A board's template to evaluate the IRO

Don't be blindsided by issues raised in the investment community. Do a check-up on the capability of your investor relations function. **By Louis M. Thompson Jr.**

Take a look at what could well result in the "perfect storm" for director elections in 2008: the convergence of potential SEC proxy rule changes with the elimination of the 10-day broker voting rule; majority voting; proxy access for nominating directors; increasing activism among pension, mutual, and hedge funds along with "empty voting"; and increased empowerment of individual investors in proxy voting.

Today, more than any other time in recent memory, corporate directors must have confidence that they are being given the best, most accurate information to perform their duties and avoid losing their board seat in the 2008 election.

Many directors have not received the full benefit from feedback provided by the corporate investor relations officer (IRO), who is on the front line communicating daily with the company's investors and analysts. This gives the IRO a unique perspective that should be shared with directors so they are not blindsided by surprises that could come from the investment community.

An activist hedge fund manager's request for a meeting with directors to challenge the company's strategy can be very unsettling — particularly if that fund has borrowed a significant number of shares to be used in a process called "empty voting" that could potentially influence the outcome of a director's election or shareholder proxy issue. (Empty voting is emerging as a tool whereby activist funds borrow a company's shares from a pension fund or brokerage firm for a fee, ahead of a company's record date, in order to gain the voting rights of those shares.)

So, what should board members expect from the IRO? Candor, credibility, and transparency are key factors, the same as the Street expects from the IRO. A majority of S&P 500 companies are receiving written reports from the investor relations officer, but far fewer invite the IRO into the boardroom for a face-to-face briefing where strategic issues can be discussed. In such a setting, board members can ask questions to satisfy themselves that they are getting the straight story and an understanding of what key investors and analysts are thinking and saying about the company.

Here is a template that directors can use to evaluate whether they are getting the kind of information and assistance they need from investor relations.

What is crucial for today's board of directors is having an IRO who is empowered to communicate with analysts/investors at a strategic level. If not, that person will be unable to obtain the quality of information from the Street that board members must have. While CEOs and CFOs should meet periodically with the investment community, their primary focus should be on running the company. Therefore, it is essential that the IRO be of the caliber to have "a seat at senior management's table" so analysts and investors are confident that they are dealing with someone who can truly speak for the company and is not merely a "gatekeeper" whose role is to protect the CEO's and CFO's

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Are We Getting?

It is a fairly common practice for the IRO to provide a written report for the board book consisting of least the following information:

☑ Yes	☑ No	☑ Could be better	
❏	❏	❏	A brief executive summary of major events in the market and in the company's industry sector that have occurred over the past quarter.
❏	❏	❏	Significant changes in shareholder composition and short position.
❏	❏	❏	Conferences and meetings with analysts and investors that senior executives have participated in during the quarter.
❏	❏	❏	A summary of all analyst reports issued during the quarter.
❏	❏	❏	A comparable chart of quarterly stock price performance vs. indices such as Dow Jones, NYSE, or Nasdaq.
❏	❏	❏	A chart on quarterly stock price performance vs. selected peers.
❏	❏	❏	A list of top shareholders.
❏	❏	❏	U.S. vs. foreign shareholder composition.
❏	❏	❏	Other information related to stock performance that is deemed important.

It should be assumed that directors would read or review the written report prior to the board meeting, so the IRO should not repeat this information during his/her presentation to the board. Instead, the discussion should be devoted to strategic issues.

Are We Discussing?

The most valuable information that the IRO can provide is through a face-to-face exchange in the boardroom. That information should be strategic, much of which is non-financial in nature. Of utmost importance are "red flags" that the board should be aware of that could put the company in a reactive or crisis mode. Much of this information may be perceptual, but perceptions have a way of becoming reality. Here are areas for board discussion with the IRO:

☑ Yes	☑ No	☑ Could be better	
❏	❏	❏	What are the investors' perceptions of the company's strategy and quality of management as well as the company's corporate governance and disclosure practices?
❏	❏	❏	What is the market's perception of the company's earnings guidance and how does this affect the analysts' estimates?
❏	❏	❏	What are the results from third-party perception surveys related to management presentations before investor meetings or conferences, and do investors understand and accept the company's strategy as presented in these forums?
❏	❏	❏	Are we insisting that the company hire a third party to conduct periodic investor/analyst perception surveys? (These provide valuable feedback and can raise "red flags" that boards may need to deal with.)
❏	❏	❏	In bringing third-party feedback reports to the board, are we avoiding "killing the messenger" if the reports contain bad news or other forms of negative information?
❏	❏	❏	How is the company being valued — at a premium, at a discount to peers, at market value, or other comparison?
❏	❏	❏	Who is buying or selling the company's stock and why?
❏	❏	❏	Does the company have the optimum shareholder mix and, if not, what is being done to change it?
❏	❏	❏	Among the major investors, who are the long-term or short-term holders and what is the level of hedge-fund activity, recognizing that the latter are not homogeneous in their intent as shareholders?
❏	❏	❏	What is the nature of shareholders in the mix — e.g., value, growth, or momentum?
❏	❏	❏	From the investors' perspective, what are the underperforming assets that fund activists might use to suggest to the board the need for a change in corporate strategy?
❏	❏	❏	How is the company communicating the "shareholder value proposition" to the investment community? • What are the key talking points used in communicating strategy? • How is the company communicating non-financial factors such as quality of management, products, services, brand, and new product development that in S&P 500 companies often represent more than 50 percent of their market value? • Where is growth coming from — acquisitions or organic means?

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time commitment.

Where you make the checkmarks on the following template may indicate whether you have the right IR person and the right IR capabilities.

Other IRO Assistance?

There are other areas where the investor relations officer can assist the board:

☑ Yes ☑ No ☑ Could be better

❏ ❏ ❏ The board should periodically review the company's earnings guidance policy — whether to provide earnings guidance or not, and, if so, should it be quarterly or annualized guidance with quarterly updates. A majority of companies still view earnings guidance as an important means of communicating with the investment community and managing expectations. But a growing number of publicly held corporations view earnings guidance as a means for feeding the sell-side's insatiable appetite for short-term performance measures to the detriment of the company's long-term value creation.

❏ ❏ ❏ The IRO and the general counsel, along with outside investor relations and legal counsel, should develop guidelines for investor access to the board of directors. Companies are required to publicly inform investors how they can communicate with the board, but this does not mean that all investors are equal in terms of meeting with the board. Based on these guidelines, the IRO can recommend with whom the board or an appropriate board committee should meet. It is important to remember that listening to investors gives them access, yet the board need not accept what they want or demand. Shutting the door on a vocal, activist fund manager can send the wrong message publicly.

❏ ❏ ❏ The IRO, corporate secretary, and general counsel should have their antennae raised for potential shareholder resolutions, given that issues such as "say-on-pay" and majority voting in director elections are increasingly receiving a majority vote even though they are non-binding. It behooves a company to be proactive with investors who intend to offer shareholder resolutions, to discuss their concerns and determine if there are grounds for compromise before they become a proxy issue.

❏ ❏ ❏ Boards should understand that many of the institutional investors subscribe to the proxy advisory services to vote their proxies according to the advisory firms' blanket guidelines on particular issues. Unfortunately, many of the institutional funds do not review the advisory firm's proxy votes on a case-by-case basis and rely on the adviser's discretion instead of taking into consideration a company's performance and governance principles. Therefore, meeting with the proxy advisory services, particularly ISS, to point out why your company may be different can sometimes be useful. ISS charges a fee for these meetings in addition to charging their client firms for their advice (which strikes many as a conflict of interest).

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