Competing for Capital

Investor Relations in a Dynamic World

BRUCE W. MARCUS

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To my wife, Mana
You make it worthwhile doing

Contents

Acknowledgments

There is a myth that individuals invent things. Robert Fulton and his paddle boat. James Watt and the steam engine. Edison and his light bulb. The Wright brothers and the airplane.

It's a myth, all right. Before each of these people produced a useable machine, a lot of scientists and thinkers and dreamers (and maybe alchemists) started the process that culminated in the inventor's invention.

The same, I can tell you, is true of books. We writers toil alone, like monks illuminating manuscripts, pounding at our keyboards and growling at the intrusions of the outside world (and our wives, of course), and in danger of thinking that just because our names are on the book jackets, we did it alone. Never in a million years.

Every concept in this book (and in every other book I've written) has been vetted by my experience—I'm not an academic, I write from my own experience—except, of course, for most of the new regulatory material. I'm not a lawyer. And except, also, for the input, and critiques and contributions and suggestions of my very wise friends. This is their book as well as mine, and I'm grateful to them beyond words.

Dixie Waterson, my once and forever colleague and friend, gave me the first list of suggestions. She is a consummate investor relations professional, and if she were older, she'd be a Grand Dame of the profession.

Lou Thompson, the president of NIRI, and his staff, was generous beyond words in keeping me up to date on regulations and techniques. The information prodigiously produced by NIRI for its members informed much of this book. No profession has a greater champion, nor a greater organization to lean on for professional wisdom.

My old friend and one-time client, Bill Donaldson, is now the head of the SEC. For appropriate reasons, he contributed nothing to this book, nor has he seen a word of it prior to completion. But he did supply two things—encouragement, and a revolution in the financial world to write about. Wall Street—and Main Street—will never be the same after his tenure, but will be better for it.

Richard Levick and Larry Smith, of Boston-based Levick Strategic Communications, LLP, are the leading practitioners of law firm marketing, and media relations, and kept me up to speed on the rapidly changing media picture. And so too did my old and dear friend, Jennifer Prosek, of New York and Stratford CT-based Cubitt, Jacobs & Prosek, who has built a mighty international publicity machine from a small operation in rural Connecticut. She has been unsparing of her time, in the use of the facilities of her firm, in the time and help of her own investor relations staff, and in her own wisdom. Her overseas partner, Mark Kollar, and Katie Vusak of her office, helped fill in some blanks from their own investor relations clientele.

I've known Jeff Corbin's father for eons, and he was a great public relations and investor relations consultant for years. Now Jeff runs the firm—KCSA—and he's built it into the world's largest independent investor relations firm. Jeff, whose knowledge of this field is formidable, gave me time and help.

I was overwhelmed by Donna Brooks, of the Hartford-based law firm, Shipman & Goodwin. She supplied expertise and her practical experience on Sarbanes-Oxley and the SEC, and then took a lawyer's pen to the draft of the chapter on regulation. This is more than a generosity of time and wisdom—it's a generosity of spirit. Jim Schulwolf, my friend and her partner, was particularly helpful with ideas and references.

June Filingeri, president of Comm-Partners LLC, who practices the investor relations art from a small town in Connecticut with big city skills, contributed her ideas, her knowledge, her challenges to my ideas, and her support.

My children, Lucy and David, were my coauthors on two parts of the book. Lucy, based in England (and the whole world, its seems), is a consultant to the financial community. Her firm is Marcus Venture Consulting (www.marcusventures.com). She contributed her widely used guidelines to writing a business plan for seekers of capital in the world's capital markets.

David, a venture capitalist, is Managing Director, Life Sciences, at Boston-based VIMAC Ventures. He brought me up to speed on what the venture capitalists are doing these days, and wrote those paragraphs for this book. A wise and good son.

At those times when an author's brains go numb, he needs the conversation and enthusiastic support of a few bright people. That role in my life is inevitably played by Patrick McKenna and Gerry Riskin, the world's (yes, the world's) leading consultants to law firms. Patrick lives in Edmonton, Canada and Gerry lives in Anguilla, but they are ubiquitous, and rarely in the same place at the same time. The one place they are always in together is in my heart and mind. Thanks for that.

