Part I

The Foundations of Financial
Communication and Investor Relations

*Theory and Industry*
Sorkin (2016) calls publicly traded companies in the United States “a dying breed” (p. B6). Indeed, based on statistics from the National Bureau of Economic Research, between 1996 and 2012 the number of publicly traded companies decreased almost by half—from 8,025 to 4,101. The number of initial public offerings decreased from an average of 436 a year in 1990s to just 120 in 2015 (Colvin, 2016). The reason for the demise? According to the leaders of the financial sector—representing such companies as Berkshire Hathaway, BlackRock, JPMorgan Chase, T. Rowe Price, Vanguard, and others—there is “too little trust and connection between shareholders and management” (Sorkin, 2016, p. B6). In other words, there is too little of exactly what the investor relations professionals are responsible for!

Why do investor relations officers (IROs) fail at their jobs? Why do they fail at building trust and connection between their companies and their shareholders? The answer to this question is not simple; in fact, there may not be a one-size-fits-all answer at all. But one of the areas where we can start looking for answers to this question is public relations and strategic communication and, specifically, underutilization of public relations and strategic communication expertise in modern investor relations.

Trust is a key focus of public relations and strategic communication activities. Richard Edelman, the CEO and president of Edelman, the largest public relations agency in the world, underscores the importance of working on building and maintaining trust in all public relations programs: “Trust in institutions and their license to operate is no longer automatically granted on the basis of hierarchy or title; rather, in today’s world, trust must be earned” (Edelman, 2016, p. 16). But do investor relations professionals see their jobs as aimed at building trust?

This handbook, focused on financial communication and investor relations, provides an in-depth overview and analysis of the profession from the communication standpoint. As a result, it describes and analyses financial communication and investor relations’ history, main activities and key players, theoretical considerations, practical implications, future outlooks and concerns, and, perhaps most importantly, recommendations on how to move forward.

Definitions

Return on Expectations

The first step is, of course, agreeing on a definition. What do we mean when we say “investor relations and financial communication”? Many investor relations professionals, undeniably, will
point to a definition of investor relations adopted by the National Investor Relations Institute’s (NIRI) Board of Directors in March 2003: “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 valuation” (cited in NIRI Board of Directors, n.d.).

Other practitioners of financial communication may suggest that investors are just one of many types of publics that corporations need to communicate with; these practitioners point to a wider definition: “a strategic communication process that builds mutually beneficial relationships between organizations and their publics” (Public Relations Society of America [PRSA], 2016). Here, of course, the word “publics” is used generically and can be replaced with a specific public depending on the function—for example, for investor relations, it would be investors, and the definition then would become: “a strategic communication process that builds mutually beneficial relationships between organizations and their investors”; for employee relations, it would be employees, and the definition then would become “a strategic communication process that builds mutually beneficial relationships between organizations and their employees”; for donor relations, it would be donors, and the definition then would become “a strategic communication process that builds mutually beneficial relationships between organizations and their donors”; and so on.

Public relations and communication scholars may suggest the classic definition of public relations by Cutlip, Center, and Broom (2000): “Public relations is a management function that establishes and maintains mutually beneficial relationships between an organization and the publics on whom its success or failure depends” (p. 5). Once again, the generic word “publics” here can be replaced with the specific publics of individual specializations, such as investors. What is unique about this definition is that instead of word “communication” we see the word “management.” It could be argued that one cannot build and maintain relationships based on communications alone—actions are perhaps as important as words, or even more important. As a result, it is not enough to communicate; it is also important to act in a certain way, and for this investor relations professionals must have access to the top management of the organization and be able to influence the strategic direction of the company’s development. This is why the word “management” replaced the word “communication” in this definition.

In the end, all of these definitions are correct in highlighting the importance of investor relations and financial communication for modern-day organizations. However, the NIRI’s definition and the definitions of the PRSA and Cutlip et al. have very different final goals: the former talks about fair valuation of security and the latter talk about relationships. Laskin (2011) conducted a Delphi study of experts in the investor relations profession to find out what should be the final measure of investor relations’ contribution to corporate value. Most of the experts rejected share price as a legitimate metric. In another study, “respondents strongly rebuked ... the notion of using company share price as a valid measure of the success of investor relations” (Ragas, Laskin, & Brush, 2014, p. 186). Instead of driving the share price, investor relations improves the availability and quality of information, helping investors and analysts to develop more reliable expectations about share prices, and this may be a better measure of investor relations’ contribution.

Relationships, on the other hand, scored significantly higher among the experts. However, they were cautious about possibility of objectively measuring and evaluating the quality of relationships (Laskin, 2011). The same was also true in Ragas, Laskin, and Brush’s study (2014). Experts highlighted that it may not be relationships per se that are significant but the expectations that they help to create, which make it easier to ignore temporarily blips in performance.

As a result, a definition of investor relations and financial communication may instead focus on expectations as the key outcome: Investor relations is a function of managing expectations. This managing of expectations is a two-way street—investor relations professionals manage the expectations of investors and financial analysts about the company’s past and future performance, but they also manage the expectations of the organization’s executive team about the financial
community’s evaluation of the company and their reactions to the corporate news. The long-known equation of “return on equity,” then, is being transformed into “return on expectations,” and managing these expectations is becoming a key part of investor relations programs.

