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Market Value Realization in the Americas

Closing the valuation gap

Once upon a time, telling the corporate story to US shareholders meant publishing quarterly financial results and answering the occasional investor query. Over the past decade, however, shareholders have made it clear they want more: more information about different areas of the business, more access to management, and more influence in decisions. While this desire had long been brewing, the financial crisis of 2008–2009 heightened levels of investor scrutiny (and often, distrust). Further supporting this behavior is the unprecedented ability investors now have to analyze and disseminate corporate information using data sources which have become more ubiquitous (e.g. social media, blogs) and advanced analytical tools.

A recent study by proxy advisory firm Institutional Shareholder Services finds that investor involvement in US public companies continues to rise. More than 80 percent of investors surveyed said they had initiated at least one contact with a company in the past year, up from 56 percent in a benchmark 2010 survey.[1] Fifty-five percent reported initiating more than 10 discussions within the year, compared with 31 percent three years ago.[2] Buttressing these findings, activist hedge fund attempts (and successes) to direct corporate activity continue to increase. According to data compiled by Activist Insight, activist assets under management exceeded $150 billion in 2014, with 344 public campaigns, almost triple the number just five years ago.[3]

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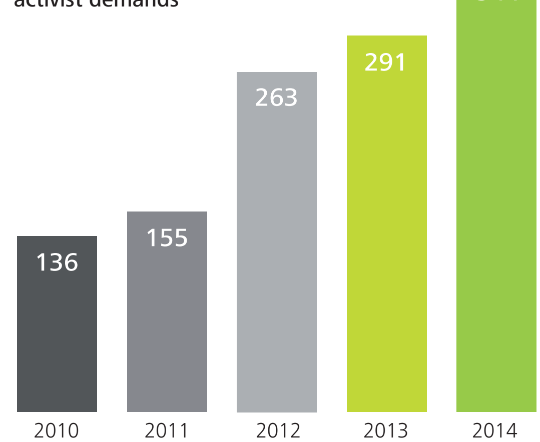
Companies publicly subjected to activist demands



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1 IRRC Institute, Defining engagement: An update on the evolving relationship between shareholders, directors and executives, 2014, Figure 5, http://irrcinstitute.org/pdf/engagement-between-corporations-and-investors-at-all-time-high.pdf, accessed March 12, 2015.
2 IRRC Institute, Defining engagement, 2014, p. 12.
3 Activist Insight in association with Schulte Roth & Zabel, Activist investing: An annual review of trends in shareholder activism, 2015, p. 9.

This phenomenon is not limited to US organizations. As foreign companies increasingly look to enter the US capital markets and US investors in turn look for opportunities abroad, similar demands and pressures are being placed on companies around the globe, including in emerging markets such as Latin America. Historical ways of doing business are being challenged and increased transparency is in demand. A recent example is Cartica—a US hedge fund that specializes in emerging markets—acquiring a stake in Chile's Corpbanca and challenging the benefits that majority owner Alvaro Saieh Bendeck will receive under a deal he struck to acquire Brazil-based Banco Itau. This attention is not always unwelcome, as fast-growing companies in the region are also proactively wooing US investors. One recent notable example: Buenos Aires-based Globant—already backed by two US private equity firms—filed for an $86 million IPO on the New York Stock Exchange.

While most companies in either Latin America or the United States will not be the target of a headline-grabbing activist campaign, all companies—public and private—could see benefits from improving their shareholder interactions. The fundamental takeaway: it is vital to proactively align stakeholders around the company's strategy and core value proposition. This means understanding the dynamics of your stakeholder base and establishing a consistent, effective cadence of communication with them.

Defining the framework

Creating a cohesive communications strategy is a useful exercise for any company, but for those in the midst of transition or transformation, it can mean hundreds of millions of dollars or more in valuation. Classic triggers are IPOs, major M&A announcements and restructurings; events which require management to be crystal clear about long-term benefits or risk losing value to short-term uncertainty. Other pivot points, such as business model changes, also call out for extra attention to how the company is positioned and being positioned by others. Consider a pharmaceutical company moving from a branded to a generic drug strategy, or a media company converting print products to digital, or a software company entering the cloud. These companies must not only execute the strategies successfully—a challenge in itself—but also convince analysts and shareholders to assess them on new sets of metrics against new peer groups. Often, management teams focus so intently on the internal transformation effort that they miss out on some of the value associated with it by failing to help external stakeholders see how profound and beneficial the change is.

It is vital to proactively align stakeholders around the company's strategy and core value proposition

Companies typically feel the pain of a communications gap long before they pinpoint the underlying problem. That was the case for a multinational conglomerate that recently shifted its operating strategy by narrowing the sub-sectors in which it chose to focus. Though management believed that this strategy would add significant long-term value to the enterprise, the company's share price initially suffered. After analyzing possible causes, executives realized that they needed to be more proactive in helping external stakeholders understand the transformation initiative. That started with attracting new, sector-specific analysts who could understand the restructured operations in more depth than the diversified analysts who had traditionally followed the conglomerate. A history of earnings misses also suggested that management needed to do a better job guiding analyst estimates. Finally, executives committed to regularly reinforcing the value of a major cost-cutting program underway, rather than letting uncertainty about its results drive a loss of shareholder confidence.

