

2nd

Investor Relations Symposium

« THE POWER OF INVESTOR RELATIONS ON MARKET VALUE »

DECEMBER 11, 2008



UNIVERSITY OF EDINBURGH
Business School

Measuring the Value of Investor Relations

Richard J. Taffler

Martin Currie Professor of Finance and Investment

University of Edinburgh

FINEO

Investor Relations Symposium

Paris

Thursday December 11 2008

- Firms devote significant amount of resources to communicate effectively with investors and analysts
- Better communication should reduce information asymmetry between management and investors
- Stakeholders more likely to engage with organizations they consider to be more predictable and trustworthy (Suchman, 1995)
 - lower information and agency costs
- Trust is crucial
 - sell-side analyst stock recommendations are driven by whether they like and trust management or not (Breton and Taffler, 2001)
 - quality of management considerations dominate in analyst argumentation
- Little previous related research

Research questions



- Do firms with better perceived investor relations programs:
 - have higher market valuations?
 - subsequently earn higher returns?
 - have increased analyst following?
 - have improved stock liquidity?
- Is investor relations market relevant?

- *IR Magazine* annual survey of investors, analysts and fund managers
 - best proxy for market perception of effective
- Respondents nominate three firms for 'Best Overall IR' program over the previous 12 months for large (>\$3bn market cap.) and small (<\$3bn) firms separately
 - average of 1,700 respondents each year
- Nomination data collected for period 2000-2002
 - average of 1,040 firms nominated, and 5,460 non-nominated firms each year
 - nominated firms classified as "best rated" (votes > median no. of nominations) and "other rated" (votes < median)

Investor relations and market value?



- Effective IR should reduce the risk premium associated with information asymmetry leading, *ceteris paribus*, to higher market value
- We find firms with better rated IR activities are rewarded with higher market valuations
 - median firm (all) market cap. of \$140m increases by \$2m if ‘other rated’ and \$10m if ‘best rated’ controlling for other factors

Investor relations and subsequent stock returns?



- If the market is efficient in understanding the implications of effective IR, firms that are nominated for the awards should not earn significant abnormal returns over the year following the nomination (Brennan and Tamarovski, 2000)
- Rated firms experience 165bp per month abnormal returns adjusting for risk in the year *prior* to IR nomination
- **However, we find the market is not able to impound good IR information in market prices efficiently**
 - rated firms earn a highly significant average 80bp per month abnormal return post-nomination controlling for other factors

Investor relations and analyst coverage?



- Sell-side analysts are poor at providing investment advice (Mokoteli, Taffler and Agarwal, 2009)
 - more than half US analyst new buy recommendations (55%) have *negative* risk adjusted abnormal returns after 12 months and only 30% are successful
 - following analyst buy advice can harm your wealth!
- But good with their rare new sells
 - 60% are successful
 - the market takes time to assimilate such ‘bad news’ signals
- Analysts suffer from acute cognitive bias (quite apart from potential conflicts of interest)
- Their key role is as information providers (intermediaries)

Investor relations and analyst coverage? (cont...)



- Is 'effective' IR associated with **increased** analyst coverage, arguably because it **decreases** the time and costs for analysts in searching for and analyzing information? (Botosan and Plumtree, 2002)
- We find firms that receive IR Magazine survey nominations have higher prior analyst following
 - incremental 4% for 'other rated' and a further 6% for 'best rated'
 - stronger impact for smaller firms
- **However, firms that receive nominations *also experience an increase in analyst following post-nomination***
 - 0.8 for 'other rated' firms and 1.1 for 'best rated'
 - 1.6 and 2.5 for large firms and 0.7 and 1.2 for small firms

Investor relations and liquidity?



- Information risk and agency theories together predict that effective IR will reduce perceived risks associated with high information asymmetry, and lower information asymmetry will lead to increased liquidity (Bushee and Miller, 2007)
 - liquidity measured by stock turnover controlling for firm size
- We find evidence of increased liquidity for smaller nominated firms
 - overall increase in stock liquidity of 7% for ‘other rated’ and 14% for ‘best rated’ smaller firms in the year post nomination
 - no effect for large firms

Summary of results



- Firms nominated for 'Best Overall IR' have higher market valuations than those not nominated, *ceteris paribus*
 - effective investor relations is value relevant
- Firms nominated for 'Best Overall IR' have higher abnormal stock returns over the year immediately preceding the nominations showing
 - past performance influences firm nominations
- However, outperformance continues over the following year, suggesting
 - the market is unable to price this information efficiently

Summary of results (cont...)