Efficient Market Hypothesis

The modern concept of investor relations is part of the efficient market hypothesis. The efficient market hypothesis is primarily associated with research by Fama (1970) and states: “A market in which prices always ‘fully reflect’ available information is called ‘efficient’” (p. 383). Such a market is in equilibrium: all securities are fairly priced, according to their risks and returns. No investors can consistently outperform, or beat, the market, and thus there is no reason to constantly buy and sell shares of companies in an attempt to outperform the average market return.

The efficient market hypothesis, however, requires key assumptions to be met: All relevant information about the company and its performance must be publicly available, all market participants must have equal access to such information on a timely basis, and all investors must be rational and capable of evaluating the information available to them. Fama (1965, 1970) talked about three levels of market efficiency: weak, semistrong, and strong. In the weak form of market efficiency, not all information is available to all market participants and, as a result, some investors can outperform others, taking advantage of better or faster access to information. In the semistrong form of efficiency, all public information is equally available to everyone and, as a result, already reflected in the stock price; however, there may be other, nonpublic, information that is not reflected in the stock price and, as a result, somebody with access to such information through, for example, insider trading can beat the market. And, finally, in the strong form of market efficiency, all information is reflected in the stock price and all investors—internal and external—have the same access to information and the same knowledge and understanding of the company.

Once again, investor relations, a function charged with providing information about a company to shareholders, financial analysts, and other market participants, is at the very foundation of the efficient market hypothesis. In fact, investor relations has become a key activity not just for particular companies but also for the whole modern economy. The survival of modern capitalism depends on how well IROs perform their task of ensuring equal access to information for various financial market participants. IROs are tasked with ensuring that the key assumptions of the efficient market hypothesis are met through extensive and timely disclosure of all relevant information pertaining to the company and its stock.

However, disclosure in itself may not be enough for a successful investor relations program. The efficient market hypothesis requires not just access to information but also understanding of the information and the development of reasonable expectations based on such information. It is possible for somebody to have access to accurate information but still make incorrect conclusions based on it or have unreasonable expectations based on that information. So, Laskin (2016) proposes that good IROs must engage in educational efforts with the goal of educating investors, “essentially outsiders, to fully grasp the value” of the company and its business model (p. 378). As a result, for IROs to be successful in the context of the efficient market hypothesis, they must do significantly more than just put the information out there—they are also responsible for making sure their messages are received, understood, processed, and acted upon.

A History of Investor Relations and Financial Communication

Preprofessional Period

Investor relations is inextricably connected with the separation of ownership and management. In the past, when blacksmiths or other craftsmen ran their businesses, they did not need to communicate their financial information or build relationships with investors because they were
the ones who financed themselves. They were the investors, managers, and employees of their enterprises. As the industries progressed, they started hiring more employees, but the original investors were typically the managers themselves. There was still no separation between ownership and management.

At some point, instead of one manager, it became more common to see a family—fathers, sons, uncles, mothers, daughters, aunts, and so on—as investors and managers, and family businesses began to replace sole craftspersons. But still, family relations were used instead of investor relations in such family enterprises. Finally, the demands of these enterprises became larger than one person or even one family could satisfy. They required resources to be pulled together from many different individuals. Shareholding companies became necessary.

It is fitting that the first shareholding company is alleged to have been a mining company. Extracting resources from the earth is a massive undertaking that indeed requires the efforts and resources of many people to come together. The copper mine in the Swedish town of Falun is believed (based on archaeological studies in the area) to have been operational since the year 1000 (Rydberg, 1979). However, the first official documentation of the Stora Kopparberg Bergslags Aktiebolag, a corporation responsible for mining the Falun mine, dates back to June 16, 1288, when 12.5% of Stora Kopparberg’s shares were sold (“The Oldest,” 1963; see Figure 1.1). Thus, we can say that the history of shareholding companies dates back to the 13th century.

In 1347, as the largest copper supplier in Europe, the company was granted a charter by King Magnus Eriksson allowing it to “[set] up a corporation of master miners” (“The Oldest,” 1963, p. 98). The company is still in operation today, with 2015 sales of over €10 billion and operational

Figure 1.1  The oldest share: Stora Kopparberg original shares, June 16, 1288. Courtesy of the National Archives of Sweden.
earnings before interest and tax of €915 million. It is still a shareholding company, with shares traded on the Stockholm and Helsinki stock exchanges. It employs about 26,000 people in 35 countries and its focus has shifted from copper to “renewable solutions in packaging, biomaterials, wooden constructions and paper on global markets” (Stora Enso, n.d.).

Although Stora Enso is the first example of the separation of management and ownership, at its start it was not a publicly traded company. In other words, not anyone could purchase a share in Stora Kopparberg. In fact, the shares were reserved for professional miners and noble people of the area. The first publicly traded company, in which shares could be purchased by anybody who was willing to pay the price, is believed to have been the Dutch East India Company. The company, founded in 1602 for the primary purpose of trading between Asia and Europe, is claimed to be not just the first publicly traded company but also the first multinational company (Van Elderen, 2011). The first publicly traded company also required the first stock exchange: “The Amsterdam bourse was founded in September 1602 within six months of the [Dutch East India Company’s] formation and was an integral component to its success” (Chambers, 2006, p. 1).

The revolutionizing idea of opening the company’s ownership up to the people allowed the company to bring in more than 6 million guilders. The share price jumped about 15% in the initial period of trading, with a subsequent increase of 300% over the next 20 years. As a result, the Dutch East India Company was able to finance its growth to unprecedented heights: It had 50,000 civilian employees, with a private army of 40 warships, 20,000 sailors and 10,000 soldiers and a mind blowing dividend flow. . . . With a market for its stocks and bonds, the Dutch East India Company became probably the most powerful business in the history of the world” (Chambers, 2006, p. 1).

