CFO Insights

Investor relations: What new CFOs should know

Juggling the demands of shareholders, analysts, bankers, and ratings agencies is enough to make even a seasoned CFO cringe. For new CFOs, those demands can be intimidating, if not terrifying. Still, there are lessons CFOs should understand about investor relations (IR) before taking the reins — lessons veteran CFOs should revisit on a regular basis.

In this issue of *CFO Insights*, we offer 10 IR strategies for new CFOs to consider. Developed by Eric Pillmore, senior advisor to Deloitte's Center for Corporate Governance and former Tyco International Ltd. senior vice president of corporate governance, the list ranges from how to allocate time to analysts to creating consistency of messaging. And while far from all-inclusive, the list offers a window into the external opportunity IR presents for CFOs, as well as its importance as the *de facto* sales and marketing function to investors.

1. Allocate your time effectively between buy-side and sell-side investors.

As CFO, you deal with both sell-side analysts, who tend to be model driven, and buy-side analysts, who typically understand your company on a broader and deeper level. It is important to understand the requirements of both, but who should claim more of your attention? The answer depends on timing. The sell-side analysts, for example, will typically be focused on your quarterly update calls and incorporate that information into their research. The buy-side analysts, on the other hand, often have well-documented strategies of when they are going to enter — and exit — your stock. Understanding their strategies provides critical information that may prompt you to create additional demand in your stock in the event of a potential exit. If you have a strong focus on who owns your stock and who may want to own it, more of your time should probably be spent with the buy side. In practical terms, you will likely spend at least 20% of your time in IR, and of that time, you may want to target an 80%/20% or 70%/30% split buy-side versus sell-side.

2. Develop realistic business expectations

In your communications with "The Street," if you forecast a particular sales target, earnings target, income target, cash flow, etc., you should have a high probability of achieving the target. Financial markets tend to be very unforgiving if you do not. And while you cannot fully account for unexpected blips, in a normal environment, it may be wise to assume some portion of your results will fluctuate based on external factors and internal execution misses. In addition, you may want to provide guidance in a range that assumes a similar variability. It is also critical that you spend the necessary time educating your investors on the drivers of the business and the company's expected performance relative to peers. Why? The value of your stock is not based on your ability to exceed forecasted results in an individual 90-day period; it is going to be based on providing consistent results quarter after quarter that meet or beat what you said your company was going to do.

3. Be proactive about being reactive

The unexpected is going to happen. When it does, you should have the mechanisms in place to react internally and the discipline to communicate to investors. For example, when I was a CFO of a telecommunications company, our largest factory in Taiwan was hit by a typhoon in the middle of the night U.S. time. The damage was so extensive that it brought the operation down for almost three weeks. Realizing the potential investor concerns, our vice president of investor relations was on the phone at 5 a.m. leaving voicemails for our important sell-side and buy-side investors and issuing a press release long before the market opened. We realized we couldn't arrange a conference call that quickly, but we knew the importance of informing investors about the impact on our manufacturing volumes and financials, as well as how soon we would be back up. As a result, there was minimal effect on the stock when the market opened. IR is a 24-hour world that requires communicating with stakeholders about changes to your stock or results, as promptly and thoroughly as you can.

4. Share your milestones

When communicating with stakeholders — whether it is your board, your employee base, your investors, etc. — use the same messages about earnings or margins or cash flow. Information should flow out of the board package into the 10Ks and 10Qs and then into the investor presentations. But stakeholders also want to understand *how* you are going to hit particular targets. They want to know what milestones you are measuring internally so progress can be tracked. So on major strategic initiatives, you should be ready to talk about milestones; and when there is an incremental change to your model, you should be able to cite the milestones affected by that change.

5. Create linkages from the assumptions in your financial model to your strategy.

Investors often get frustrated when strategic effects are not quantified. Say, for example, your CEO touts a growth program in China and uses a GDP growth assumption of 8%. What happens if growth drops to 4%? Without question, investors will want to know the effect on next year's earnings, revenues, and margins. That means you have to be in a position to react quickly and quantify the effect on your forecasted results when there are significant strategic changes.

6. Commit to one comprehensive financial model

Just as there should be one overall strategy, there should be one comprehensive financial model. It should reflect the same set of numbers that the financial planning and analysis team develops inside the business. And just like your strategic model, you may want to include some flexibility for the numbers you're committing to in the event of execution misses. The difference is that your strategic model is typically a three-to-five-year timeframe, whereas the financial model usually involves the current year. To avoid confusion, you need to continually come back to those original assumptions and not have two or three different models operating in different parts of the business through the year.

