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Are You my Investor?

Institutional investors come in all shapes and sizes. Here's the nutshell of what every roadie needs to know.

Introduction

Many of our stakeholders ask us what we do when we travel around the world. Inevitably we answer: "We meet the buy-side." At IPO, when the vast, white expanse of the world's financial hubs is their oyster, our clients often ponder: are all institutional investors created equal, or are some more equal than others? What do I need to know about the universe I'm meeting for the first time?

The great majority of IROs state the following **top 5 objectives** for their company's IR programme:

1. Ensure effective disclosure
2. Coordinate the IR message with the company's PR efforts

3. Ensure management visibility and accessibility in the markets
4. Monitor and diversify the shareholder base
5. Be part of strategic decision making

Notice 3 out of the top 5 objectives pertain to knowing and relating well to the investors. This White Paper, produced by Mediatree's knowledge management initiative thinktank, aims to shed some basic light on the complex ecosystem of 'the *buy-side*' and spell out some of its key characteristics.

1. Geographic dispersion of the *buy-side*: the why and where of roadshow travel

Roadshows are the primary way in which the IR team and a senior management stay in front of the investor community. There are two types of international roadshows: deal-related and non-deal related. Deal-related roadshows usually happen in the course of an IPO, an SPO (Secondary Public Offering), Rights Issue, Debt Raising and also sometimes Bond issuance and/or even M&A transaction.

There are two ways corporates approach it, and both are important: they either visit people they know and who already hold the company stock; or they decide to widen the net and embark on a 'missionary' roadshow, in order to conquer new horizons and generate a new pool of interest. Regular missionary roadshows are important, especially when markets or the business activity evolve. In some cases, even geo-political considerations can trigger a missionary approach. This was the case for example with Russian companies in 2014 after the sanctions imposed from the West because of the Kremlin's annexation of Crimea in Ukraine. Russian company IROs started heading East (Hong Kong and China) to explore whether they could create a buy-side community around their stocks.

Still, travelling far and often is an important part of building traction with the market. The BNY Mellon 2017 Report on "Global Trends in Investor Relations (11th edition)" summarises some of the most recent trends concerning roadshows. The information is based on responses from investor relations officers from 537 companies in 51 countries in a global survey conducted in 2017.

Below are some key findings for 2017:

Goals for the IR function/programme for the next 12 months

Key trend: IROs are shifting their focus to targeting

	2013	2015	2017
Expand or enhance engagement with existing shareholders	54%	46%	61%
Diversify shareholder base	36%	33%	47%
Increase international shareholder ownership	45%	37%	24%
Increase domestic shareholder ownership	21%	18%	8%

IR Magazine and Bank of America Merrill Lynch published the following on global roadshows in 2015:

	Asian Companies	European Companies	US Companies
% who go on the road	85%	92%	89%
Number of roadshows/annum	7.2	13.0	6.7
Number of days on road	15.9 days per annum	22.1 days	13.9 days

- The large cap companies surveyed do on average 11 roadshows per year and spend 23.8 days on the road
- The gap has widened between small-cap companies (77 percent) and larger companies (94 percent-95 percent) when it comes to going on the road. This represents a gap of 17-18 percentage points, as opposed to 10-11 percentage points in 2014

- IROs are relying on sell-side more for investor targeting- many of them are saying today that this will not change with MiFID II, but the first 3-6 months in 2018 will see emerging some new trends
- The tier 1 cities in Mainland China, like Shanghai and Beijing, are notable in their absence from the top 20, suggesting that outside Hong Kong the country is still not a major roadshow destination for global companies.

Top-20 frequently-visited cities for roadshows

Ranking 2015	City	% of mentions	Avge days spent in city
1	New York	83.1	3.2
2	Boston	72.2	3.2
3	London	70.8	1.7
4	Chicago	47.4	0.8
5	San Francisco	45.0	0.7
6	Frankfurt	40.6	0.8
7	Toronto	38.6	0.6
8	Paris	37.8	0.6
9	Los Angeles	37.2	0.5
10	Edinburgh	32.1	0.5
11	Zurich	29.5	1.0
12	Geneva	27.4	0.4
13	Amsterdam	24.9	0.4
14	Montreal	24.0	0.9
15	Singapore	23.2	1.2
16	Hong Kong	21.6	0.4
17	Baltimore	21.1	0.3
18	Stockholm	20.8	0.3
19	Philadelphia	20.7	0.2
20	Denver	20.4	0.2

2. Investor targeting: the who of roadshow travel

Shareholder identification is something that IROs require on a regular basis. Most IR teams have extensive databases, which are proprietary and which they run themselves to keep an accurate register of the company's key institutional shareholders. Often it is thought that company IR teams rely on brokers to identify and target investors to visit, but actually, many companies have their own understanding of the community and who they want to see. With the advent of MiFID II, it is likely that IROs will develop their targeting muscle even more, likely supported by independent agencies like Mediatree.

