REVISED 1/27/2003

What You Need To Know To Measure Investor Relations

Commission on Measurement and Evaluation
Institute for Public Relations

David Michaelson, President, David Michaelson & Company, LLC

John Gilfeather, Vice Chairman, RoperASW

January 2003

Table of Contents

Foreword

Public corporations serve many stakeholders: customers and prospects, employees, host communities, regulators and legislators, media, society as a whole and investors. Investors and those who influence investors are a multi-dimensional and interconnected constituency. To be effective, investor relations executives need to understand the intricacies of this constituency and communicate well with all parts of this constituency.

Investor relations itself has two dimensions.

- The first is *compliance*. The Securities and Exchange Commission (SEC) regulates public companies in the United States. Started after the crash of 1929 by President Franklin Roosevelt (Joseph P. Kennedy was the First Commissioner), the SEC's main duty is to ensure fair and orderly markets. To this end, it has promulgated rules and regulations to which public companies must comply. For more information on the SEC, visit www.sec.gov.
- The second is *marketing*. A key goal of any investor relations executive is to ensure that the company's stock is selling at a fair value. There is ample evidence that stocks that are not well known at times can be significantly undervalued. There are also case histories that show that seasoned investor relations executives can increase the valuation of an under-known stock by using simple principles of marketing: targeting the right investors, shaping a message that will be attractive to these investors and using the most efficient communications channels.

This paper focuses on this second dimension of investor relations by:

- Defining the players who comprise the investor relations constituency
- Exploring the communications channels
- Discussing ways to evaluate progress.

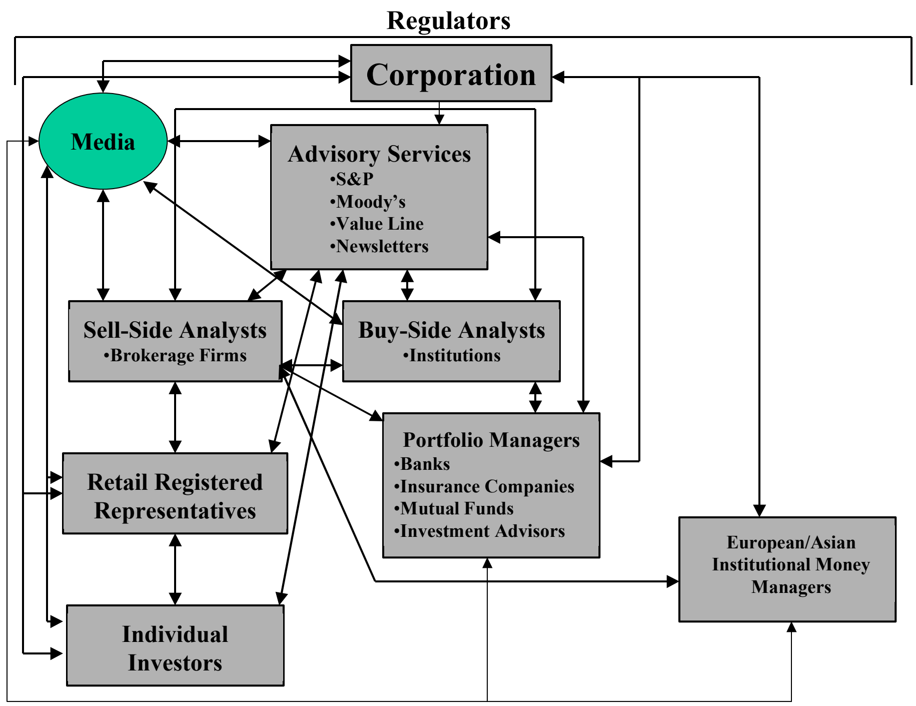
The goal of this paper is to introduce the basic concepts of investor relations. It is intended to be a primer (of the "See Spot Run" variety) rather than an advanced textbook. For more information on investor relations, readers should contact the National Investor Relations Institute (www.niri.com). This association, of corporate investor relations executives and counselors, offers programs and publications that are very worthwhile.

The authors wish to acknowledge the Commission on Measurement and Evaluation of the Institute for Public Relations. The Commission is a group of volunteers who, in a short period of time, have produced an impressive number of publications. This paper is another building block for this foundation of knowledge. The authors also express thanks to Art Rivel of Rivel Research Group, who conceived of and was kind enough to share the key schematic in this paper.