Research, when you live in a small town in Connecticut, ain't easy. That's why I cherish the Libraries in Easton and Trumbull. I worked my way through college (it was medieval times, I think) in the Brooklyn Public Library, in Brooklyn, New York, and I know the mettle of librarians. That's why I cherish the likes of Easton's head librarian, Bernadette Baldino, and the magician of the EPL computer, Penelope Papadoulis, as well as the patient, helpful and always accommodating staff at the Trumbull library. Thank you ladies and gentlemen.

Kathryn Davis, a dear friend, has long since surpassed the record I once held for the number of annual reports I wrote. Believe me, she was helpful. As was Scott Greenberg, who heads the remarkable Curren & Conners, certainly the leading producers of corporate annual reports and other material for the financial community. He gave me his valuable input on the trends in the field. He knows, and he's the best at what the knows.

August Aquila and I go back many years in the professional services marketing field, and so it was natural that he and I should write the ultimate book on marketing professional services—*Client At the Core*, also published by Wiley in 2004. He is a good and knowledgeable friend, and a patient one at that.

And as ever, my friend and mentor, Richard Weiner. He knows, and he taught me what he knows.

As the author of many books, I know full well the tensions that arise between publishers and authors. But for more than 20 years, and through two publishing houses, Pamela van Giessen has been my publisher, my muse, my task master, and the patient and gentle guide to quite a few of my books. She prods, appropriately, but never nags. She gets it done. As a writer, I'd follow her anywhere. And she always has assistants who give surrogate a good name. Jennifer McDonald, in this case, helped bring this book to your hands.

As for the good lady Mana, my wife of more than 40 years, there are not enough words of praise and gratitude in the language equal to the task of describing her. I think it must be easier to be a coal miner's wife than the wife of a writer. She could give lessons. She is a muse above all others, and will be for the writing to come.

There are, of course, others. But the list would be longer than the book itself. To all of you, my eternal gratitude.

This book descends from my first book, also *Competing For Capital*, published in 1975, and *Competing For Capital in the '80s*, published in 1982. It's amazing the changes that have been wrought in the intervening years. It's amazing what's stayed the same. If you've read any of these books, you'll find some of this vaguely familiar. The vagary comes from change in the world of investor relations.

Readers of my books on marketing, and my online newsletter, *The Marcus Letter on Professional Services Marketing* (www.marcusletter.com), will find the basic marketing principles familiar as well. They're principles I've been espousing for years, in books and innumerable articles.

And so, this is more than my book—it's *our* book. I'm lucky to know and to have the help and guidance of friends like these. Who says writing isn't luck?

Bruce W. Marcus

Preface

To ignore history, said the philosopher Santayana, is to doom oneself to repeat the past. Go tell that to the investment community, and those who serve it.

In 1975, when the first edition of *Competing for Capital* was written, we lived in an era in which I said that three chestnut venders could meet, greet one another cordially, and then go public. We called that time in history the *go-go years*, when the small investor and the large institution alike discovered the great investing game as a year-round sport. Companies were going public at breakneck pace, the institutions were growing at breakneck pace, and the small investor was learning to read the ticker tape. Corporate America, steeped in the tradition of privacy and shutting out the general public, began to see the advantage of opening its books to attract investors, thereby breeding the new practice we now call investor relations. It was an era of a new populism in the stock market, fed by hope, by great stories in new companies, and by unbridled optimism.

It was a time, too, when financial publications were read mostly by investment professionals, when business news in popular media was relegated to the obscure corners and reported by reporters with little or no financial background, and when new communications vehicles (PR Newswire, for example) were emerging. And of course, there were no computers. Investing was in. Basic investment principles were out in this new game of investing and raising capital.

When the bubble burst in 1987, and the market took a nosedive, the sobering effect on the investment community, and particularly the individual investor, was a promise of "never again." Never again would the public be taken in by such irrational exuberance (familiar phrase?). Never again would the people's capitalism be tainted by such greed and gullibility.

We can laugh about that now. The exuberance of the 1990's, fed by the new world of technology and its producers, far exceeded that of the *go-go years*. We talked of a new economy, a new breed of investors, a new kind of economic sophistication in which a small investment could be parlayed into a vast fortune almost overnight. We talked of a new music we could dance to until dawn without growing weary.