In the United States, investments in the securities of companies became popular at the beginning of the twentieth century. Macey and Miller (1991) explain this development by pointing to a variety of factors happening at the same time:

The growth of large industries such as railroads and heavy manufacturing stimulated unprecedented demands for capital. At the same time, increases in wealth among the middle classes created a new source of capital that could be tapped effectively by means of public securities issuance. Developments in transportation and communication technology made widespread promotion and distribution of securities practicable. Realizing the potential purchasing power of the rising middle class, bond issuers began to offer securities in denominations of $100 instead of the traditional denominations of $1,000 or even $10,000. A surge of new investment followed. (pp. 352–353)

In addition to traditional blue chips, many speculative securities appeared that promised get-rich-quick opportunities: metal mines, oil companies, gold companies—usually something distant and at the very early stages of development. “The speculative securities in the early 1900s were typically equity securities issued by mining and petroleum companies, land development schemes (such as irrigation and tract housing projects), and patent development promotions” (Macey & Miller, 1991, p. 353). Many investors lost money in these schemes. The securities markets at the time had a severe informational problem—it was difficult, if not impossible, to verify the claims made about the securities, especially if the shares were part of a distant California gold mine, for example.

These speculative securities were also distributed outside normal distribution channels—often by door-to-door salesmen and in other face-to-face solicitations. The securities salesmen were also among the first to use mailing lists—which traditional brokers referred to as “sucker lists”—where securities were hyped beyond any measure: “one-third of which [letter] is devoted to an extravagant flattery of the intelligence of the recipient, and the remaining two-thirds to the extolling of the excellent merits of the Gold Hammer Mines and Tunnel Company, from the investment standpoint; after which this most valuable stock is offered at the amazingly low price of seven and one-half cents a share” (as cited in Macey & Miller, 1991, p. 354).
As a result, thousands and millions of dollars were lost to “pure fake” and “near fake” enterprises (Macey & Miller, 1991, p. 367). Other enterprises may only have been too risky and too speculative, but the end result for investors was the same—loss of money. Investors could not rely on the truthfulness of statements made in connection with securities transactions, and that put the whole securities market in jeopardy. A banking journal at the start of the 20th century wrote: “So many people have lost their money on ‘fake’ investments that they seem to be incapable of distinguishing the false from the genuine, and hence are distrustful of all” (as cited in Macey & Miller, 1991, p. 394).

These developments required Kansas in 1911 to enact legislation to protect its citizens from these con artists. As Kansas Banking Commissioner J. N. Dolley complained, these fakers were duping unwitting investors by selling worthless interests in fly-by-night companies and gold mines along the back roads of Kansas. Yet, no actual assets backed up these securities, nothing but the blue skies of Kansas (Gelber, 2013). The first actual use of the term “blue sky” dates back to June 5, 1895, when an article in the Colorado newspaper *Castle Rock Journal* stated: “When a promoter by artful persuasion succeeds in getting money for something which has no value except in the mind of the credulous purchaser he is said to have been selling ‘blue sky’” (as cited in Gelber, 2013). As a result, these types of securities were called “blue sky” and “hot air” securities (Wooldridge, 1906), and later just “blue sky securities.”

Soon after Kansas, other states followed with their own regulations and, as a result, a network of comprehensive securities legislation developed at the state level. These state laws are commonly referred to as “blue sky laws”:

The name that is given to the law indicates the evil at which it is aimed, that is, to use the language of a cited case, “speculative schemes which have no more basis than so many feet of ‘blue sky’”; or, as stated by counsel in another case, “to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines and other like fraudulent exploitations” (*Hall v. Geiger-Jones Co.*, 1917, p. 539).

These laws created the first requirements for disclosure and securities registration. The issuers were required to file periodic reports on the financial conditions of the company; before selling its securities in a state, the company was required to provide a business plan and a copy of the securities offered for sale. The state had the right to ban the company from doing business in the state if it did not “promise a fair return on the stocks, bonds or other securities” (as cited in Macey & Miller, 1991, p. 361).

So, as a result, the first type of securities regulation that could have started the development of investor relations and financial communication in the United States, blue sky laws, were created as

a means to thwart the schemes of a class of people who were denigrated repeatedly as fly-by-night operators, fraudulent promoters, robbers, cancers, vultures, swindlers, grafters, crooks, gold-brick men, fakirs, parasites, confidence men, bunco artists, get-rich-quick Wallingfords, and so on. Against this class of bad operators was counterpoised a class of victims, usually portrayed as innocent, weak minded, vacillating, foolish, or guileless, and usually cast in the roles of widows, orphans, farmers, little idiots or working people. (Macey & Miller, 1991, p. 389)

The legislation was needed not just for their protection, however. In fact, “if consumers could not discover accurate information about the quality of securities offered for sale, a loss of confidence in securities markets generally might result” (Macey & Miller, 1991, p. 394). The legislation was needed for the protection of the whole of society. “The functioning of capital markets in facilitating capital formation would be severely impaired, to the detriment of issuers, buyers, and the economy at large” (p. 390).
Blue sky laws were not universally praised, however. Some issuers had concerns about how these laws could affect their ability to raise capital and the extra burden the regulations imposed on them. But probably the biggest opponent of blue sky laws was the Investment Bankers Association, which saw these laws as an attempt to keep money within state borders and prevent or impede interstate security trade—and perhaps not without reason. One Louisiana financial professional was quoted as saying: “the sooner we learn the lesson of keeping our money at home and patronizing home industry, instead of putting it into the hands of the New York Stock Exchange speculators and gamblers, the better it will be for our State and the South” (as cited in Macey & Miller, 1991, p. 361).

