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Plea for Strategic IR

The IRO role—mouthpiece or strategic advisor?

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THE IRO ROLE—MOUTHPIECE OR STRATEGIC ADVISOR?

An increasingly complex global capital markets environment and the growing willingness of institutional shareholders to become active, if not activist, investors have amplified demands on how companies interact with shareholders, and put significant pressure on IR teams. Today more than ever, making full use of the IR role means deploying it as a strategic asset that gauges market sentiment and helps Board members to decide, market and—where necessary—defend corporate actions and strategy. For many listed companies, this means upgrading the IR role by adding strategic responsibilities, hiring or developing strategic thinkers into their IR teams, and rethinking organisational structures and reporting lines. Importantly, a highly effective and strategic IR capability frees up management time and creates greater reach for the CEO and CFO.

TWO-WAY COMMUNICATIONS

Investor Relations has been a discrete function for some 50 years in the US and for about 30 years in Europe. Corporate Communications was traditionally one-way communication with the media and the same was initially the case with many IR teams. Even today with the rapid growth in social media channels, many listed companies evidently continue to feel most comfortable with the tradition of one-way traffic, outbound only. This narrow focus ignores an extremely important second aspect to the IR role: the participation in, and constant analysis of, the debate that the market conducts about the company. The ebb and flow of this debate can radically increase or limit a company's strategic options, and therefore should inform the way the company communicates. Ultimately, the quality of communication and engagement influences valuation.

CHICKEN AND EGG

Many Board members agree with this line of reasoning in principle, but argue that while they would be quite willing to give the Investor Relations Officer (IRO) the leeway to conduct an active, strategic dialogue with the market and to offer his or her opinions at Board level, they do not believe that their IROs have the breadth of experience to warrant a seat at the top table in their own right. And many IROs are perceived to lack the wherewithal and the confidence to operate at that altitude. At the same time, ironically, many IROs voice their frustration, in separate conversations of course, at being reduced to mouthpieces as they are denied the opportunity to engage internally in shaping the message; nor do they contribute to forming strategy.

So either the Board, despite assurances, isn't truly willing to give otherwise perfectly capable IROs the benefit of the doubt, or individuals with insufficient strategic skills, or perhaps communications skills, are occupying the IR role. A classic chicken-and-egg situation: the right people have to be in place if the full range of IR services is to be delivered, but they will not be attracted to the role if they are not given a sufficiently wide, strategic brief.

REPORTING LINES

The first step is to consider the internal organisational set-up of the IR team. Today, most Heads of Communications report to the CEO and, typically, Heads of IR report to the CFO. (A few notable exceptions report to the CEO—usually to good effect). This traditional arrangement leaves one of the communications mantras, corporate one-voice-policy, exposed to the quality of the relationship

between CEO and CFO, and to the ability and willingness of the Heads of Communications and IR to cooperate and coordinate. An IR reporting line into the CFO also signals, prima facie, that the role sits firmly within the finance function but does not necessarily carry strategic responsibilities. Having said this, we generally feel comfortable with the Head of IR reporting into the CFO. Nonetheless, to address the risk of mixed messages to the market, including about the importance of IR, we envisage at least two potential options:

Firstly, an expanded remit for IR and a seat on the Executive Committee. We also see examples of IR reporting directly to the CEO, for example both BASF and Volkswagen have worked with this structure. At Commerzbank, the Head of IR sits on the Executive Committee.

Secondly, we also see some IR Directors taking over the broader Communications role while retaining their IR responsibility, for example Wolseley plc and Experian plc in the UK. This second option is that of a strategic communications "superhead", who typically sits on the Executive Committee and embraces IR within a full range of communications activities.

The "superhead" role should ideally report to the CEO with a strong dotted line to the CFO. This is the case at Rheinmetall AG in Düsseldorf, for instance. The risk with this structure is that IR becomes too far removed from the decision-making body. However, we recognise that, driven by digital advances, the interaction between all communications disciplines has to become much closer and more collegiate. Moreover, because clearly such a "superhead" could not personally engage directly with all stakeholder groups, he or she would have to adopt a coordinating background role for the various functions, taking on frontline duties only in his or her field of expertise. Beyond that, the individual would have a strong incentive to attract and recruit, and/or develop, suitable individuals to report to him or her for the other communications disciplines. Well executed, this set-up would ensure one voice, but it would also achieve a direct financial goal: the communications superhead would have one single budget to allocate across the entire communications remit. This may well serve to recalibrate what we consider to be currently a budgetary imbalance in favour of Communications and to the detriment of IR which, after all, looks after the group of stakeholders that ultimately own the company and control its strategic direction: i.e. the shareholders.