I. The Investor Relations Constituency

The investor relations constituency is broad based and includes a wide number of audiences. These audiences range from the media to regulators to advisory services to analysts and ultimately to the investor – *individual as well as institutional.*

The chart below shows target audiences and main communications linkages within the investor relations constituency. The following section describes each of the target audiences.



II. The Target Audiences

A. Regulators[1]

The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public, which provides a common pool of knowledge for all investors to use to judge for themselves if a company's securities are a good investment.

The SEC also oversees other key participants in the securities world, including stock exchanges, broker-dealers, investment advisors, mutual funds, and public utility holding companies.

In 2000, the SEC promulgated Regulation Fair Disclosure (Reg FD), which addressed the problem of selective disclosure.

B. Public Corporation[2]

A legal entity that is separate and distinct from its owners. A corporation is allowed to own assets, incur liabilities, and sell securities, among other things. In a public corporation, institutions as well as individuals own and the Securities and Exchange Commission regulates disclosures by these public companies.

C. Advisory Services

There are a number of organizations that compile information about specific companies and publish this information for institutional and individual investors. The best known of these services are Moody's, Standard & Poor's and Value Line. However, there are many newsletters, ratings services and proprietary research services that provide data and advice about individual companies.

[1] Source: www.sec.gov
[2] Source of definitions: www.duke.edu/~charvey/classes/wpg/bfglosm.htm

D. The Media

1. General Media

Many people receive their business news in the course of their everyday use of media. Newspapers, magazines, radio, broadcast television, cable TV and Internet browser home pages, all contain reporting of business events. In some of these media outlets, there are specific sections for business news. However, information about specific companies and products can appear almost anywhere and at any time.

2. Financial Media

Within the media category, there are specific outlets that cater to financial or business news. In newspapers, these would include: The Wall Street Journal and the financial/business sections of major newspapers like The New York Times, Washington Post, Chicago Tribune, etc. In magazines, major financial/business publications are: Business Week, Forbes and FORTUNE. (Trade magazines cater to specific vertical industries.) On television: CNBC and CNNfn are major financial news outlets.

3. Internet Media

These are Internet or web sites that specialize in news and information that is of interest to the investment community. These sites can include general news sites that are often affiliated with traditional print or broadcast media such as The New York Times, The Wall Street Journal, CNN and MSNBC, as well as sites that are exclusively available on the Internet. The Internet only sites include: Yahoo Finance, The Street.com, The Motley Fool and other web sites that offer current news and historical information about particular stocks and industries.

Other Internet media that are also key sources of information are sites that are operated by investment companies and brokerage companies. These sites offer historical information, breaking news as well as analyst reports typically prepared by the firms' analysts. Many of these sites offer individual investors access to their brokerage accounts as well opportunities to determine current pricing. Several firms also allow individuals to buy or sell through their sites.

E. Analysts

Analysts are employees of brokerage firms or institutional investors *(e.g., banks, insurance companies, mutual fund managers)* who study companies and make buy-and-sell recommendations on stocks of these companies. Most specialize in a specific industry.

Analysts fall into two distinct categories:

- *Sell-side analysts* (also called Wall Street analysts) work for brokerage firms. Their recommendations are passed on to the brokerage firm's brokers, institutional investors and individual investors. These analysts prepare reports and recommendations on specific companies that are used as vehicles to promote stocks and other securities to customers.
- *Buy-side analysts* typically work for institutional investors. Non-brokerage firms, typically one of the larger money management firms that purchase securities for their own accounts, employ these financial analysts. These analysts cover specific industries or major economic sectors. In smaller firms, they often also are responsible for managing funds.

F. Retail Registered Representatives

These individuals are registered and licensed to solicit business for a commission house or futures commission merchant. These registered representatives are also known as stockbrokers or financial consultants. These stockbrokers manage brokerage accounts on behalf of individual investors. They solicit buy and sell orders for individual stocks, mutual funds, bonds, bond funds, futures and commodities.

These registered representatives fall into two general categories:

- Those who work for *full-service firms* and who offer advice and recommendations to their clients. They are typically compensated by commissions or by management fees from their activities
- Those who work for *discount brokerage firms* and who do not make recommendations or offer advice. They typically execute buy and sell orders that originate from their customers. They may be compensated by either commissions or receive a salary.

G. Portfolio Managers

Professionals responsible for the securities portfolio of an individual or institutional investor, such as a mutual fund, pension fund, profit-sharing plan, bank trust department, or insurance company. In return for a fee, the manager has the fiduciary responsibility to manage the assets prudently and choose which asset types are most appropriate over time.