Often the aim for the corporate is to be building a balanced portfolio of shareholders

- by investment style (active fund managers who pursue Capital Growth, Income, Special Situations, Social Responsibility, including long funds, pension funds, insurance funds, hedge funds)

- by geographic location

A few angles for IROs to consider when doing their targeting:

Peer group analysis is examining the shareholdings of companies in a peer group or sector and being able to identify differences and get ideas for your own investor base.

Fund weighting analysis comparing funds holdings in other stocks and calculating whether they are holding more or less than their average for your sector (over or underweight) in the company stock. Target underweight investors to buy and stay in touch with overweight investors so they don't sell.

Analysis of investment style is targeting the funds which are investing in companies that fit the company's earnings and growth profiles.

Types of Equity Institutional investors

Equity investors own the shares of a company. Their primary objective is to earn a return on their investment. Returns are measured in two ways: yield or dividends (this is the income the investor receives while owning the investment) and capital growth (this is the share price evolution and the value is realised only upon sale of the shares). There are two types of investors: institutional and retail (private investors). Our focus here is on institutional investors, as they are the focus of the IR Team's efforts.

The main institutional investors are:

Pension funds

Pension funds are a key source of funds in the financial markets. The impact on the equity market will be measured by the asset allocation between equities and bonds.

What is important to look at is: how are these pensions funded? By private funds, or by the state? Is there actually a fund, or are the pensions paid out of current taxation and contributions? Different countries have different traditions. There is a strong tradition of pension funds in the USA, the UK, the Netherlands, Switzerland and Japan, where money is invested from either private pension funds or employers' pension schemes. In Germany, the company pension funds are important, but the investment is determined by the company itself–the amounts are available for the general purposes of the company and payments made from corporate funds. In France, for example, the state pension pays out of current taxation, not from a fund.

Insurance companies

Insurance companies either deal with Life assurance and long-term business (savings business) or general insurance (providing cover). Many life assurance companies provide pensions as well as life assurance. They have also expanded into investment management groups which offer unit trusts and other financial services.

Unit trusts and mutual funds and investment companies

These are collective investments run by fund managers, with the purpose of spreading the risk to the investor. They will typically have investments in Bonds, stocks, money market instruments or financial futures.

Funds are either open-ended (the investor can buy units in the fund, increasing the value of the fund, eg Mutual Funds) or close-ended (investors buy shares of the fund and there are limited number of shares in issue at any one time, eg Investment Trusts).

Hedge funds

A hedge fund is a type of investment fund that has the following characteristics:

- Active management
- Partnership in which investors are either shareholders or limited partners
- Structured to be tax-efficient
- Fee structure designed to align the managers of the fund and the shareholders (profit share, incentive fee…)
- Use of hedging techniques such as shorting
- Use of leverage or gearing
- Absolute return rather than market outperformance

The key attraction as shareholders is that they provide a good degree of liquidity, which is an important and key feature of a stock.

Sovereign Wealth funds and Family Offices

The biggest trend in shareholder development in the past 2-3 years, especially for Asian stocks, is the approach to SWFs for 'core shareholdings', also called 'cornerstone investment'.

SWFs are government investment vehicles funded by foreign exchange assets, which manage those assets separately from official reserves. The funds managed by SWFs are huge, exceeding the assets managed by hedge funds and private equity funds. In the same way large family offices can provide a very solid platform for the stock.

Retail investors

Retail investors are communicated to in a parallel, but separate channel from institutional investors. Some fund managers only manage funds from private clients. Depending on the countries, retail shareholders play a more or less important role in the companies' capital structure.

3. How investors look at it

Investment styles

The two fundamental styles of investment are active investment, where the fund manager seeks to outperform the index by selecting specific stocks that show better growth, or passive investment, which is aimed to perform in line with the market and track an index.

Different styles of investment include:

Growth funds: a mutual fund whose aim is to achieve capital appreciation by investing in growth shares. Here the total capital appreciation is more important than the dividend flow.

Value funds: a mutual fund that invests in companies which it determines to be underpriced by fundamental measures. The fund manager identifies the opportunity to buy before the upturn in price when the stock is looking undervalued. The stocks selected tend to be 'safe', so showing a good balance between capital appreciation and dividend payout. Usually these will be companies with low P/E ratios.

Quant funds: these funds are run purely by a series of computer models or algorithms. The rationale here is that the market shows inefficiencies and the models will identify these and enable some profitable trading opportunities. The fund managers create screening processes to identify a pool of stocks to invest in. For IROs dealing with quant funds, it is essential to provide timely and accurate market information—data feeds provided directly from source documents are important to update the algorithms.

GARP - Growth at a reasonable price: these funds have a hybrid method of investing. They will typically look for undervalued assets with growth prospects.

Socially responsible funds: certain funds have an investment strategy which seeks to consider both financial return and social good to bring about a social change

Momentum investing: Momentum is the perceived strength behind a price movement—some traders believe the stocks trade up or down due to the momentum of the market pushing the price up or down. This is a short-term investment type which is very technical and based on market timing.

Trends in investment management and recent capital markets developments

IROs struggle to keep track of their company's share ownership because many investors have ways to take an economic interest in the company without appearing on the register.

