps companies build liquidity by creating demand for their stock.

An increase in demand for shares, in turn, promotes tighter pricing and has the effect of producing higher share prices. This leads to higher price/earnings ratios, which lower the cost of

capital for companies. Investors benefit as well, since higher stock prices result in higher returns on investment. The objective for companies is to take full advantage of opportunities to create liquidity, reduce volatility, build demand and competition by increasing their number of Market Makers. Companies actively contacting and working with brokerage firms have scored considerable success in increasing their Market Maker penetration.

In expanding contacts, conducting market research is a logical starting point. What types of Market Makers are right for your company? The answer depends on setting some investor relations objectives, such as whether to pursue more retail or institutional shareholders or to build local holdings.

The Market Maker universe divides into four types.

1. Retail firms (like Kemper Securities) have a substantial network of brokers serving individual investors.
2. Institutional firms (like Goldman Sachs) specialize in pension funds, mutual funds, insurance companies and investment managers; they often execute large orders.
3. Regional Market Makers (like Dain Rauscher Wessels, Inc. in Minneapolis) specialize in companies and customers located nearby. They seek to create advantages in serving their customers by bringing in-depth knowledge of the companies in their market through solid research and analysis. The goal is to offer both institutional and individual customers more extensive coverage of these companies than others are providing.
4. Wholesalers (like Herzog, Heine, Geduld, Inc.) are the fourth type of Market Maker. Wholesale firms make shares available to other broker-dealers who need the shares for a customer and are not regular Market Makers in that company. They contribute to creating liquidity by being an important source of shares for retail, institutional and regional firms.

In addition to trading shares, many Market Makers can also conduct research on companies. Some Market Makers have extensive research operations, adding substantially to the amount of good information in the marketplace on a company.

The more Market Makers a company has, the greater its liquidity is likely to be. By competing among themselves, Market Makers also narrow the spread between the ask and bid prices. Spreads essentially are market-driven, with spreads tighter for highly liquid, frequently traded stocks and wider for less active stocks.

Contacting Market Makers

Once you've completed your market research and know which Market Makers to target, be proactive about contacting them. Generally, with any Market Maker, initial contact can be made through the head of equity trading or the Nasdaq trading department.

When contacting an institutional firm, determine if it has a minimum market cap requirement and if it specializes in or favors certain industries. You can tell by the companies it recommends and whether analysts for specific industries are on the research staff. A logical place to begin the contact process is with the industry analyst or director of research, who assigns companies to specific analysts.

Institutional firms also may be following companies fitting certain investment styles — growth, value or income — and that's important to know.

Retail firms are partial to local companies, consumer companies with branded products, companies in growing industries, new companies with hot new products, services or technologies. The initial contact is likely to be through an analyst or the research director. But often it can occur through a broker who has taken an interest in the company. The broker will help "sell" your story to other brokers in the firm and to the appropriate analyst.

And small cap companies should never get discouraged about the prospects of attracting Market Makers. Companies offering good investment opportunity will not be ignored. Analysts and investors are constantly on the search for a new company. The company's job is to get to the marketplace, telling its story effectively, making the market in its stock more efficient.

For companies of all sizes, the story should focus on the fundamentals, earnings history, growth potential, products, markets served, market position, and should include stock trading information. The financial history provided should include the IPO date, deals done since then, research available, and a composite picture of current shareholders.

Companies are urged to work at building relationships with Market Makers through regular communication. This means communicating with the Market Maker regularly, maintaining close contact with the analyst following the company, and continually trying to increase the number of brokers recommending shares to their customers.

In addition to making regular visits, companies should fax releases on new developments, invite the firms to participate in conference calls, and stay in touch by telephone. You should also encourage Market Makers to contact you when they have a question or when unusual activity is occurring.

Growing Influence of Shareholder Activism

Any discussion of investor relations would be incomplete without mention of activist shareholders and their involvement in — and dissatisfaction with — how companies are governed. Two issues occupy the center of the prime interests of these shareholders: corporate performance and accountability. The two clearly are related. Investors see performance improving as management and the board of directors become more accountable to the shareholders for results.

Shareholders are urging companies to have independent boards, with a majority of directors from outside the company. They don't want the lead director to be a member of senior management. In addition, they're often asking for an outside chairman and totally independent compensation, audit and nominating committees.

Having diverse representation on the board also interests shareholders. They definitely are looking for more women and minority members in creating a fair balance of interests. The notion of having directors who represent shareholders has given way to the idea that directors' first and prime responsibility is to shareholders.

Accountability for results is definitely the main focus of the veteran activist institutions today. Proxy rules give investors a better opportunity to evaluate performance. Proxy statements must contain a chart showing shareholder returns for the last five years — in absolute numbers, compared against an industry peer group and a market index like the S&P 500.