World War I, the Great Depression, and World War II slowed down the development of financial markets as well as of investor relations and financial communication. However, the most important federal regulations appeared at that time—the Securities Act of 1933 and the Securities Exchange Act of 1934. These laws paved the way for the professionalization of investor relations and continue to influence the practice of financial communications in the United States today.

Professional Period

The history of the professional period of investor relations and financial communication in the United States begins after the end of World War II. This period saw the creation of professional associations; the appearance of such titles as “investor relations officers,” “vice presidents,” and “specialists”; the arrival of big and small financial communication agencies; and the advent of stand-alone corporate investor relations departments. This period can be divided into three historical eras (Laskin, 2008, 2010b): the communication era, when the investor relations and financial communication landscape was dominated by people with communication backgrounds; the financial era, when the pendulum swung the other way and the field became dominated by professionals with financial and accounting degrees; and, finally, the current era, the synergy era, in which the industry is looking for a balance between communication and financial fields of expertise (see Table 1.1).

Table 1.1 Historical eras of investor relations and financial communication, and their characteristics.

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<td>Comparison with public relations models</td>
<td>Press agentry/publicity and public information</td>
<td>Two-way, asymmetrical</td>
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<td>Purpose</td>
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<td>Direction of communication</td>
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<td>Intended beneficiary</td>
<td>Organization</td>
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<td>Structural location</td>
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<td>Background of practitioners</td>
<td>Communication, journalism</td>
<td>Finance, accounting</td>
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It is also possible to draw parallels between the three historical eras of investor relations and four historical models of public relations: press agentry/publicity, public information, two-way asymmetrical, and two-way symmetrical (J. E. Grunig & Hunt, 1984), although many differences can be observed as well. In the following sections, each of these three eras will be described in more detail.

Communication era: 1945–1975

Although J. E. Grunig and Hunt (1984) identify press agentry/publicity and public information as two separate models in the development of the public relations profession, in investor relations press agentry/publicity and public information developed in the same time period and represent the same era. This era was characterized by the domination of public relations and other communication professionals in performing the duties of IROs. Thus, this era is labeled the communication era.

The earliest mention of the investor relations function is traced to Ralph Cordiner, a chairman of General Electric who in 1953 created a department in charge of all shareholder communications (Morrill, 1995). The first consulting agencies also began offering investor relations services. Most of the investor relations work focused on putting the word out about organizations and attracting the attention of financial publics to the stock. Silver (2004) recalls that “investor relations emerged into its own in the 1960s, often associated ... with the so-called dog and pony shows for sell-side analysts and retail investors, usually held at the offices of securities brokerages” (p. 70).

These developments were a response to the post-World War II economic boom that generated wealth for private Americans and at the same time encouraged business growth to satisfy the constantly growing needs of consumers. The corporations needed money to grow and develop; people needed a way to invest surplus income. In this situation, the meeting of the two worlds was inevitable.

The first corporations to strategically target private shareholder–consumers were car companies, such as Ford, GM, and Chrysler. It was no surprise that car companies figured out that, if you give at least one share to a person, that person will never buy a competitor’s vehicle from that point on—and vice versa. Product marketing, as a result, merged with stock marketing. Increasing the demand for stock became an important part of the corporate agenda: “Occupants of the executive suites were quick to see, that all of this demand for stock was helping to push prices up and up. This helped immensely to finance growth, enhance empires” (Morrill, 1995). The companies accustomed to competing in the product market brought similar tactics to their competition in the financial markets.

In fact, shareholder capital is a finite pool and companies have to compete for this resource. Marcus and Wallace (1997) quote James J. Needham, a former chairman of the New York Stock Exchange, who suggested that “even if the equities markets are called upon to supply no more than 10 to 15% of the total, we will be asking American investors to pony up an amount roughly equivalent to the entire present federal debt to keep U.S. business moving forward during the next 10 years” (p. 7). Thus, the investor relations function was charged with the task of grabbing investors’ attention and selling them the company in a fierce competition with other corporations.

This was, however, a new experience for many corporations, and a form of competition for which they were not prepared. Thus, most corporations looked outside for help. Unfortunately for them, investor relations agencies did not exist yet. In this vacuum of investor relations expertise, someone had to fill this niche. Not surprisingly, management turned to the recognized experts in communication—public relations; investor relations was viewed as an extension of the public relations function.

In the 1950s, however, public relations was not a well-established practice itself. Only the largest companies had internal public relations staff and the functions and roles of public relations were
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quite limited. Cutlip (1994) suggests that in the first half of the twentieth century many viewed public relations as a simple adjunct to advertising to stimulate better sales. In addition, the end of World War II and the booming economy left little time for public relations, which was sliding to the bottom of the priority list. In fact, “many companies were undergoing radical change, often in the form of mergers and acquisitions, with new businesses and new executive personnel appearing on the scene. In these fluid situations, public relations often fell to the person nearest at hand—an administrative officer, a personnel chief, the senior lawyer or corporate secretary” (Morrill, 1995).

In other words, when corporations turned to public relations to manage investor relations, public relations was not yet ready to take on this challenge.