LOOKING MANAGEMENT IN THE EYE

Regardless of the IR reporting line, it is understandable that investors want to speak to the decision-makers in target companies: the CEO and the CFO. Investors are also increasingly building relationships with the Chairman and Non-Executive Directors / Supervisory Board Members. This is entirely understandable given that it is ultimately the Board which takes the strategic, value-enhancing or destroying decisions for the company. However, this in no way diminishes the role of IR: there is a wealth of day-to-day interaction which wise investors prefer to have with a well-informed IRO. And when the IRO also has deep knowledge of the company and understanding of the sector and the environment, it is eminently possible for the IRO to maintain a strategic dialogue with the buy side. This does not undermine the critical role of the CEO or CFO, but certainly facilitates a much better use of their time and ensures that investors are well prepared in advance of management discussions.

CNC Communications & Network Consulting recently conducted a global study of investor and sell-side views involving over 500 interviews split evenly between Europe, the US and Asia. The increasing importance of high-quality IR to the global investor community was one of the features of the results. Exactly half of investors said that a dedicated and—crucially—well informed IR function had become more important in allowing them to understand a company's equity story over the past few years, a view echoed by two-thirds of sell-side respondents. Furthermore, 86 % of investors believe that the quality of a company's investor communications is an important driver of valuation for any company.

SHAREHOLDER ACTIVISM

Shareholder activism is no longer just a phenomenon we see across the other side of the Atlantic. Activist assets under management were recently estimated to be in the region of $120bn by The Economist/Hedge Fund Research February 2015. A not insubstantial portion is available for investment in European companies. Activism around governance in the UK has certainly picked up, in particular regarding Executive remuneration and Board composition, for example. Many observers expect this phenomenon to establish itself imminently and fully in Continental Europe.

Strategic IR very much comes into its own when confronted with aggressive investor activity: a compelling, long-term equity story offering unequivocal strategic direction and showing a clear trajectory for continuous value generation is the best antidote to activists' frequently short-term profit agenda.

Given the growing activist focus on governance in Europe, we are surprised to see some IR Directors, particularly in the UK, walk away from difficult strategic and governance topics such as senior executive pay. In many companies, we see IR ceding ground to the Company Secretary, for example. There is a very real danger of poorly co-ordinated communication between the company and its shareholders and some of the disagreements on executive pay have almost certainly been exacerbated by lack of alignment internally. We consider it ill-advised for IR to stand back from this thorny topic. In Continental Europe, with its different governance structures, we typically find the IR Director out of necessity being much more hands-on regarding governance issues, including, for example, remuneration and the thorny topic of CEO succession to the role of Chairman of the Supervisory Board.

THE STRATEGIC IRO—THE IDEAL PROFILE

Quite clearly, structures are dependent on people and the calibre of the individual in the IR role is of paramount importance. If he or she does an excellent job, the demands on senior management time will be reduced. If the IRO is not seen to be up to the job or close enough to the strategic and decision-making hub of the organisation, senior management can expect that their phones will continue to ring. This is the challenge and the opportunity for the Board when hiring or promoting into this position. So what is the ideal profile for strategic IR?

There is no silver bullet, no perfect profile. The optimal IR capability is company dependent and determined by market capitalisation and freefloat, capital structure and shareholder composition, geographic footprint and stakeholder make-up. An effective IR team is one that helps to deliver the company's strategic goals by creating strategic freedom to act for the Board. More often than not, delivering strategic IR is complex and typically a team effort.

COMBINING A RARE SET OF SKILLS

IR is an unusual function. It combines heavy-duty, highly technical valuation skills with compelling storytelling abilities. More recently, a working knowledge of social media has also been added to the mix. It is indeed rare to find individuals who excel at these very distinctive skills. Thus most IR functions, certainly for larger companies, are a composite.

In Continental Europe, particularly Germany, we find larger teams and larger budgets, albeit considerably smaller than the Communications budgets. Equally, we frequently find a more structured, sometimes even a strategic, approach to IR. This extends to a clear sense of the roles and responsibilities within the IR team with distinct skill sets, for example team members focusing on key clients of IR including institutional buy- and sell-side, often with a geographic split; retail investors; debt investors; CSR and more recently digital.