Companies also must show the total compensation for each of their five highest-paid executives and include a reasonable calculation of the value of stock options at the time they're exercised. Further, the compensation committee must provide a statement showing how the compensation is linked to performance.

Shareholders are not only evaluating companies on their performance but on their governance practices as well, which encompass both performance and social actions. Shareholders are getting help in calculating returns and measuring social behavior. Institutions are focusing on Total Shareholder Return as the operative measure of company performance. Companies seen as lagging in total return are candidates to be targeted for meetings or shareholder proposals. Returns are compared against the market (S&P 500 Index) and companies' peer groups.

The Council of Institutional Investors (CII) publishes an annual "focus list" of companies with under-performing returns over the last year, three years and five years. Members of the Council (over 100 institutions and corporate pension funds) are encouraged to consider appropriate actions in urging better performance from these companies.

The California Public Employees' Retirement System (Calpers) also publishes a list of under performers each year. Nine companies were on the 1999 list, selected on the basis of such criteria as shareholder returns below the company's peer group and market, not satisfying several accepted governance practices, and not achieving certain economic measures of value. Calpers uses Stern-Stewart EVA (economic value added) as a metric in gauging and comparing corporate performance.

CII, Calpers and other institutions actively promote their various principles and practices of good governance. CII has a series of general principles, core policies, shareholder voting rights. It spells out what constitutes board accountability to shareholders. Calpers has written a shareholders' bill of rights and laid out a series of global governance principles. Calpers is playing a leading role in encouraging investors to actively participate in corporate governance in Europe and other places in the world.

While the focus continues to be on larger companies, mid-sized and smaller companies have not escaped attention. They often seem to be targets more on social issues than on performance.

Two Basic Approaches: Proposals and Meetings

Activist investors tend to divide into two camps as they pursue better performance and "good governance" practice among companies in their portfolios. One group continues to use proposals as the medium to get attention and results; the other is turning more and more to meetings with management and the board.

Labor unions, organized groups of individuals and several leading individuals continue to submit proposals. In 1999 some nearly 500 proposals were started of which about 300 came from individuals. Nearly half of all resolutions originated were never voted on, either withdrawn or omitted. Labor unions submitted about 60 proposals initially, while environmental groups offered about 75. Key issues involved repealing classified boards, allowing cumulative voting, eliminating poison pills or having shareholders approve them, issues involving board independence and composition and executive pay, adopting codes of environmental principles and global warming.

Pension funds have been gradually reducing their number of proposals. In 1999, there were about 75 from a dozen pension funds. Leaders were the Longview Fund with 17, mostly involving poison pills, and the State of Wisconsin Investment Board, starting with 15 proposals, the bulk against repricing underwater stock options. Some 30 proposals came from members of the Interfaith Center on Corporate Responsibility, with half seeking to link executive compensation to the companies' social performance.

Overall, subjects garnering the largest number of resolutions were to repeal classified boards, to sell or study the sale of company, to redeem or let shareholders vote on poison pills, to allow cumulative voting, to link executive compensation to social/environmental performance, to not allow repricing of stock options, to increase or report on board diversity, to have majority of directors be from outside the company, to put caps on executive compensation, and to allow shareholders to vote on golden parachutes.

A major trend began to emerge in 1999 — that of submitting binding proposals. Historically, most have been precatory, giving companies the option of adopting them. Few have been adopted in the past, even though passage or high shareholder support sent a message to management. Some 60 binding bylaw proposals were submitted in 1999, an increase from 23 the previous year. More than one-third of these were dropped. Key issues involved poison pills, repealing classified boards, allowing cumulative voting and not repricing options.

Meanwhile, the veteran activist public funds have been moving more toward meetings as the vehicle for negotiating agreements. Calpers, the Council of Institutional Investors, and other public funds identify under-performing companies, initiate meetings and seek courses of action designed to improve operations and financial results.

Most of these meetings are taking place behind closed doors, out of public view. The institutions no longer are seeking publicity to put pressure on companies but instead are looking to accomplish their goals through an intelligent exchange of information and opinion in a more positive environment. Proposals have become something of a last resort for these institutions, and this largely explains the decline in total number of proposals from public funds.

Institutions essentially are focusing on the issues that impact performance. They are following the logic that management/board accountability, incentive compensation and good governance practice all contribute to higher valuation and stock price. Institutions are less concerned with how much executives are paid, more concerned with the relationship between pay and corporate value. Proposals capping compensation at certain levels are being promoted more by activist individuals.

Social issues still occupy a prominent place in the activism movement. Most socially-based proposals originate with individuals, religious groups and specialized socially-oriented institutional funds. Social issues focus on people's rights — fair treatment of individuals; good employment practices; and health issues, such as dangerous toys and the promotion of tobacco products.