At that time, public relations was still struggling for the right to strategically manage itself as it was often a purely technical function of media relations. Public relations education and research were not fully developed. Lack of a systematized body of knowledge and qualified, educated personnel made it difficult for public relations to provide quality service in the investor relations field. Although pioneers of public relations, having acquired tremendous experience during World War II, started offering strategic counseling, for many public relations was still mere press agentry. *Fortune* magazine reported that press agentry was a dominant tool in the public relations arsenal on the eve of the 1950s (“Business,” 1949). Robinson (1966) notes, “The practitioners in the field, along with the whole discipline of public relations itself, just ‘grew like Topsy’ without a common body of knowledge or without evolving any theory to guide their problem-solving efforts” (p. 40).

Although professional books on public relations existed, the first public relations textbook was published only in 1952. The authors of the book, Cutlip and Center (1952), in the preface to the first edition, recognized that there was no “single book, fundamental in its approach and yet comprehensive in its coverage of the practice” (p. v). Public relations courses at colleges were quite rare despite the fact that the very first course on public relations was taught by Edward Bernays at New York University back in 1923 (J. E. Grunig & Hunt, 1984). J. E. Grunig and Hunt note that the majority of practitioners did not have a formal education in public relations. In fact, public relations education “took off” only in the 1980s (p. 78). The first public relations scholarly journal appeared only in 1975 (Wright, 2007).

As a result, the new and not-well-established public relations function was suddenly charged with the additional duties of the investor relations job—a job for which most practitioners on the corporate and agency sides were not qualified. So, they approached this new task in the same way they approached other public relations tasks—relying on press agentry and publicity:

In concrete terms, shareholder relations became transformed into publicity, promotion and pageants…. The annual reports suddenly blossomed as a 48-page, glossy sales brochure for the company’s products. The financials were there, mandatorily, but the sell was in the sizzle, not the steak…. The annual meeting became a huge, gala free-for-all. A large eastern railroad put together a special train for stockholders and carried them first class to a company-owned hotel in the southern Appalachians for the meeting…. An international telecommunications company held a large gathering under two large tents in central New Jersey. A bountiful lunch was served, and there were several open bars. Members of the press were delivered in limousines from New York and returned the same way. Products were richly displayed. The chairman, himself a noted gourmet and bon vivant, addressed the gathering. Reactions were enthusiastic—but absolutely nothing of substance was done…. Companies made gifts or gift boxes of products available to shareholders, sometimes free. Liquor companies also provided their products under advantageous purchase agreements…. Perhaps [the way companies treated their shareholders] could be compared more to entertaining a blind date than developing a relationship. (Morrill, 1995).

In addition, public relations practitioners who suddenly found themselves in charge of investor relations often “had little or no understanding of finance or of financial markets” (Morrill, 1995).
and did not understand how the markets worked or who the players were. The public relations practitioners were not ready to manage investor relations:

Punctilious attention to financial details was not one of their strong suits. The story was. They were skilled in using the media, and the brokerage community, to propagate stories about their clients best calculated to arouse investor attention. Often they did not really understand more than the bare rudiments of what they were trying to sell. . . . The trend to producing, peddling and promoting half-truths and untruths, even if cloaked in hedged language, was increasing at an accelerating rate—a sort of monkey see, monkey do syndrome. (Morrill, 1995).

Laskin (2010a) concludes that “public relations was set up to fail in investor relations—it just came too early” (p. 11).

The variety of new private shareholders was also a novelty for many corporations in the 1950s and created another incentive (along with the need to compete for capital) for the formation of investor relations departments. The new shareholders owned very small amounts of stock and had very little understanding of business and finance, but the sense of ownership among them was great. These new shareholders craved information, yet, because of their large numbers, it was difficult to communicate with all of them directly. The financial intermediaries who transmit large amounts of financial information today were not well developed in the 1950s. The private shareholders had to be the direct targets of early investor relations communications.

However, the management also did not want to take the private shareholders seriously and invest any effort in communicating with them. So, managers were looking for a way to communicate with these shareholders from a distance, to give them information without meeting with them in person, preferably without any chance for shareholders to respond or ask questions. Public relations was ready to oblige again: “Many have engaged public relations counsel, or similarly styled agencies who issue press releases” (Benjamin Graham writing in 1951, as cited in Morrill, 1995). Today, hardly anyone would equate investor relations with media relations. Laskin (2009) claims that media relations is among the lowest-priority tasks for today’s IROs. In the 1950s, however, press communications was a significant part of the investor relations job.

In addition, the corporations did not have any interest in listening to their shareholders—the focus was on a one-way stream of information from the company to the financial publics. Chatlos (1984), the founder and former president of the NRI, notes: “The trickle of information sponsored by corporations became a torrent” (p. 85). No feedback was received or analyzed.

The publicity and public information eras of public relations contributed substantially to the development of many negative connotations of the term “public relations” today. This was probably also the cause of investor relations trying to actively distinguish itself from public relations and disassociate itself from public relations education, professional associations, and consulting agencies. Cutlip et al. (2000) observe: “As press agents grew in number and their exploits became more outrageous—albeit successful, more often than not—it was natural that they would arouse the hostility and suspicion of editors and inevitable that the practice and its practitioners would become tainted. This stigma remains as part of the heritage of public relations” (p. 107).

The same stigma tainted public relations in the financial world: “The word public relations became increasingly a pejorative in Wall Street” (Morrill, 1995). Public relations practitioners lost credibility in the eyes of the financial publics—their ethics, integrity, and simply their ability to handle investor relations were questioned. Investor relations engaged in significant efforts to distinguish itself from any public relations background. Whereas at first they had considered joining the PRSA, in the 1960s investor relations practitioners began to talk about the need to create their own professional organization where the public relations “chaff” would not be allowed.