In the UK, the IR team is typically smaller, quite often comprising a Head of IR with access to a PA or perhaps an analyst. Traditionally in the UK, the corporate broker has effectively provided an extended work bench for the IR team. Since the financial crisis, however, there has been some evidence of withdrawal of the corporate broking resource. Indeed in response, the in-house IR function is beginning to pick up where the broker left off. In addition to the core valuation and communication skills, we are seeing much greater attention being paid to softer skills which include the ability to influence; a proactive targeting capability; and a strong grasp of how digital can support the IR function.

In summary, we see the following characteristics as providing the basis for strategic IR:

- **Heavy-duty valuation skills**

  As the IR remit becomes more global, we have seen increased demand for technical and valuation skills in the IR function. Good IR ensures that investors have the information they need to value the company. It therefore tends to reduce the valuation gap between the company and the market, and also irons out volatility caused by clumsy guidance. Indeed expectations management is core to the IR role. This includes soft skills but importantly also necessitates a robust understanding of how investors go about the process of valuing a stock and a company. This will clearly shape disclosure.

  If the IRO has a strong financial background, we frequently see the IR role combined with corporate development, particularly in companies with an affinity towards strategic acquisitions or divestments. Having IR closely involved in these transactions lends additional credibility to the strategic significance of the IR role.

For Private Equity investors looking to bring a company to market, the IR role is regarded as being important in an IPO and we find PE investors are taking a keen interest in the calibre of the IR professional filling that role. Here, we typically see a keen expectation with regard to valuation skills, as well as a preference for in-house, hands-on IR experience.

- **The story-teller**

  One of the key IR responsibilities is crafting and developing an equity story that resonates and compels. The ability to quickly absorb and process new data, distil and make sense of a complex set of circumstances is a pre-requisite. More importantly, a highly articulate, strategically astute professional is required to translate raw information into an equity story and to identify the 'hooks' to the investment community. For companies with multinational operations, performance is often affected by both macro- and micro-economic factors. A high-performing IR team needs to be on the front foot and highly attuned to the sensibilities of both the buy- and sell-side audience. Shaping the narrative is a critical element of the IR role.

- **Influencing inwards and outwards**

  We see most IROs demonstrating a strong ability to communicate externally spending time 'on the road' and building strong relationships within the investment community. Not all, however, are as diligent at demonstrating their strategic value internally by conveying valuable market feedback back into the organization; the two-way street mentioned earlier. A successful IRO absolutely needs to hone internal influencing skills; the ability to shape opinions both internally and externally is critical in a matrix organization with multiple stakeholders. From being the spokesperson for the company, to playing a supporting role for the management team; from coordinating amongst peers in other departments to gathering information, to feeding back difficult and challenging messages straight to the Board, IR requires maturity and judgment, as well as conviction in the value the role delivers.

- **Nature or nurture?**

  All this begs the question what is the route into IR? Over the years, it has been typical for sell-side analysts in particular to cross the fence and become IROs. After all, the sell-side analyst has a firm grasp of valuation and typically a deep sector understanding. Also they are used to marketing as it has become a much larger part of what the sell-side analyst does. Interestingly, however, as IR has become a more mature profession, we have also seen a number of companies insisting on prior in-house IR experience. Part of the reason for this is that not every investment banker transitions well into a corporate environment. As mentioned, the ability to influence internally is critically important to strategic IR and a seasoned corporate executive may well be better at this than a more narrowly focused analyst.

  Very few start their career in IR and we certainly see the benefit of prior experience. There is no one route into the profession and the best IR teams will be diverse in terms of experience and career trajectory.

CONCLUSION

We are firm believers in what IR as a profession can deliver. We also agree that many IR teams do not yet have the seat at the top table that is needed in order to make a strategic contribution which ultimately flows through to valuation. If IR is to occupy this strategic position the Board, colleagues and investors must be won over. The first step for IR is to be confident and articulate about the value that the function can deliver. The next step is embedding strategic IR within the organisation. Here Board-level buy in is crucial.

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ABOUT CNC – COMMUNICATIONS & NETWORK CONSULTING

CNC is an experienced international strategic consultancy which helps clients solve business problems through communications. When Communication Matters, companies, institutions and individuals use CNC's unrivalled expertise to advise on communications affecting decisions, valuation, and change and reputation. We work in corporate and financial communications, public affairs, crisis support and change management, underpinned by a strong understanding of the rapidly evolving digital media environment. CNC has 11 offices in eight countries worldwide.

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Fidelio operates internationally from London and its talented, highly qualified in-house research capability includes fluent Mandarin, Cantonese, German, Italian and Spanish speakers.

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