Environmental compliance is important to investors, too. Numerous companies have been asked to sign the Ceres Principles, a model for good environmental citizenship. Environmental issues are watched closely by institutions because of their potential impact on the bottom line.

Companies are becoming proactive in adopting good governance practices. A number of companies have gained positive exposure from their actions — annual board elections, separating the jobs of CEO and chairman, having independent boards and committees, appointing an outside lead director, setting "reasonable" compensation plans and describing them in proxy statements, allowing confidential voting, eliminating or having shareholders approve poison pills, not giving excessive compensation to directors, paying directors through incentive options rather than cash, requiring directors to hold certain minimum share levels, and so on.

Companies also seem to be more willing to come to the negotiation table. They are recognizing the value of working together toward common goals rather than continuing on the confrontational "we/they" path. At a minimum, agreeing to meet tends to reduce institutions' zeal to submit proposals, get media attention, and perhaps precipitate a crisis.

It would seem that potentially there is much to be gained in learning from knowledgeable investors. Observers believe a trend is underway leading to closer cooperation between companies and their investors. They believe this reality is inevitable, given the substantial and growing stock positions held by institutions.

Chapter 9

Business and capital market developments are front-page and prime-time news stories.

The Value of a Proactive Media Relations Program

The capital markets impact our economy dramatically. Their size alone mandates that they be covered by the media. Daily trading volumes of securities are measured in billions of dollars, after all.

Business and capital market developments are front-page and prime-time news stories. They fill expanded sections of business news in the daily papers, have spawned highly successful publications and Web sites devoted just to business and finance, and are the subject of numerous television programs. Business, finances and the markets are in the spotlight, and our best bet is to take advantage of the opportunities being created and to be prepared to handle any media situation that may occur.

Media visibility can have a positive or negative effect on stock price. A company can influence the effect and its extent by how it handles the specific situation. Being prepared, so that the company responds quickly and professionally, often determines the outcome.

Since the media doesn't always uncover positive news, the company can benefit from bringing a positive development to the media's attention and making sure its full importance is recognized.

In the same way, companies should deal actively with events and news likely to cause a negative reaction. This means being prepared to address the situation quickly and intelligently. The best plan is to anticipate the story, prepare a response, and move swiftly to see that your comments are contained in the original coverage. A balanced story from the start should be the company's goal. Studies have shown that initial coverage of an event has the most impact on the audience.

Ongoing proactive efforts by the company to build visibility through the media also can result in a higher stock price over time. This is especially true when the coverage occurs in media used by investors as part of their research process. Sell-side analysts follow trade publications closely; individual investors read business magazines and newspapers, visit business-focused Web sites and cable business/investing programs; institutional investors read industry and business publications.

Companies benefit from appearing regularly in the media, describing their performance and detailing new business developments — technology, products, markets, services and acquisitions. The net effect is to convey leadership and solid management.

Organizing a Program

Every company should be prepared to work with the media on a professional level. Essentially, this means two things: have a plan and have expertise in media relations.

A media relations plan covers both responsive and proactive ways of dealing with the press. The components of a planned, responsive program include having a team ready to deal with the media, knowing who is going to speak on behalf of the company, properly preparing the spokesperson(s), and anticipating the subjects likely to come under media scrutiny. Many companies select certain subjects in advance, prepare responses to probable questions, and even practice role playing. This process is described in more detail in the next chapter, which focuses on crisis communications.

A planned, proactive program consists of several parts, as described later in this chapter: how to handle news; how to position the company as a leader by being included in stories about trends, issues and developments; and how to build steady media coverage through articles and interviews.

Success with the media on a professional level also requires knowing what the media wants. The ultimate objective is to figure out how to benefit your company while satisfying the media's perceived needs.

Companies can get what they want from a story by deciding what they want in advance, then determining how to accomplish it. The "how" part is achieved by planning the content and scene in which the story is told. The scene may be a science lab, a customer location, the CEO's getaway or wherever is appropriate. The content of the story is carefully shaped by determining ahead of time what is to be said and who the best people are to say it.

Working from your own "script" still allows you to be cooperative and to add substantially to the information requested. This approach works equally well when "placing" stories, providing information for stories initiated by the media, and responding to media questions about sensitive subjects.

Having media expertise also applies to the individual who will function as a company spokesperson. Companies are advised to limit the number of media spokespersons to ensure consistency of communications and to have some control over what is being said and reported.

Depending on the topic, spokespersons are typically the investor and public relations professionals, CEO, CFO, chairman, president and others designated to speak in certain situations. Operating unit heads may be asked by the IR officer to talk at an investor conference, or a scientist may be pegged for a media interview on a new technology.

Spokespersons can benefit from being coached on how to give crisp, compelling answers; handle tough questions quickly; come across as sincere and likable; maintain an executive presence; and deal with different reporters. Coaching can pay off not only in effective media interviews but in effective presentations and conference calls to the financial community. Imparting information well and making a good impression help to build both credibility and relationships.