Framework for improvement

For corporate executives, the starting point in defining a comprehensive shareholder engagement program/message often begins with asking questions. Do investors truly understand our value proposition, and if not, why? Are our financial disclosures sufficient to show our strengths or are there additional metrics or key performance indicators that we should present? Do we engage shareholders in the right way, with the right frequency? Does our social media presence enhance or distract from what we see as our value?

To align the stakeholder engagement and expectations with the company's value proposition, it can be helpful for management to consider four key areas:

Capabilities: What is the company doing or planning to do?

The company looks internally to define core sources of value, and what it wants shareholders to understand. Executives define key messages and value drivers and help ensure that the internal organization is ready to both deliver the promised value proposition and has the proper processes in place to generate the metrics/information to keep stakeholders informed.

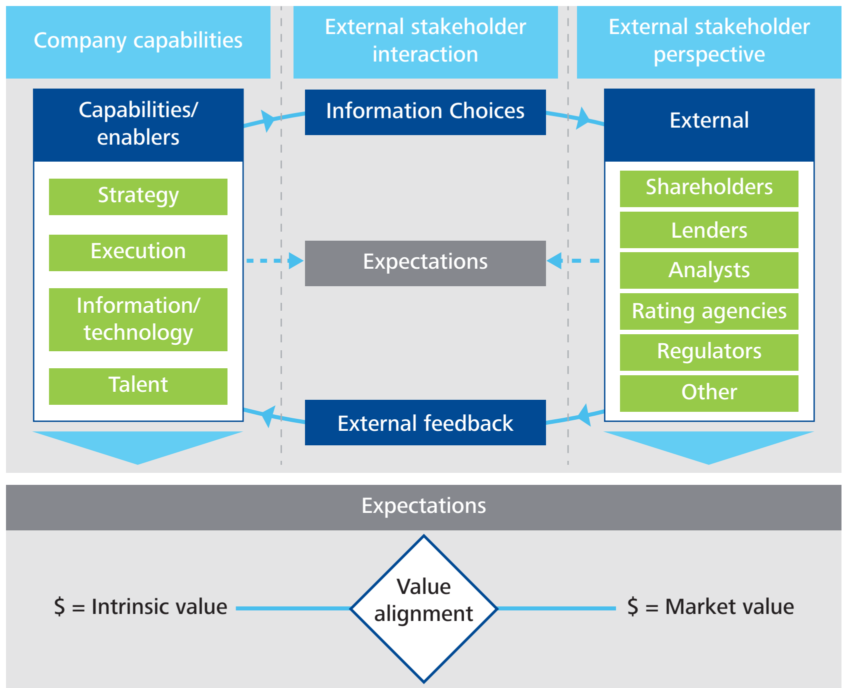
Communication choices: How are you going to communicate it?

The company anticipates and prepares content that underscores the key messages it has defined. In addition to a company's legally obligated disclosures, management should consider how and when to provide additional communications and information to stakeholders. Planning should cover resources for recurring communications, as well as plans to deal with significant one-time events.

Stakeholder engagement: Whom will you reach and when?

Rather than simply reacting to stakeholder requests, the company establishes a consistent cadence of communication, setting up a regular calendar of outreach in various forms. Importantly, the company takes into account the diversity of its stakeholder base—including equity shareholders, analysts, debt-holders, et cetera—to make sure the content is relevant and meaningful for each.

Market Value Realization (MVR)



External feedback: How will you do it better?

Based on interactions with stakeholders and their feedback, the company gains an understanding of how investors perceive its value. Executives adjust and refine communications, taking factors such as investors' preferred metrics into account.

This framework can help to not only strengthen and streamline a company's communications process, it can also lead to market value realization as the four factors create a continuous cycle of improvement. As companies offer better information to stakeholders, they can also leverage what they learn from stakeholders to improve relationships and interactions over time. More profound, doing the hard work of engaging shareholders and tailoring communication to their perspectives can help prevent a gap between the company's perception of value and that of its stakeholders.

Importantly, these factors are also applicable to companies with aspirations of participating in the global public capital markets. Even within a closely-held company, or one that features a single controlling family—as is common in Latin America and other regions—management teams that strive to bring in leading communication practices may inspire more confidence and gain greater autonomy. These positive results may ultimately build on themselves, potentially enhancing a company's ability to attract both financial and human capital from markets abroad.

Conclusion

As information travels faster and more freely, investors' appetite for greater transparency is only likely to grow. Not only do shareholders in the United States expect more from companies, they have increasing power to protest if they don't get what they want, using the Internet and social media to help amplify their campaigns. They are quickly extending these expectations to attractive companies in other growing regions, including Latin America.

These trends are not only changing how public companies interact with shareholders, they also imply a new set of communications standards for private and other closely-held companies, especially those that aspire to participate in the global capital markets. Companies should consider proactively helping stakeholders understand the value of the company, and develop a fulsome outreach program that can accommodate both regular updates and significant corporate events. Since stakeholders cannot value what they don't understand, done well, these practices may help minimize the gap between management's perspective of intrinsic value and the valuation determined by the market.

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