An association of investor relations practitioners, the Investor Relations Association (later the NIRI), came about in 1967. It kept its promise and made every effort to differentiate its members from public relations practitioners by conducting strict background checks on all applicants: “Our
aim is to separate ourselves from the so-called financial public relations consultants, who operate on the fringe of stock touting, and who are fouling the nest” (as cited in Morrill, 1995). As a result, investor relations emerged as a subset of public relations. However, it emerged at a time when public relations itself was rarely more than press agentry. Lack of financial expertise, lack of ethics, and lack of strategic vision hurt investor relations in its early stage and moved the function away from public relations departments. Much of the public relations and communication expertise was voluntarily cut off and disregarded as unnecessary or even harmful in favor of financial and accounting expertise.

**Financial era: 1975–2005**

The 1970s saw a shift from individual retail investors to institutional investors. On one side, the enormous growth of investment activities in the 1950s and 1960s put pressure on the financial markets’ infrastructure. The growth in individual investors in the United States was exponential in the years after World War II: from 4.5 million in 1952 to over 20 million in 1965, which represented every sixth adult in the country. Chatlos (1984) writes:

As the trading and brokerage system creaked and strained under the increasing load of activity imposed on it, Wall Street’s response was less than prudent. Profitable success after success as “the only game in town” proved to be a harsh taskmaster to the system. When problems emerged because sale activities were extended beyond the back offices’ ability to handle the resulting volume, the immediate response was arrogant quick fixes rather than anticipatory long-term business planning. (p. 87)

When it became painfully obvious that the system could not handle any more transactions, the response was a monopolistic one. Banks stopped taking on any new clients. Brokers became particular in choosing whom to work with or whom to drop from the client list. The processing times were long and the services were not friendly.

Another problem was the track record. The market was growing in leaps and bounds after World War II and shareholders (especially individual shareholders) expected it to continue like this forever. The expectations became too high for the reality to deliver. In other words, “success bred a level of expectations that could not be fulfilled” (Chatlos, 1984, p. 87). The system was destroying itself: A system built on volume of transactions could not handle that volume any more and the customers were ready to quit:

Customers were less than happy and did what might have been expected. They walked away. They did not sell their shares. They just walked away. For a system geared to the retail trade—and in many respects it remains so today—it was a devastating blow. The system was geared to volume, couldn’t plan for high volume, and suddenly had very little volume. Again, as could have been expected, broker failures and bankruptcy-avoiding mergers followed. It was a grim sight and the individual shareholder moved further away from the system. (Chatlos, 1984, p. 87)

Professional investors began replacing retail investors. Consolidation was the name of the game. It was time to take all these retail investors with a few thousand dollars in investments each and pull them together into investment funds. Although mutual funds had existed for years, they became popular only in the 1970s. The first ever index fund available for individual investors, First Index Investment Trust, was formed in 1976 by the Vanguard Group (“Vanguard 500,” 2016) as a response to the changing market demands.

This, however, meant a change for investor relations—instead of retail shareholders, they would now face professional investors. Instead of less-than-knowledgeable individuals, overqualified stock analysts became the main contacts of investor relations. The whole expertise previously geared toward private retail shareholder was becoming less and less relevant. It was no longer relevant to issue communications through mass media to reach a crowd of retail shareholders or to
organize majestic special events to put the company’s name out there: “Because of the legal fiducial responsibilities to their clients, these institutions ... demanded detailed and timely strategic and financial information” (Higgins, 2000, p. 24). They could not be satisfied by gift baskets or tours of company headquarters—they demanded detailed information on the company’s performance.

Financial analysts, however, were not valued highly in the corporate world; in fact, they were often regarded as “pests or worse” (Morrill, 1995). Yet, educated and knowledgeable, analysts demanded a large amount of information on the company’s finances, strategy, sales, research and development, and so on. Investor relations practitioners at the time, however, were not capable of providing such information and often even of speaking the same language as the analysts did.

In addition, financial analysts themselves were not accustomed to dealing with investor relations people. In fact, analysts were around long before the 1970s. In 1945, the New York Analysts Society already had 700 members and the number was growing fast (Morrill, 1995). IROs, however, did not communicate with the analysts before the 1970s as they were mostly occupied with the retail shareholders, the dominant market force of the time. The job of communicating with analysts often fell to a CFO or somebody in the CFO’s office. As a result, when the 1970s brought a shift from retail to institutional ownership, many institutional analysts already had their preestablished contacts at the organization—most often in the finance department. Furthermore, many analysts were not even aware that they needed to communicate with the investor relations or public relations people instead. They tended to go to the same source they used to go to earlier—a person in the treasury or finance department.

The role of mass-mediated communications in investor relations suddenly lost its importance. Public relations practitioners were losing their grip on investor relations, while the financial departments were engaging in talks with analysts and institutional investors more and more often.

In addition, typically, CEOs were actively trying to avoid the financial gurus of Wall Street as much as they had been trying to avoid private shareholders earlier. Managers were used to being the ones running the show and they did not plan on sharing their power with either poorly educated private shareholders or overeducated financial analysts. However, private shareholders were easy to deal with and could be kept at bay by using mass media and giving them occasional handouts. Management succeeded in creating “a nice warm feeling” in shareholders and keeping them “happy and calm” by avoiding “telling them anything that wasn’t legally required” (Morrill, 1995). The financial analysts, however, were far more difficult to please.