Investor relations and public relations professionals are encouraged to participate in the coaching process, even though they get lots of practice by talking to reporters and investors every day. In fact, it is the importance of their daily contacts that makes professional training advisable for them.

How to Relate to the Media

A media visibility strategy works best when it flows from understanding how newspapers, magazines, wire services and broadcast programs are put together and how journalists think and operate. The goal of the company is to be a part of the media process — to have the company seen as a source of information, news, commentary, background and knowledge. Companies earn this position by being complete, candid, honest, accurate and timely in their response to requests and in proactively presenting their information.

Reporters are always looking for sources, and a company can be a valuable source, either on or off the record. "On the record" means being quoted or having the information attributed to you. "Off the record" means you are providing some background and insight, but it isn't to be attributed to you or the company. The end result is that the company helps reporters gain information, knowledge and understanding, and the reporters help the company gain visibility and a reputation as leaders and experts in their industry.

A healthy attitude toward media relations parallels the attitude managers should have in seeking a fair valuation of the company's stock: provide the information so the market can value the stock fairly; provide the information so the media will cover the company fairly.

Good companies shouldn't fear the press, even when there is a problem. The best action is to deal with the problem, keeping all constituents informed. In seeking to cover the story fairly, the media will be more inclined to give full treatment to the company's actions when you are forthcoming and working to achieve a resolution.

A healthy attitude toward media relations parallels the attitude managers should have in seeking a fair valuation of the company's stock...provide the information so the media will cover the company fairly.

This is evident in media coverage of a number of crises handled well by companies, including contamination of Johnson & Johnson's Tylenol product and of soda made by PepsiCo. In these cases, the companies were open and forthright, made no attempts to downplay the situations, immediately went to work in getting answers, kept the public informed of progress, and made appropriate offers to concerned customers. The companies enhanced their reputations and probably retained most existing customers and even won some new ones.

Conducting a Planned, Proactive Program

To fully capitalize on a media relations program, companies should think in terms of a planned effort to: match subjects of value to the company with media outlet opportunities; target releases, articles and story ideas to appropriate media.

A starting point in a planned program is to list all the subjects that play to the company's expertise and business strengths. They can be divided into three categories: suited for reporting through news releases; best covered in feature articles, either written by the company and placed with the media or resulting from interviews; and best suited for commentary by certain company people.

The next step is to match the information with appropriate media outlets. The goal here is either mass coverage from a release or targeted coverage through an interview or specific article idea. In the case of an article idea, you are offering to write and submit the article or suggesting that the editors send a reporter to cover the story. A review of the content and readers of different publications will tell you which material should be of most interest to which publication.

Companies also should link their media relations program with their disclosure policy and practice. This serves as a guide in determining the subjects and specific information points that will and won't be shared with the media.

Chapter 10

Seeing crises as inevitable is essential to being prepared to deal with them.

Managing a Crisis

Corporate crises are more common than we might realize, suggesting that every company should have a plan to deal with one. The Institute for Crisis Management reports that about 10,000 crises hitting companies each year are important enough to merit media coverage.

The Institute suggests that a major reason is the determination of people to take legal action when they believe they've been wronged — and the encouragement they receive from lawyers.

According to the Institute, "white collar" incidents account for about one-quarter of business crises, followed by labor disputes, mismanagement, environmental issues, defects and recalls, and class actions. The fastest-rising business crises are sexual harassment suits, class actions and executive dismissals, the Institute reports.

Crises can be organized into categories, with virtually every one having the potential to drive down a company's value and stock price: poor financial performance; product recalls, tampering and deficiencies; accidents and natural disasters; employee, shareholder and other stakeholder group dissatisfaction; and regulatory problems.

With crises occurring so frequently, the Institute urges companies to be prepared instead of assuming it can't happen to them. Crises can come upon a company quickly or smolder for years. In fact, most build over a period of years, suggesting the value of an early warning system, a plan and procedures for action. Seeing crises as inevitable is essential to being prepared to deal with them.

Step 1: An Early Warning System

The key first step in a crisis management plan is having an early warning system. This primarily involves methods of obtaining information — gaining knowledge and insight on people's feelings and opinions, tracking trends and detecting developments in the earliest stages.

The places to turn for this information are the myriad networks of people who deal with your company. They include employees, customers, suppliers, regulators, legislators, business leaders,

industry officials, economists, consultants, industry analysts, industry association executives, institutional investors, local business and consumer group leaders, influential contacts and friends.

It's important, too, to be reading the right materials — industry magazines, advocacy newsletters, union newspapers, specialized publications — to spot changes in attitudes and thinking.