- Although higher prior analyst following is associated with best overall IR nominations
 - firms that receive best overall IR nominations *also* experience subsequent increased analyst coverage
- Consistent with the information asymmetry hypothesis
 - we find evidence that effective IR increases liquidity for small firms

Conclusions and implications for IR practitioners



- IR activity is a high + NPV investment for the firm
- It can have a key role in enhancing feelings of trust and 'liking' by sell-side analysts (and thus investors)
- Analysts and the market have great difficulty in dealing with bad news on a timely basis
- Analysts are prone to cognitive bias and are poor at making stock recommendations
 - IR can help them in their real role as information providers
- **We conclude that effective IR significantly increases market value for *main exchange* listed firms**
 - the first time this has been demonstrated formally in the research literature in this way to our knowledge

MICHIGAN 

ROSS SCHOOL OF BUSINESS

Building Value with IR

Gregory S. Miller

The 2nd Investor Relations Symposium

Three Discussions in Three Weeks

- “Every time we start to talk budget or manpower they ask about deliverables and proven impact” – IRO, one of the largest companies in the world
- “The board wants us to do something, but how do we even know this works?” – CEO, midsize public technology company
- “Every client eventually asks the same question: but what was your real impact?” – IR Consultant

A Set of Projects to Investigate

- Understanding outcomes of IR
 - ~ Press, Analysts, Institutions and Price
- Understanding the importance of managerial relationships
 - ~ Conference Presentations, Employment Changes

So What Good Does this Do You

- Evidence that process matters
- Suggests some performances measures
- Potential to benchmark
- May suggest areas to intensify focus for your firm

Understanding the Process

- Study a group of firms just beginning serious IR efforts
- Focus on understanding outcomes
- “Investor Relations, Firm Visibility and Investor Following” Bushee and Miller (2007)

IR and Getting Coverage

- Press coverage can be quickly impacted
- Analyst following increased, but it does take more time
- These are intermediate, but important steps

Strong Impact on Institutions

- Increase amount of investment by existing institutions
- Attract new institutions
- New institutions are a different type
 - ~ Larger institutions
 - ~ Invest in larger firms
 - ~ Greater geographic dispersion

Positive Valuation Impacts

- Approximately 25% price change over 1 year
- Under valued firms impacted more
- Firms with increases in press/analysts coverage and those with changes in institutional investment impacted more

Managers Relationships Matter

- This is a hard topic to nail down, but important for managers to understand
- Two papers that look at conference presentations
- One project that looks at managers moving companies

Conference Presentations

- Important features:
 - ~ Managers are face-to-face during presentation
 - ~ Informal mixing (maybe meetings also)
- Usually no “new” information, similar presentation may be used all year
- Increasing number, median in our sample four a year

Market Impact of Presentations

- Positive market response, more trading activity
- Large trades outside of presentation time, particularly in hours following
- Results stronger if CEO present
- Smaller, less known firms impacted the most

Longer Term Impact of Presentations

- Increase in institutions investing in the firm
 - ~ Particularly for smaller, less known firms
- Increase in analyst following
 - ~ Greater for larger, more well known firms

Do Relations Move with Managers?

- Changes in CEO and CFO's examined
- Analysts begin following new firms when managers move
 - ~ Particularly if move in same industry
- Institutions also likely to move or increase investment
- Some evidence of a flow back to old company

Summary of these Findings

IR matters in setting price and creating a reasonable investor/following base. The process involves many components and requires top management involvement to get maximum benefits

What about Today?

Many of these results show small, less known firms benefit the most. However, in today's market there are questions about all firms, pushing everybody into the "less known" category.

Your Thoughts

- I am always interested in getting perspective from practitioners
- Glad to make suggestions
- millerg@umich.edu

3rd

Investor Relations Symposium

SAVE THE DAY!

NOVEMBER 26, 2009