Growth in Derivatives: in recent years the growth in the derivatives market has blurred the ownership structure of shares. Derivatives include: futures and forwards contracts, options, swaps. These instruments have become very popular because they enable fund managers to hedge their positions and protect the returns of their portfolios.

The latest research shows that most IROs believe short selling has negatively impacted equity trading. A significant of companies also view high-frequency trading, dark pools and hedge funds as having a negative impact. However, it is important to have major hedge funds involved in the shareholding base, because they often provide an important element of liquidity and 'smart trading' which has value. These 'technical' developments of trading have meant that volatility on a given stock is much greater nowadays, that there is an increased likelihood of 'flash crashes' and that there is less transparency in the ownership structure. On the plus side, these developments have enhanced the efficiency of the markets–which means the IR communication needs to keep up with it!

Other stakeholders

Debt investors

Traditionally, the Treasury team in a company communicated with the debt investors and the IRO spoke to the equity investors and other stakeholders. Increasingly, though, the IRO also receives credit, funding and liquidity questions from equity investors. It is not uncommon also for the IROs to deal with the ratings agencies and certain bond investors.

The financial crisis in 2008 highlighted the interaction between credit markets and equity valuations. Investors' analysts realised the importance of assessing the credit risk and this has become a focus in the equity valuation, so a change in credit rating now frequently means an impact on the equity valuation, even if none of the fundamentals have changed.

Rating agencies

A corporate credit rating is an option on the credit risk of the company, the ability of the company to meet its debts. The rating affects the company's ability to raise money in the capital markets.

Although it is an essential measure of creditworthiness, it is important to remember the rating is an indication of future ability and is not therefore a guarantee.

4. Day-to-day relationships: the how of quality IR

The quality of the IR effort is driven by the initiatives taken by the IR team. The more involved the team is, the better the perception from the market. The programme should be initiated and controlled by the IR team, with priority given to the active investors. Some golden rules for successful IR intervention include:

- Daily direct access to the IR team
- There should be senior representatives from the IR team at any meeting with analysts and investors
- Great care needs to be taken not to disclose information that may not be already disclosed elsewhere, such as:
  - Information about the operational units, subsidiaries or countries
  - Any turnover or profit figures before the group has announced them
  - Forecasts – any, including profits, turnover, margins, future investment plans or volumes
  - Budgets or internal control levels
  - Any information the company may not want competitors to see
- However, publicly available information that can be very useful can be released:
  - Economic, market and industry background pieces
  - How a particular business unit or subsidiary fits into company's overall strategy
  - Areas identified for growth or development
  - New business wins (if they have been announced and are material)
  - Strategy, management changes, responsibilities
  - USP's and how the company distinguishes itself from competitors
  - Market shares

With shareholders

Identify top largest 20 investors and offer 1-1 meetings with CEO and CFO twice a year. Below top 20, offer meetings once a year with CEO and CFO or as requested. For new investors, IRO plus CFO/CEO depending on size. All other investors should be seen by the IRO.

Encourage a two-way dialogue. Major shareholders should be consulted in advance on key corporate governance issues. Many investors are wary of becoming insiders, so it is not always a good idea to consult them in advance of major strategic moves. The call is down to the relationship between the company and its shareholder—and the best gauge of that is the IRO. There is a strategic role to be played there.

With analysts

With the advent of MiFID II, IROs need to stay informed as to what research coverage their company will continue to enjoy. The reason it is important to have widespread analyst coverage is because they are opinion-makers. Their reports reach thousands of investors and millions of individuals around the world. They act as an information resource, providing in-depth and differentiated data, industry trends and their own unique perspective.

They also provide IROs with a lot more: estimates, comparisons with peers, sophisticated valuation models and real insight into the global market.

The most highly influential analysts should have access to CEO or CFO, and others should meet Treasurer or Financial Controller. The IR team can manage all interviews too.

All new analysts should be given a briefing with the IR team to understand the company as quickly as possible. Analysts may submit their financial models to the IR team. Guidance should be restricted to correcting factual or arithmetic inaccuracies in the model. It is acceptable to discuss the analyst assumptions to correct the model if it is leading to inaccurate forecasts. The IR team compiles the summary of the models and make adjustments to put them all on a comparable basis. Consensus forecasts should be reviewed and shared with senior management. In certain circumstances, the company may need to correct expectations, if they deviate too much from the management forecasts.

With the company Senior Management

It is critical that Senior Management and Board receive regular, ongoing information about the market and investor sentiment from the IR team, especially in light of the fact that the IRO's role will change, as will the IR budgets, after the advent of MiFID II early 2018. Advising the Board should ranks highly in the list of goals and objectives of many IROs globally. It is this senior-level 'face time' that offers them the forum to explain that the IR effort is more than just 'controlling the share price'.

IR Best Practice

For the majority of IROs, investor relations organisations are the go-to outlets for IR professionals in search of relevant industry trends. Other ways they can update on trends include peer activity networking and IR publications, as well as specialist training by an IR consultancy. IR conferences and seminars, as well as publications by IR practitioners are also a prime source of information.

So, are you my investor? Hopefully the guide above will have given you a framework to help you answer that. There are matches in the market for most stories, so be out there and reach out.

Thinktank

Get with it!