Good relationships with a wide variety of people can help a company pick up on rumors, trace them to their originators, get a sense of how constituent groups feel about the situations, and learn what people are saying. Companies can also use the Internet as a major source of intelligence on a crisis in the making. Monitoring the Internet daily can reveal discontent, changing attitudes or the building of opinion against the company on a certain issue. Today, chat rooms and message boards are potential sources of crises.

Step 2: Put Together a Crisis Team

Next in a crisis management program is forming the crisis team. It should represent all interests in the company that would be affected by a crisis, consistent with the various kinds that can occur. This means the team is likely to include the heads of or representatives from investor relations, corporate communications, legal, human resources, security, marketing/sales, finance, operations, manufacturing and regulatory affairs.

At least one senior officer should be on the team — executive support and participation are crucial to successful implementation. The CEO must endorse the concept and be part of the process. Too many well-conceived and rehearsed crisis plans come apart under pressure because the CEO wasn't part of the effort from the beginning.

The basic responsibility of the crisis team is to prepare the crisis plan, give it depth by making sure it is comprehensive and detailed, and give it life by making sure every participant is fully prepared to execute his or her role. That usually is best accomplished by conducting initial and periodic "dry runs."

A comprehensive plan has a structure. It identifies all the crisis team participants, spells out their assignments, and provides participants with all the support they may need, including information and skill building. It designates appropriate spokespersons in specific areas and instructs employees and others not on the team to refer any calls to the designated spokespersons.

The chief spokesperson may be the CEO, or that role may fall to someone else seen as more appropriate for the situation (division president, plant manager or CFO). The more serious the situation, however, the more important it becomes that the CEO is seen as taking leadership, assuming authority and speaking on behalf of the company.

The need to address several audiences simultaneously may dictate having multiple spokespersons — one or more for each stakeholder group. The groups would include investors, employees, customers and the public, among others.

When more than one person is discussing the crisis, it's essential that decisions be made ahead of time on what to say, how much to cover, and what not to cover.

Briefing and debriefing sessions are desirable, the former to go over what to say, the latter to review whether consistency is being maintained in what was said.

To make sure the message is consistent and to exercise control over the information flow, a company should conduct its communications effort from a centralized location rather than from field locations.

Step 3: Determining the Message and Information

As a crisis unfolds, the message and information need to be realistic, and the essential parts of the company's story must not fundamentally change. That would be different, of course, if further investigation revealed a basic change or new facts that differed from what was learned originally. Creating a message that will stand the test of unfolding events requires careful thinking up front, based on the best information available.

Companies need to keep the long term in mind as they report on the current situation. Think beyond what is happening at the moment and evaluate how the company will be perceived going forward after the crisis. Assess the impact and damage that may occur, and how best to repair the situation.

With so much at stake in a crisis and so many things to think about while it is going on, the need for a well-thought-out plan and rehearsed steps becomes clear. To be coolheaded enough to have a long-term perspective, to be assessing damage in the midst of the crisis, requires a well-planned and often-practiced process.

Companies also benefit from keeping a crisis localized, if possible, by taking swift action to contain it. Don't let it boil up, causing more debate, fueling emotions on both sides, and prompting extended media coverage. As local media coverage continues, the possibility of attracting national media grows.

Nonetheless, companies should be careful not to minimize a story too much. Consumers, stakeholders or advocates who sense a company is trying to stonewall an incident or event will become more aggressive in pursuing it. The right balance is to be responsive, move quickly, present all the information possible, discuss the company's actions to solve the situation, and express appropriate concern.

Some crisis management consultants advise companies to try to communicate primarily through the written word. Written statements enable the company to be more deliberate and precise in presenting information. They also can be disseminated widely, and they are likely to be carried immediately by the many media outlets that receive them.

Verbal statements and discussions carry some risk of error or misinterpretation. Discussions can go beyond the content the company intends to communicate. There is also the risk of the spokesperson becoming ruffled and either saying something incorrectly or saying too much. However, a real person doing an effective job of discussing the crisis will humanize the company and can evoke respect and support.

Spokesperson coaching is a must for everyone who will be talking to anyone in a crisis — to the media, investors, customers, the community or other constituents. Training consultants will simulate real crises, putting the crisis team on the spot to see how well they respond. The exercise will be critiqued harshly, and the practice sessions will continue until a level of expertise is reached.

Companies should practice frequently how they will handle a crisis, using a different crisis each time and selecting from among those most likely to occur. The company's early warning system can help identify vulnerability to certain crises.

Role of Investor Relations Professionals

Investor relations professionals can play a vital role in preparing for and participating in a crisis through their regular contacts with the investment community. The investment community can give early indications of a crisis to come. Analysts are a good information resource for hearing about problems, hearing what competitors might be saying and doing. They also are good sources of information for learning how other companies handled a similar situation.