Those managing mutual or pension funds often manage hundreds of millions or even billions of dollars. They are typically responsible to the firm they are employed by rather than the investors. Their compensation is typically closely linked to the performance of the fund. These funds can range from general investment funds such as Fidelity's Magellan Fund to specialized funds such as social responsibility funds, technology funds or international funds.

H. Individual Investors

These are individual owners of a financial asset who typically invest on their own behalf. While an overwhelming proportion of Americans currently own stock or other financial equities, most of these assets are invested in pension funds such as 401(k) plans that offer limited discretion in making investment decisions.

The more traditional individual investors are those that make self-directed investments, albeit often with the input and advice of analysts and registered representatives. These investors typically fall into two categories:

- Those who invest in *individual shares*. These are often those with a high net worth.
- Those who invest in *mutual funds*. This constitutes the vast majority of "middle-class" investors.

Other types of individual investors include those who invest in commodities, futures and other speculative investments as well as "day-traders." "Day-traders" are often professional investors who manage their own portfolios and move in and out of stock positions usually on minimal movement in stock price.

III. How Investor Relations Work

A. Targeting Institutional Investors

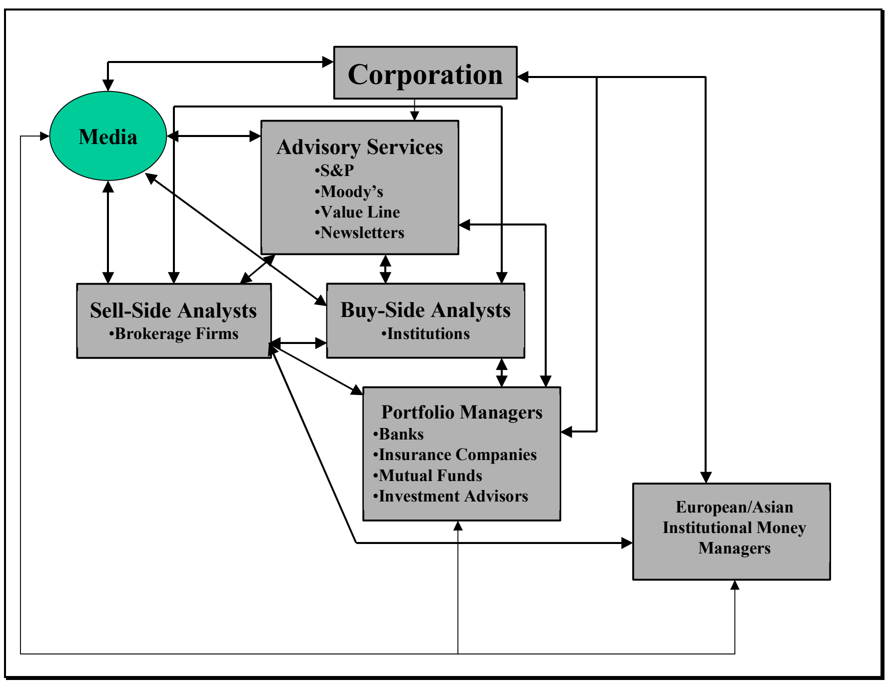
Institutional investors own most of the stock in major public companies and, therefore, are prime targets for investor relations communications, for both compliance and marketing reasons. A prototypical way of communicating with institutional investors follows:

- The most fundamental investor relations tactic is communicating with sell-side or brokerage firm analysts. The process is straightforward. Analysts in major firms cover specific industries and companies. It is easy to identify which analysts follow your industry and, therefore, should be following your company. These analysts make research recommendations to their institutional clients.
- The second step in many investor relations programs is to ensure that the company is being covered in the major advisory services, since these are often used by portfolio managers and buy-side analysts as reference tools for early screening of potential investments.

- However, research has consistently shown that the communications link between sell-side analysts and institutions is very inefficient. Analysts are paid to know about the relatively limited number of companies they cover. Portfolio managers usually have broader purview. Accordingly, investor relations executives, who have the resources to mount more sophisticated programs, develop communications to institutions both to buy-side analysts and even direct communications to portfolio managers.

The communications strategies used can range from broad mailings to highly sophisticated campaigns targeted to institutions with investment objectives or styles best suited to the characteristics of a particular public company. These campaigns can include "road shows" where senior executives meet with analysts individually or in groups as well as corporate advertising campaigns to introduce the company to institutional investors, as well as other key constituencies outside the investment community.