Financial analysts were not satisfied by the little amount of substantial information the companies were disclosing. They asked questions, sometimes questions “that management had not asked itself, or for various reasons did not want to answer” (Morrill, 1995). Even more, they had power over the companies they owned stock in and perhaps even more power over the companies they did not invest in. Large institutional players could sweep all of the company’s shares off the market, pushing the price up just to unload the same shares several days later, plummeting the stock. Chatlos (1984) recalls: “The new institutions had so much money to invest that there literally was not enough time to observe the prudent ground rules. The new method was to dump the shares when a sell decision was made and to buy as quickly as possible when that decision was made. This had a severe impact on market price volatility” (p. 88). If earlier private shareholders at least smoothed out this volatility, in the 1970s, with individuals off market, the price was in the hands of the financial analysts. A single word from a company to a financial analyst could change the price of the stock enormously. The management decided they would rather avoid meeting with analysts altogether for fear of saying something wrong.

As a result, the investor relations profession in the 1970s experienced a notable change. Investor relations moved away from the public relations practices of the 1950s and 1960s. First, there was no longer any need for mass-mediated communications to the myriad private shareholders, who had moved out of the market. Second, institutional investors demanded other communication channels than mass media. In addition, earlier public-relations-based investor relations practice had left a bad taste in the mouth of Wall Street professionals, and financial analysts rarely wanted
to communicate with this breed of investor relations. Institutional investors and analysts tried to talk with the management of the company directly. The management, however, avoided any direct contact, choosing instead to communicate through corporate secretaries or forward the calls to the CFO’s office or the treasury department.

In response to these changing demands, the press agentry/publicity and public information types of the communication era of investor relations were being substituted with new types of investor relations professionals who came to investor relations from financial or accounting positions. Management often saw former financial analysts as ideal IROs because it was anticipated that they would easily find a common language with the company’s financial analysts and professional investors. Wall Street-based firms started offering investor relations services, too. These firms were often outgrowths of investment banks and thus had strong connections with and a deep understanding of the financial markets.

These changes in the investor relations landscape had a strong effect on the investor relations function itself. Powerful and knowledgeable institutional investors evaluated every action a company took and were not afraid to ask questions and provide criticism if they did not believe the action was in the best interests of shareholders. Higgins (2000) describes the new institutional investors: “They have successfully sought an activist role in corporate governance, focusing their institutional power on company’s performance, the proper role of the board of directors, and executive compensation. . . . The overall impact of the institutionalization of U.S. equity markets has been to make the job of the investor relations executive infinitely more challenging and complex” (pp. 24–25). From providers of information, investor relations professionals had to turn into defenders of managers’ decisions—if investors criticized companies’ actions, investor relations was expected to provide counterarguments to explain and protect those actions. Proactive investor relations practices called for anticipating shareholders’ reactions and being prepared to respond to them in advance. Shareholder research became a necessity. Other IROs simply did not allow negative questions to be asked at conferences and annual meetings, tightly controlling the communication channels.

The focus was on persuasion and making the sell. Marcus and Wallace (1997) explain that investor relations was “the process by which we inform and persuade investors of the value inherent in the securities we offer as means to capitalize business” (p. xi). Ryan and Jacobs (2005), financial analysts turned investor relations consultants, suggest the investor relations contribution helped management “to package their story for institutional buyers or sell-side analysts” (p. 69).

This financial era of investor relations history was focused on professional investors and financial analysts. For the task of defending the corporation, CEOs were hiring former financial analysts and professional investors, who became the new investor relations professionals. They lacked public relations knowledge and skills, but they understood the numbers and knew the rules of Wall Street. CEOs needed to have somebody between themselves and the professional investment community and decided to give it a try. Investor relations at that time was often viewed as a marketing activity with the goal of having a positive impact on a company’s value, according to an older definition of the profession by the NIRI (Laskin, 2008). This led to a constant struggle for an overevaluation and attempts to push the share price up by any means necessary.

The collapse was inevitable. The chain of corporate scandals brought down even companies once thought to be among the leaders of their fields—Enron, Tyco, WorldCom, Arthur Andersen, and others. CEOs realized that investor relations is more than just a financial function and started looking for communication expertise again—the pendulum was swinging back:

It is not the ordinary and rather static “punch up the numbers,” financial modeling or knowledge of legal precedent which grabs the attention of the CEO. Rather, having a solid pedigree in communications effectiveness . . . is the key differentiating factor that CEOs most commonly say adds the greatest value in an investor relations officer. . . . In no uncertain terms, CEOs indicated that they now more often value the IRO as a communications partner as opposed to an executive steeped in accounting, finance or compliance. (Rivel & Peebles, 2008, p. 18)
Yet, this communication expertise was not easy to find—programs, majors, minors, and even individual courses in investor relations were rare (Laskin, 2014).

**Synergy era: 2005—**

The future of investor relations, however, seems likely to hold more changes in the role and scope of investor relations activities. Protecting the company and its management through persuasion and pushing up the stock price through marketing may give way to dialogue, managing the expectations of the management and shareholders, and the development of long-term understanding. This shift indicates a certain return of communication expertise to the investor relations profession, but it also indicates that financial expertise must remain as well.

In fact, this era requires expertise in both areas—communication and finance—to be present and coexist in investor relations programs. Such investor relations practice will finally be what Morrill (1995) envisioned when he explained that both communication and finance must merge to create sophisticated and successful investor relations programs. IROs will need to gain proficiency in both areas as well through dual degrees, graduate degrees, or professional training.