In a crisis, investor relations professionals must work to keep analysts and investors up to date on company actions and to help them interpret the impact on the company's operations, finances and valuation. Timely communication of worthwhile information is critical. Silence is damaging, uncertainty and changing messages can be deadly to corporate credibility.

Investor relations professionals also serve as a source of feedback to management on how the investment community is reacting to the crisis. That information can be a major component in management's decisions on how to handle the situation in the best way.

Chapter 11

The objective is to show how improved communication increases market knowledge as reflected in share price.

Measuring an Investor Relations Program

An investor relations program can be measured in several ways. The objective is to show how improved communication increases market knowledge as reflected in share price.

Measuring Effectiveness with the Buy Side

Programs designed to attract institutions can be measured in several ways:

Increasing the positions of current institutional shareholders. Measuring institutional holdings both before and after a pro-active targeting effort can indicate the success of the effort. These positions can be tracked through 13(f) filing data and shareholder identification programs.

Broadening the base of institutions holding shares. Companies can identify certain institutions, increase the flow of information and amount of contact, then monitor their share positions. Having more institutional holders increases the number of buyers, to raise demand, while reducing the risk of a few sellers pulling down the price.

Changing the mix of institutions based on their investing styles. This targeting effort typically seeks to strengthen the holdings of longer-term institutions. Companies also can target growth, value or income investors, as well, by emphasizing strengths and programs important to each group.

Results are measured by monitoring the shareholder base, identifying new holders and their styles, while tracking the institutions that sell and their styles. Buying patterns of institutional holders are watched closely for buildups in positions that can be linked with the investor relations effort.

Measuring Effectiveness with the Sell Side

Companies can also measure initiatives to increase sell-side coverage and support with both analysts and brokers. First, analysts:

Increasing the number of analysts following the company. This is easily measured by targeting certain analysts and picking up the pace of contact to encourage them to cover the company. The effort is successful if the analysts start following the company.

Building the interest and enthusiasm of certain analysts already covering the company. The objective is to urge them to be more aggressive and bullish in recommending the company to investors and to push the stock harder with the firm's institutional and retail brokers.

Most analysts have favorite stocks that they push at any given time. The analyst's enthusiasm for your company will depend on an appraisal of prospects, the level of increased return expected, and his or her confidence that the returns can be achieved. That level of confidence can be enhanced by good information and stronger company relationships.

Companies can measure the progress being made in the number of research reports being written and the quality of the reports. When the reports display more knowledge about the company and more insight into value drivers, that probably comes from the closer IR contact. Also, the complimentary words of an analyst often stem from improving relationships with the company.

Companies can increase institutional or retail holdings by creating more sell-side coverage through brokerages specializing in specific market segments. They can build institutional holdings by gaining sponsorship from brokerages with big institutional client bases, such as Goldman Sachs. The same is true on the retail side, by focusing on firms like Morgan Stanley Dean Witter, Salomon Smith Barney or Prudential.

Tracking increases in share positions by customers of the brokerages requires monitoring the process directly with the firm. Most brokerages are willing to share the knowledge of their success with the company.

Measuring the amount of stock placed with individuals through the brokers of a specific firm. This can be the result of an ongoing communications program with a Market Maker. Or it can be the result of a specific campaign with a brokerage firm — mailings of materials, a CEO presentation across the broadcast network, or face-to-face meetings in broker offices.

Measuring the increase in stock positions in certain cities following a campaign. Companies can follow up a series of broker meetings in several cities by watching for a pickup in retail positions in those cities. Check the registered and beneficial shareholder lists and the positions of brokerages contacted in these cities.

Follow-up becomes an important activity in maximizing the value of communications programs as well as measuring their results. Follow-up activities include mailings of new printed materials to brokers attending meetings and phone calls to update brokers on new developments.

Several other retail-oriented investor relations programs can be measured. The National Association of Investors Corporation (NAIC) tallies the number of shares held in each company by its investor clubs and members. Companies with active NAIC programs can expect their share positions to grow.

Direct mail programs aimed at brokers also can be measured. *Research* and *Registered Representative* magazines keep track of the brokers requesting reprints of articles and corporate profiles, and the number of reprints they order. Research follows up with select groups of brokers to count the number of new customers and the amount of stock placed with these investors as a result of the reprint mailings.

Value of Investment Community Feedback

Investor relations measurement should encompass the value of analyst, broker and investor feedback in helping companies refine strategies as they focus on value creation. Feedback that helps executives understand how investors will react to certain corporate actions can have a direct impact on strategic decisions and share price.

Increases in trading volume are a strong indication that an investor relations program is producing results. Steady increases in volume suggest a greater interest by the market in buying shares, which should have a positive effect on price.

