sección especial en idioma inglés

the risk-reduction concept: how to win investor support in a fire-sale market

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If U.S. companies are going to get serious at last about investor information policy, they had better take a completely fresh look at the matter. Informed investors may well be their only salvation in the coming scramble for capital.

During the next five years, a high proportion of America's middle-size companies are going to have to meet part of their capital needs through a forced marketing of equity securities. At current price/earnings ratios, the decision will be unpalatable at best; more likely, it will be devastating to shareholders.

How can a company avoid ist own fire sale?

Obviously, the answer is not the traditional pat solution: "Just earn more money and let the record speak for itself". The record isn't speaking for itself, if it ever did. Thousands of companies are earning more money than ever before, budgeting new record highs next year, and still watching their equities sell at an ample discount from book value and at multiples representing, in many cases, an all-time low.

Nor is the answer spending more money for investor relations. Most companies already doing this have been getting nowhere.

Nor is the answer buying back chunks of one's own stock on the open market, thus driving up the price. All that this accomplishes is to narrow the float, diminish a company's ownership base, decrease its appeal to the stockbroker, and eventually move it toward private-company status—which will foreclose the one avenue such companies desperately need for future growth capital. Also, it they ever stop buying, the stock price will plummet.

But there is an answer. It isn't fancy or easy. It takes had work and guts. It involves finding the missing ingredient in a company's investment appeal that can win and sustain support. This ingredient is serious top-management commitment to the concept of risk reduction.

Spotlighting the unknown

Management knows that people buy the stocks of companies with successful track records. Management also knows that people buy stocks because they like a company's productos, its industry, and its balance sheet. But management rarely understands that, while the market sets a given price on all thes *known* elements, the price also includes either a premium or a discount on the *unknown* factors. These unknowns combine to form investment risk; they include:

—How talented the company's management *really is.*

—How much the company *might* be able to widen its operating margins on those sales.

—How much the company *might* earn in that time.

—How wisely *might* these earnings be reinvested to ensure longer-term growth.

Nobody, including management, knows these things today. But management will learn about them much faster than you or I or the average investor.

Management's willigness to *share* this learning process with investors can significantly reduce risk. While a security analyst, broker salesman, or plain private investor may not sum it up in these words, he's quite willing to pay a handsome premium in the stock market for this element of reduced risk. In reality, he's buying an extra measure of safety, an early warning system. He's paying for some precious lead time that can help turn unknowns into known. In short, he's going to have the confidence that he really knows what's going on with his investment and will continue to know what's going on.

Should management really share what it knows with the public? Is it possible that the whole truth may become fashionable? Isn't this carryng disclosure a bit too far? Isn't it too high a price to pay for investor affection?

Not at all. A few smart companies have been doing it profitably for years. They don't divulge supersensitive product developments prematurely or let their competitors in on marketing-campaign strategy. But long before the SEC twisted their arms to bare their operations to investors, they were aggressively helping investors to truly understand—in lay terms, not legal ones—their business mix, their competitive position, their market outlook, their lean and fat parts, and their growth goals. They shook off the tradicional corporate paranoia. They said to themselves: "We're optimistic about our fundamentals because of what we know. But everybody else can see only the tip of the iceberg. If we share what we know about ourselves, then perhaps they'llshare our optimism."

Establishing credibility

Equally important, they made a commitment to share consistently. Their face-to-face briefings with investment professionals were as detailed and frequent in bad quarters as in good ones, as were their shareholder reports and management's availability for candid interviews with financial news services. Essentially, these companies left little—good or bad— to the investor's imagination. While most companies began to give more lip service to terms such as *candor, full disclosure,* and *open door policy,* these companies stood the the real test.

The result was a real reduction of risk, a rare ingredient the investment equation that paid off overall. In bad years, because the gloom was laid bare early and management let it all hang out, little was left to imagine. Certainly the stock dropped, but it did so less precipitously than the others and rebounded earlier on the economic upside. In good years, once again litlle was left to imagine of fear, and a market premium was paid in confidence.

In summary, risk- reduction goes beyond establishing credibility. It creates the feeling of assurance that there are seldom going to be any surprises.

Dispelling the hot air

How then, does a company intelligently share what it knows with investors? From a practical standpoint, what risk-reducion all about?

To most companies, investor relations means an eternal process of reacting, instead of acting, in a planned, systematic way. Under this well-meaning banner, therefore, they stumble along. Alert, decisive company presidents become gullible, vascillating pigeons, seeking and often following everybody's advice—no matter how capricious—at one time or another.

Hence, today, a president may bear his annual report to impress his directors, fashion his annual meeting address to please his attorneys, draft his press release to satisfy himself.

But what satisfies the investor?

Obviously not enough. That's where the wishful thinking, the selfdelusion, exists in corporate boarddrooms today. The net result is hot air ("It sounds goods to us...") but little communication. And risk is increased, not reduced.

If at last U.S. companies are going to think seriously about investor information policy, they had better take a completely fresh look at the matter.