7. Gain working cross-functional knowledge

As CFO, you may miss a lot if you just sit in your office and manage the finance function. To gain a full picture of the business, you have to be ready, willing, and able to get out and engage people outside of finance. The more you understand the issues your strategic business unit leaders and the various functions are focused on, the better prepared you will be to address investors' concerns. Particularly as a new CFO, you need to be a sponge. And as you gather your knowledge, develop ways to effectively communicate it to the CEO and the board, so they are equipped with the information to properly oversee the company.

8. Develop a playbook

As a new CFO, you are going to be asked a multitude of questions in your interactions with investors, and invariably there will be one or more for which you do not have an answer. One idea — developed by an enterprising young analyst I once worked with — is to create a playbook, similar to the plasticized sheets coaches use during NFL games. After listening to a series of quarterly conference calls over several years, we found that about 80% of the questions are common. And those common questions are typically tied to models that both sell-side and buy-side analysts are building. If you know the questions and you have a solid understanding of how their models are structured, you can build the answers into a physical playbook — one you can share with your CEO, IR director, and business unit leaders. The other 20% require preparation, including dry runs and leaning on internal resources, particularly when you are new.

9. Give bad news all at once

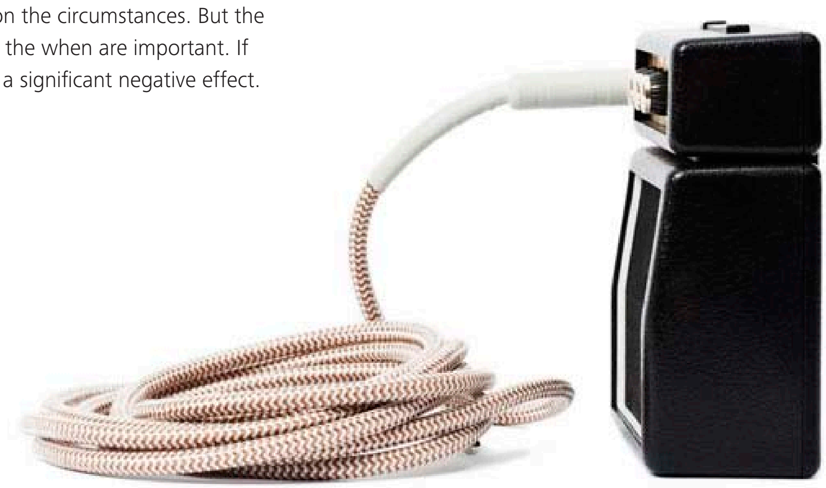
Inevitably, there will be bad news. When that happens, make sure you fully understand the implications, because you usually get just one shot. (Unfortunately, this is often the case even when unforeseen circumstances make the situation worse.) If you communicate bad news one week and add to it a week later, it only makes things worse. Before you offer the news, however, make sure cross-functionally that the CEO, the CEO's direct reports, and the board understand what is being communicated and why — and that you have their support. In addition, how you communicate and when are also crucial. This approach may vary depending on the circumstances. But the who, the what, the how, and the when are important. If you mess one up, it can have a significant negative effect.

10. Demonstrate the depth of your team

Investors are a lot like customers. They are buying your stock and, as CFO, you want an IR director who can build trust and make these constituents believers in the company's strategy. Ideally, that someone should be able to grasp the numbers, work cross-functionally, and communicate in a way that fosters trust. In addition, you need to have confidence that they have the backbone to stand their ground with investors, if it comes to that. But stakeholder relations should not just be limited to someone with an IR title. Train your business unit leaders to be fluent in your messaging and equip them to go to conferences and represent your company. Showcasing such bench strength widens your touch with the investor base and demonstrates that you have the depth of management shareholders want.

Ultimately, think like an investor

CFOs want external stakeholders to view them as having high integrity, as being a competent steward of shareholder resources and a strategic thinker, and of course, as being right. Gaining such a reputation does not happen overnight, however. In order to achieve it, you need to know the business, the drivers of that business, and the questions investors want answered. Those questions are typically the same ones you ask internally: if you want the answers, then so do your investors. As CFO, do your homework, be prepared for a multitude of questions, do dry runs, and create a playbook. But ultimately, think like an investor.



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