An increase in the number of Market Makers actively trading the company's stock is another positive measure of investor relations progress. Some of the increase in activity may be because the market itself is strong, but some also can be traced to more frequent IR contact.

The company's price/earnings ratio is still another indicator of investor relations effectiveness. A P/E ratio above the market and peer group average suggests confidence in the company's future. An effective communications program is very likely contributing to that confidence.

Finally, a company can conduct meaningful studies that would attempt to correlate price with corporate communications. These studies would carefully track share price gains following specific announcements of new strategies, initiatives, transactions, reports on results, and major communications presentations.

Chapter 12: Important Resources for the Investor Relations Function

In the last decade, there has been an explosion of services to help companies disseminate and gather information and operate the investor relations function efficiently. New services — especially online services — are introduced regularly, making it impossible to maintain a comprehensive listing.

The resources and service providers identified in this chapter are not intended to be all-encompassing. They are a starting point for companies to do their own research to find providers that best meet their needs.

Resources for Releasing Information

Wire Services

Business Wire
212-752-9600
www.businesswire.com

Canada Newswire
416-863-9350
www.newswire.ca

First Call
617-345-2280
www.firstcall.com

PR Newswire
212-596-1540
www.prnewswire.com

PrimeZone
800-307-6627
www.primezone.com

Mass Communications

Fax-on-demand Services

Business Wire
212-752-9600
www.businesswire.com

PR Newswire
212-596-1542
www.prnewswire.com

Mass Mailing Services

ADP Investor
Communications Services
631-254-7553
ics.adp.com

Financial Reports Mailing Services

World Investor Link
804-327-3454
www.worldinvestorlink.com

Teleconference Providers

AT&T Teleconference Service
973-564-2204/800-232-1234
www.att.com/conferencing/

Conference Pros International
800-522-3377
www.conferenceprosinc.com

E-Conference
303-786-8789
www.econference.com

Evoke Communications
800-878-7326
www.evoke.com

Genesys Conferencing
303-267-1272
www.genesys.com

Global Crossing Conferencing
800-525-8244
www.globalcrossing.com

MCI WorldCom Conferencing
703-841-6656/800-475-5000
www.worldcom.com/usa_products/conferencing/

Premiere Conferencing
913-982-1114
www.atsgroup.com

Tele-Systems Marketing
800-622-0190
www.telesystemsmarketing.com

Web Site Services

Business Wire, Corporate IR.com
888-381-9473
www.businesswire.com

CCBN.com , IR Eye
617-531-2999
www.ccbn.com

Corporate Communications Center
214-871-2941
www.corpcom-mail.com

PrimeZone, IR Connect
800-307-6627
www.primezone.com

PR Newswire, vIRtual IQ
212-596-1542
www.prnewswire.com

Investor Care
303-534-6229

Investor Media Network
415-621-0020

InvestQuest
614-876-1900
www.investquest.com

Media Network
415-437-4205

Merrill Corp., IR Edge
877-647-3343
www.merrillcorp.com

Quote.com
408-327-0700
www.quote.com

Red Chip Register
888-733-2447
www.redchip.com

Shareholder.com
800-990-6397
www.shareholder.com

StockGroup.com
800-650-1211
www.stockgroup.com

StockSmart
1-888-447-8625
www.stocksmart.com

Zacks Investment Research
312-630-9880
www.zacks.com

Resources for Obtaining Information

Directories

Association for Investment Management and Research
804-977-6600
www.aimr.com

BigDough.com
800-254-1005
www.bigdough.com

Thomson Financial/ Carson Group
212-581-4000
www.carsongroup.com

National Investor Relations Institute
703-506-3570
www.niri.org

Evergreen Enterprises
301-549-3939

Money Market Directory
804-977-1450
www.sandp.com/ContactUs/Sales_Americas.html#MMD