Who controls the float?

To most companies, the investor audience is simply their shareholder roster, a jumbled collection of cards and letters received over the years from analysts and broker, or a list of analysts bought from some mailing-list firm. The wasted postage in continually sending materials to uninterested or even deceased people is not the major tragedy, however. The big misfortune is in who *isn't* getting the word.

These companies fail to calculate who really controls their float. Obviously, nobody is as vital to a public company's current and future support as the specific investment professionals who directly influence groups of present shareholders. But generally, these professionals are not listed on shareholder rosters and often are unknown to management, except for the persistent callers. Many of them, while influencing thousands of shares, may never have met management face to face and may even be receiving shareholder reports only sporadically. Yet when the stock opens for trading each morning, it is likely to be these individuals—each a "resident expert" in his house or instituion—whose advice is sought on buy/sell/hold decisions.

Identifying these people is not difficult. A diligent, direct survey of street sources can usually provide the answers. The starting point is the latest shareholder roster. Specific contact must be made with brokerage houses showing major concentration of street-name holdings. It may well be that the research director or industry specialist at that house is *not* the key influence on the company's stock. It may be a generalist, a senior partner at a branch office, a sales manager, or a few influential registered reps who, over the years, atracted a circle of clientele to the stock.

Following this task, contact must be made with major *institutional* holders. These are under nominee names that can be easily decoded. If the instituions is a mutual fund or insurace company, the target individual is likely to be an industry-specialist analyst in the management firm handling the fund's portfolio or else a key analyst of the instituional brokerage house close to the fund. If it is a bank trust department, the task is to identify the specific trust officer related to the account holding the stock.

Although this procedure can be tedious, it nevertheless is vital. Once done, it can provide a current profile of those 25, 100, or 300 individuals who will truly determine the strength of the supply/demand ratio for a stock in the months and perhaps years to come.

Looking for new targets

Identifying who controls the float is less than half the story. Brokerage sponsorship and other forms of street support have been ficle historically. Any company that has consistently maintained a fair equity value has done so by tirelessly attracting new faces to the scene. Thus the second step must be to identify those investment professionals, nationwide, who have never shown any interest but whose tastes and preferences make them top-priority targets—the most logical candidates to be introduced for the first time.

But where are these new faces? Most companies, if they try at all, fail to look in the right places and in the right manner. One common mistake is to charge out in all directions, seeking invitations to appear before groups of security analysts in any city from Tampa to Tacoma. The problem with many of these potluck ventures is that the likely target is reached only by chance.

An even more widespread mistake is their fixation on the term "security analyst" itself. The number of these oracles across the country has dwindled from about 14,000 to about two-thirds of this figure during the recent years of dislocation and cutback. But, more importantly, the true analyst today is more institutionally oriented than ever before. This means that his standards of minimum stock float are steadily increasing, thus narrowing the range of companies in which he's willing to take an interest, much less recommend. Meanwhile, thousands of company managements either fail to recognize this fact or delude themselves by continuing to believe thar their rompany is of potential interest to a broad range of institutions.

In addition, most managements still obscure the concept that their true audience is on the *sales* side of the retail brokerage industry. Although the ranks of these professionals too have shrunk in recent years (from 55,000 in 1970 to about 33,000 now), there are hundreds of registered representatives who may be precisely suitable for any given company if they are educated to their liking. A recent nationwide survey of 649 registered representatives by Technimetrics, Inc. confirmed a number of significant changes taking place in the retail brokerage field. Essentially, the finding showed:

* Most broker receive far fewer printed

materials than companies believe; more than 65 percent receive fewer than 10 corporate reports a week.

* Meanwhile, more than 76 percent of reps are asking that materials be sent to them directly. One reason: only 28 percent say that corporate reports are effectively circulated through their staff on a regular basis.

* More than 54 percent of reps report that they regularly pass along corporate materials to their clients for study.

* Representatives today are more autonomous and influential. More than 59 percent say that they rely strictly on their own research for investment recommendations. And, while stock recommendations once were limited to the official list of the house, that day is fading. Over 40 percent of reps say that less than one-fourth of their sales are based on this list, and another 32 percent say that less than one-half are based on the list. Moreover, more than 75 percent say that their recommendations are followed in more than one-half of all client transactions, and 73 percent say the more that three-fourths of all transactions follow their choices.

* Reps are increasingly anxious to personally sit in on briefings by corporae management, with 76 percent saying that they prefer this to summarized interpretations. Meanwhile, most brokerages no longer discourage their reps from independent research, with only one-half of 1 percent of all houses still maintaining any inhibition on the practice.

With proper research, any company can determine within 60 days the analysts and brokerage-sales executives who should have top priority in any introductions to a firm's fundamentals. Although the New York City community is always important in this regard, the greatest emphasis should be placed on regional financial centers closer to a company's home base. Using a concentric-circle method, this means screening likely individuals in the strongest regional retail brokerage houses based in nearby cities plus the branches of houses based elsewhere.