New investment vehicles, new forms and sources of data transmittal and other uses of a new technology, a proliferating business and investment media, the 401(k) retirement investment vehicle, the glamorous new stars of industry, and a new generations of investors and investment professionals (perhaps too young to remember the go-go years)—all created a new climate for the end of the century. The Dow Jones Average, a comfortable 3000 in 1975, reached more than 12,000 in 1999, and then, following the dot com disaster, fell again to around 10,000. By 2004, it was still hovering around 10,000, but not comfortably.

Participation of individual investors is changing. More than 50% of Americans now hold stocks, not only as individual investors, but through corporate retirement funds, mutual funds and straight out purchase.

It also produced a massive greed that inevitably generated bold and pervasive corruption, and an epidemic bending, breaking, ignoring rules. Ingenious corporate officers who knew how to amass fortunes at the expense of investors and employees. Accountants, the guardians of the public interest, so immersed in the greediness of their clients that they broke tablet after tablet of the auditor's commandments to protect the interest of the investor. Vast corporate investment in political life corrupted law makers. "It's not that humans have become any more greedy than in generations past," said Alan Greenspan, chairman of the Federal Reserve Bank. "It is that the venues to express greed had grown so enormously."

In the best traditions of greed, day traders—investors who jumped in and out of the market in a single day to take advantage of incremental market movements—warped the market itself, diminishing its orderliness. The daily volume of stock trading burgeoned, and where once a price/earnings ratio of 14 to 18 was considered responsible, stock prices were being run up by a greed-driven market to price/earnings ratios in the hundreds, as blind optimism trumped reality.

And then, once again, the bubble burst. So many of those wonderful dot com companies that we believed were perpetual fountains of unlimited wealth fell apart, and proved to be glitter on the outside and hollow on the inside. An astonishing number of CEOs, whose salaries and bonuses and stock options reached outlandish ratios to the salaries of their employees, turned out to be authors of outrageous frauds. Enron. WorldCom. HealthSouth. Tyco. And all aided by the greed of auditors, who seemed willing to subvert the independence of their invaluable attest function in order to accumulate more revenue from their clients. Then there was the corruption of the brokers and security analysts who knowingly lied to the public about the quality of the stocks they touted, because their firms had financed those companies, and the analysts didn't want to shut the fountain of new investment business from their investment banking clients.

It's not the purpose of this book to assess the reasons for this rash of skullduggery, other than to note that greed is greed, mendacity is mendacity, and stupidity is stupidity, and arrogance is bred of greed and mendacity and stupidity. The events speak for themselves.

The years 2001 and 2002 saw a reaction by the public, the investment community, the White House, Congress, the regulatory agencies, and the rule making bodies of the various professions involved in making and monitoring the rules governing their professions. The optimism of the last decade changed to skepticism, fear, anxiety and a loss of faith in the integrity of the very organizations supposed to protect investors. Suddenly, the face of capitalism changed, and is continuing to change.

In fact, the regulatory changes brought about by Sarbanes-Oxley, and by a newly energized and empowered Securities and Exchange Commission, are causing a revolution in American capitalism. Responsibility for corporate financial helmsmanship moves more and more from the CEO and CFO to the board of directors. The rules have changed, and corporate governance will never again be as they were in the 20th century.

Nor will the professions be the same. New accounting firm and auditing regulations mean new ways—and new responsibilities—to deal with old reporting problems may radically change traditional accounting firm structures and practices. Note that the once Big Eight is now the Big Four, not only by merger of the giants, but by the demise of the once-great Arthur Andersen.

Law firms, too, face new real and potential changes, with challenges to their responsibilities to clients and to traditional client confidentiality rules.

All in all, it's a new economic environment in which the corporate world must function.

So too is the practice of investor relations changing, and changing radically. New rules. New problems in projecting investment values and the integrity of corporate management and corporate information. New problems in separating the political from the financial reality. New problems in knowledge management. New sources of data, and data that proliferates at an overwhelming rate. New technology to speed data, if not wisdom, to target audiences. The growth of internationalism, bringing us closer to one world than ever before.

When I first started in this business, more than 40 years ago. We didn't call it investor relations. It was financial public relations—public relations, but to a financial community. The first investor relations practitioners were actually public relations practitioners, usually with the merest smattering of understanding of finances and investment principles. Gradually recognizing the advantages of financial knowledge, a few firms started hiring some out of work security analysts. A few of us went back to school to learn how to read a balance sheet and other financial arts. Ultimately, as the investment world matured, and reached out in many ways to a growing investment public, financial public relations grew to become investor relations, and the financial public relations practitioner became the investment relations officer.