The Money Paper
914-381-5400
www.directinvesting.com/moneypaper/

Nelson Publications
800-333-6357
www.nelsoninformation.com

Thomson Financial
Investor Relations
212-509-5100
www.thomson.com

The Victoria Group
703-691-8484
www.victoriagroup.com

Zacks Investment Service
312-630-9880
www.zacks.com

Trade Publications

BuySide magazine
415-621-0220
www.buyside.com

Institutional Investor
212-224-3300
www.iimagazine.com

Investor Direct
415-621-0220
www.investordirectmag.com

Pensions & Investments
212-210-0227
www.pionline.com

Registered Representative magazine
212-818-9888
www.rrmag.com

Research magazine
415-621-0220
www.researchmag.com

Securities Reports and Data

Associated Press
212-621-1585
www.ap.org

Bloomberg Financial Markets
212-318-2200
www.bloomberg.com

First Call
617-345-2280
www.firstcall.com

I/B/E/S International
212-437-8500
www.ibes.com

Nelson's Earnings Outlook
914-937-8400
www.nelsoninformation.com

Research Data Corp.
415-621-0220

Reuters
212-603-3341
www.reuters.com

Zacks Investment Research
312-630-9880
www.zacks.com

Market Research

Thomson Financial/Carson Group
212-581-4000
www.carsongroup.com

Christensen & Associates
203-975-1118
www.christensenassoc.com

BigDough.com
800-254-1005
www.bigdough.com

National Investor Relations Institute
703-506-3570
www.niri.org

Rivel Research
203-226-0800

Robert Amen & Associates
203-629-2244

Thomson Financial
Investor Relations
212-509-5100
www.thomson.com

Vickers Stock Research Corp.
516-423-7710
www.argusgroup.com

Zacks Investment Research
312-630-9880
www.zacks.com

Other Investor Relations Resources

Investor Relations Publications

Cross-Border Publishing Ltd.
212-425-9649
www.irinternet.com

Kennedy Information LLC
603-585-3101
www.kennedyinfo.com

Lawrence Regan
Communications
312-335-0037

Share Holder Value Magazine
212-972-3720

Securities Data Publishing
212-765-5311
www.sdponline.com

Proxy Solicitation

ADP Investor
Communications Services
631-254-7553
www.adpiicc.com

Beacon Hill Partners
212-843-8500
www.beaconhillpartners.com

ChaseMellon Shareholder
Services
800-777-3694
www.chasemellon.com

Corporate Investor
Communications
201-896-1900

D.F. King & Co.
212-269-5550
www.dfking.com

EquiService
201-222-4099
www.equiservice.com

First Union National Bank
704-383-5647
www.firstunion.com/
corptrust/equityserv.html

Georgeson Shareholder
Communications
212-805-7000
www.georgesonshareholder.com

MacKenzie Partners Inc.
212-929-5500
www.mackenziepartners.com

Morrow & Co.
212-754-8000
www.morrowco.com

Regan & Associates
212-587-3005

Shareholder Services

Fulfillment Firms

Affinity Group
303-294-5741
www.affinitygrp.com

Corporate Communications
Center
214-871-2941
www.corpcom-mail.com

Interactive Telesis
800-931-5050
www.interactivetelesis.com

Shareholder.com
978-371-9595
www.shareholder.com

Specialists in Targeting

Beacon Hill Partners
212-843-8500
www.beaconhillpartners.com

Bloomberg Financial Markets
212-318-2200
www.bloomberg.com

BigDough.com
800-254-1005
www.bigdough.com

Thomson Financial/
Carson Group
212-581-4000
www.carsongroup.com

J.M. Lafferty & Associates
312-553-0800
www.jmlafferty.com

Mitchell & Company
781-466-9500
www.mitchellandco.com

Rivel Research
203-226-0800

Thomson Financial
Investor Relations
212-509-5100
www.thomson.com

Valuation Technologies
415-433-9443
www.valtechs.com

Vickers Stock Research Corp.
516-423-7710
www.argusgroup.com

Zacks Investment Research
312-630-9880
www.zacks.com

Valuation Services

BARRA
510-548-5442
www.barra.com

Boston Consulting Group
617-973-1200
www.bcg.com

DeMarche Associates
913-384-4994
www.demarche.com

Helfert Associates
650-377-0540

HOLT Value Associates
312-322-0050
www.holtvalue.com

J.M. Lafferty & Associates
312-553-0800
www.jmlafferty.com

L.E.K. Consulting
617-951-9500
www.lekconsulting.com

Mitchell & Company
781-466-9500
www.mitchellandco.com

SCA Consulting
312-424-6451
www.scaconsulting.com

Stern, Stewart & Company
212-261-0724
www.sternstewart.com

Valuation Technologies
415-433-9443
www.valtechs.com

Vangard Partners
203-438-1240
rejvangard@compuserve.com

Investor Relations Associations and Institutes

Association for Investment Management and Research
800-247-8132
www.aimr.com

Conference Board
212-759-0900
www.conferenceboard.org

Investment Company Institute
202-326-5800
www.ici.org

Manufacturing Alliance for Productivity and Innovation
703-841-9000

National Investor Relations Institute (NIRI)
703-506-3570
www.niri.org

Securities Industry Association
212-608-1500
www.sia.com

Corporate Governance Organizations

California Public Employees' Retirement System
916-326-3000
www.calpers.com

Council of Institutional Investors
202-822-0800
www.cii.org

Institutional Shareholder Services
301-545-4204
www.isstf.com

Interfaith Center on Corporate Responsibility
212-870-2936
www.iccr.org

Investor Responsibility Research Center
202-833-0700
www.iccr.org

The Lens Fund
202-298-6612
www.lens-inc.com

Proxy Monitor
212-785-3450
www.proxymonitor.com

NASDAQ®

nasdaq.com