Institutional Investor Communications

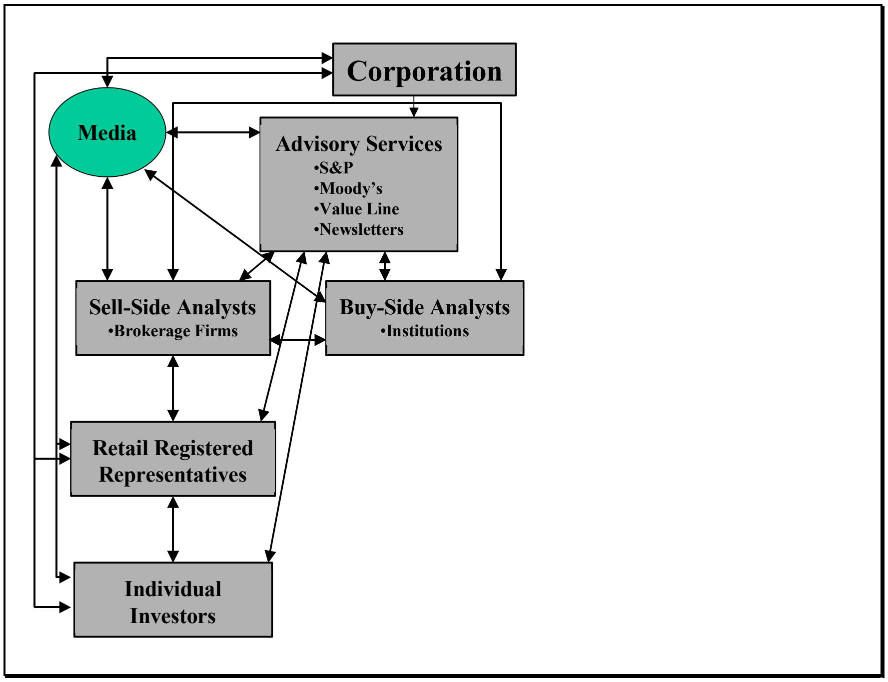


B. Targeting Individual Investors

Few public companies have specific campaigns to market their stocks to individual investors. Most investors prefer mutual funds to direct investment in stock. Furthermore, individual investors have relatively little impact on markets or stocks because of the concentration of capital in a relatively few institutions. However, individual investors are attractive to some companies because they tend to buy stocks and hold them. Institutions are much quicker to sell stocks than individuals (*day traders excepted*).

Because of this structure, communications to individual investors can often be more complex than communication with institutions since both groups need to be included in this process in order to be effective.

Individual Investor Communications



To reach individual investors, the basics still apply: reaching sell-side analysts and making sure the company is covered in key advisory services. Other tactics include:

- Direct mail to brokers in firms where analysts have written positive reports about the company
- Marketing to investment clubs
- Corporate advertising.

IV. Measurement and Evaluation

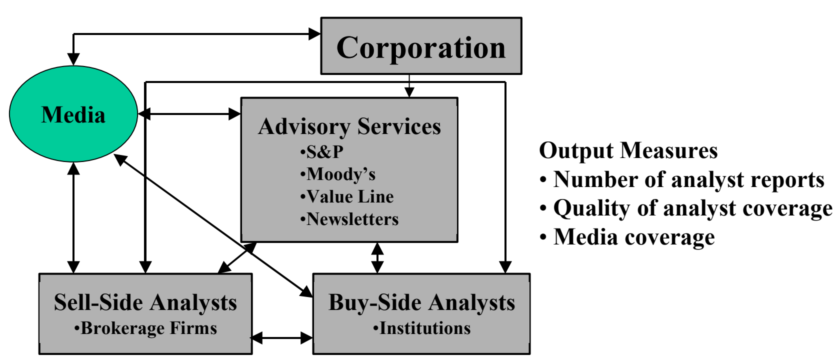
The behavioral measures of progress in the investor relations arena typically fall into one of two major categories – *either outputs or outcomes.*

Outputs are the result of communications program. In investor relations this can include any of the following types of measures that directly represent the short-term implementation of communications activities.