The investment relations officer has long since been a fully trained financial professional, who uses communications skills to impart the values of the company to an investment public. The organization serving the investor relations professional—The National Investor Relations Institute (NIRI)—is as valuable to its members and the profession it serves as any professional body, including the American Bar Association and the American Institute of Certified Public Accountants. NIRI sustains the professionalism of its members, informs and educates them, and fosters their integrity. NIRI membership is now in excess of 4,400.

NIRI defines investor relations as "...a strategic management responsibility that integrates finance, communication, marketing, and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuations."

I concur. But in 1975, in the first edition of this book, I defined the process as a form of competing for capital in a highly competitive capital market. This is still the case, except that in view of the events of the first years of the 21st century, the rules have changed substantially, as have the participants and the vehicles of communications to the investment public. How to do it—how to think about it—in this decade, in a new and tumultuous environment, is what this book is about.

Bruce W. Marcus
Easton, CT, August 1, 2004

Competing for Capital

CHAPTER 1

Strategic Factors in a New Environment

The Coming of Sarbanes-Oxley and the Brave New World

In the few months at the end of 2001 and the beginning of 2002, the corporate and financial world saw the beginnings of a revolution of a magnitude not seen since the 1930s. Reports of corporate fraud in major companies burst like fireworks in a Summer sky. Long established concepts of prudence and integrity in financial reporting were shown to have eroded to a degree that not only surprised and shocked the investment community, but caused the downfall of a great many prominent and once-admired corporate leaders. The number of giant companies and great corporate names revealed to be rotten at the core began to be double digit. Perhaps most shocking, because it had been the icon for integrity and probity for so many generations, was the destruction of the auditing and accounting firm Arthur Andersen, once the leading and most respected name in the accounting profession. Andersen had, it seems, been derelict in too many of its audits, and was found to have been at least asleep as client fraud paraded by. The firm had possibly been a participant in the fraud at some level.

Not surprisingly, investor confidence sank to new lows. The stock market, already suffering from the burst bubble of the dot com failures, dropped precipitously. If the financial information coming from such giants as Enron, WorldCom, Tyco, HealthSouth and many, many others was so flagrantly and dishonestly reported to investors, how could an investor trust the numbers and other information coming from any other corporation, no matter how big, no matter how well respected? If numbers given to the government and investors from such companies as these and others too numerous to list had to be restated, how could an investor know which corporate numbers could be trusted?

If Big Four accounting firms, the bastions of independence, could be sued for one or more careless or faulty audits, where are the concepts of integrity in the attest function that once gave comfort to both management and investors?

Where were the monitors—those who were supposed to protect the investor? The U.S. Securities and Exchange Commission, overwhelmed, under-funded, restrained by Washington politics, had neither the teeth nor the manpower to do what they knew had to be done, nor the support of congress to enforce the SEC's mandate. The New York Stock Exchange, whose traditional structures had barely changed in the decades in which a vast array of business and economic changes had transpired, was caught in a management maelstrom that toppled its leadership.

For decades, the accounting profession had fought repeated attempts to have the accountants give self-regulation over to an outside governmental body. The American Institute of Certified Public Accountants—the AICPA—continued to the last minute to insist that only the accounting profession had the knowledge and wherewithal to set accounting standards and to uphold the integrity of those who audited financial statements. But then the events of this business revolution clearly showed them to be incapable of any real control over the integrity of the attest function.

On Wall Street, the presumed independence of security analysts and others who supply investment advice to shareholders was shown to be a farce in a great many quarters. Analysts with security underwriting firms were found to be giving false positive recommendations on securities underwritten by their own firms. It was a scandal that led to indictments of prominent names on Wall Street.

In his book, *The Future of Freedom*, Fareed Zakaria, the editor of *Newsweek International*, says that professionals (accountants, lawyers, investment bankers, and even doctors) have turned their backs on their traditional responsibilities to protect and guide the individuals they serve. The chicanery epidemic was no longer a secret.

And so, the increasing anxiety of a vast number of investors, both institutional and individual, and their growing skepticism about the informa-