- Number of analyst reports written about the company – *a clear and objective indication of progress in courting sell-side analysts.*
- Quality of analyst coverage – *this can be measured by who is writing the reports (top analysts in top firms or fringe players) and what is being said (buy recommendations or something less positive).*
- Media coverage – *quantity, quality and favorability in how the company is covered in media most influential to the investment community.*

These output measures generally only take into consideration those communications activities among a select group of targets for a company's messages: the media and analysts who report on and cover specific companies. By themselves, these groups can influence stock price and their opinions are critical in the buy or sell decision.

Output Measures

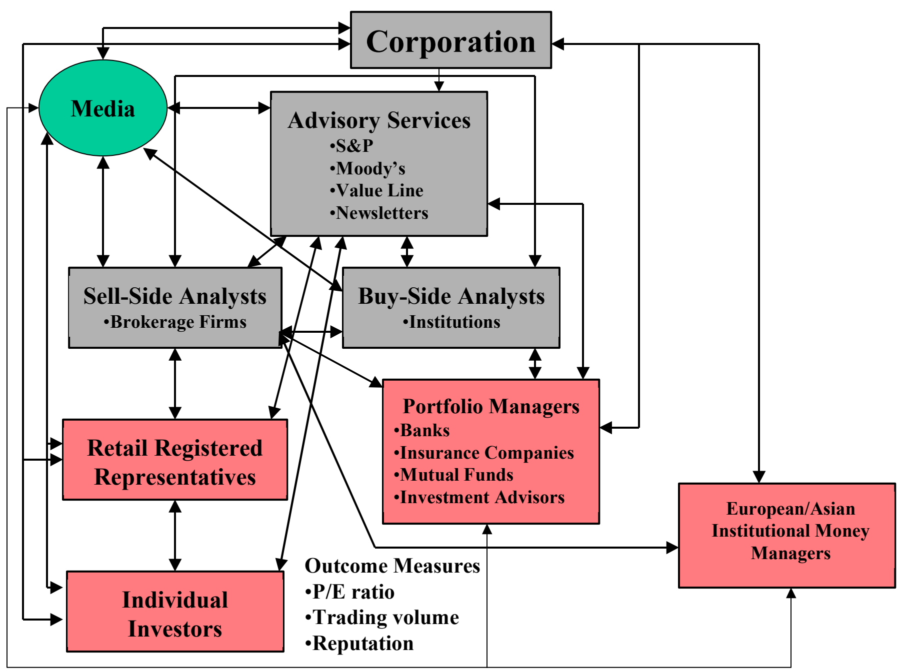


However, for investor relations, it is outcomes that are the critical standard for measuring and evaluating success. **The one bottom line measurement for the investor relations executive is achieving a fair market value for the stock.** Few communications functions have such a readily available – and public – measurement standard. It is an outcome that is tangible and traceable.

While fair market value is the most basic and fundamental outcome of investor relations, there are other outcomes that can be evaluated in light of an investor relations program. These outcomes include:

- P/E ratio in comparison to peer companies – *is the company selling at a premium or is selling at parity to its peers?*
- Trading volume – *though this is a two-edged sword. Neither very low nor very high trading volume is necessarily good.*
- Specific corporate reputation measures that have been developed and promoted by the business media *(e.g., Fortune's "America's Most Admired Corporations")*

Outcome Measures



These measures are a direct result of the actions taken by investors – *institutional as well as individual* – based on the outputs produced by the media and analysts.

An additional outcome measure is survey research that can used to measure how successful investor relations efforts have been. Surveys typically focus on securities analysts, portfolio managers, stockbrokers, individual investors and the financial media. Such surveys ask detailed questions about the company:

- Awareness of the company and/or its securities
- Specific knowledge of the company
- Evaluations overall and specific to company attributes
- Currently holding or recommending stock
- Likelihood to hold or recommend stock.

These surveys can include custom research that is used exclusively within a corporation as well as syndicated research that is sold to many companies offers extensive comparative data between corporations overall as well as among peer groups of companies.

Surveys also provide diagnostic insight for investor relations executives. With survey data in hand, these executives can answer key questions. For example:

- Should there be more awareness building?
- Are key facts about the company known?
- Are there important weaknesses to be addressed? What are they? Among whom do they exist?
- Is the stock vulnerable? Will current holders continue to hold? Will current recommenders continue to recommend?
- Are there upside opportunities for the stock? Among whom?

Finally, investor relations executives can keep their fingers on the investment community pulse by monitoring media stories about the company. There are several sources that provide everything from clips (from selected publications) to sophisticated content analysis and company coverage across all media.