In the 1970s, when investor relations was being shuffled between the public relations and treasury departments, Savage (1972), in a *Harvard Business Review* article, observed the need for synergy:

Aside from those companies that assign to the investor relations function whoever happens to be available (one major corporation, for example, gave investor relations duties to a retired chemist), many organizations make one of two common errors:

1. Some companies will decide that investor relations are properly a part of public relations. They are unaware that many security analysts feel uncomfortable when talking with public relations people because, rightly or wrongly, analysts are generally suspicious of being “snowed.”
2. Other companies assume that the best candidate for the investor relations function is found in the treasurer’s or controller’s department. Security analysts, they reason, are figure-happy, and who is better qualified to throw around statistics than the man who has lived with them? Such reasoning is unsound, and if it accomplishes nothing else, it serves to demonstrate that the chief executive of the company has not got the message of what investor relations is all about. A moment’s reflection will reveal that knowledge of the figure does not, per se, establish ability to communicate that knowledge effectively.

The solution to be found lies somewhere between these two extremes. The best candidate for the investor relations post will have had experience in both public relations and the financial phases of a company’s operations. (pp. 126–127)

The synergy era requires IROs to be experts in both communications and finance, and to have knowledge about securities laws. The new investor relations professionals are not mere advocates of management—they listen to investors and analysts and bring the feedback back to the company. Shareholder research and the collection of feedback from the financial community have become of vital importance. Chatlos (1974) suggests that the goal of investor relations is “reaching and hearing from a diverse audience” (p. 3). Investor relations professionals are responsible for the important task of researching “who the shareholders were, what they perceived their needs to be and how best to communicate with them—and for them to communicate with management” (Morrill, 1995).

In today’s investment market, responsibilities of IROs to the investment community at large are growing. “Investor relations officers should heed marketplace rumblings about earnings mea- surers and understand exactly what analysts and investors of the company want, but may not be getting, from financial disclosures,” writes Allen (2002, p. 210). Investor relations today is based
on dialogue rather than monologues—two-way communication has become a key strategy in communicating with investors.

This feedback serves both the management of the company and the shareholders. Shareholders are as likely to persuade management to adopt the shareholders’ propositions as management is likely to persuade shareholders to follow management’s recommendations. Similarly to the two-way symmetrical communication model (J. E. Grunig, 1984) or mixed-motive model (Murphy, 1991), IROs have become loyal both to their employers and to their target publics. The goal of investor relations is to have the interests of shareholders and management aligned. Indeed, serving investors is exactly what corporations’ management requires from IROs. Lou Thompson, a former president of the NIRI, elucidates:

The role of investor relations is to minimize investor risk by assuring that the company is providing information that is clear and understandable through means that achieve full and fair disclosure. The lower the perceived risk in investing in a company, the lower the company’s cost of capital. There is a true bottom line benefit of full and fair disclosure. (as cited in Allen, 2002, p. 209)

In other words, the more investor relations serves the public—the investment community—the better it is for the organization because it decreases investors’ risk and thus decreases the cost of capital for the company. Two-way communications appear to be at the very heart of the investor relations profession.

Kelly, Laskin, and Rosenstein (2010) applied the models of public relations to the investor relations practice. They discovered that, although most of the studies in public relations have found press agentry/publicity to be the dominant model of the practice, “investor relations officers and their publicly owned corporations predominantly practice two-way symmetrical public relations with investor publics” (p. 17). This result, however, was expected by L. A. Grunig, Grunig, and Dozier (2002), who suggested that investor relations is likely to practice the two-way symmetrical model because the investors are influential publics with significant power over organizations.

The previous era saw IROs as technicians following directions or responding to shareholders’ requests. Rao and Sivakumar (1999) observed that IROs were mostly consumed by technical rather than strategic activities: “an exclusive emphasis on intended technical activities deflects attention from the symbolic nature of investor relations departments and the institutional sources of organizational structure” (p. 30). Investor relations today is becoming a management responsibility with a certain autonomy and decision-making power within the corporate structure. IROs are engaged in more proactive communications than before, through conference calls, roadshows, conference participation, and similar (Laskin, 2009).

As in the previous eras, the shift to the synergy era was caused by changes in the economy. The shocking corporate failures of the early 21st century, including the collapse of dot-coms and accounting scandals at the largest companies, put the whole model of the corporate United States to the test. Allen (2002) explains: “In the post-Enron era, investor relations vaults to the top of the corporate agenda, as companies must begin to rebuild investor confidence” (p. 206). Laskin and Samoilenko (2014) suggest that the collapse of Enron was the wake-up call for investor relations practice, which now had to assume more responsibilities than ever before. Suddenly, the unprecedented growth in the stock market was replaced by recession. Competition for capital became more intense. Investor relations became one of the key activities that could make or break a corporation; CEOs saw that investor relations is not an auxiliary function but an activity that can create “a competitive advantage” (Allen, 2002, p. 207).

The scandals led to stiffer regulations from the US Securities and Exchange Commission and Congress, with the passage of the Sarbanes–Oxley Act in 2002, aimed at improving corporate governance and making managers and boards of directors more accountable. The Act expanded the scope of required disclosures and changed the disclosure procedures. But investor relations has to go beyond the publication of obligatory disclosure documents. Investor relations is not
about the amount of information provided. Rather, it is about understanding. Investor relations’
task is to help investors understand the company and its business model. The goal is not as high
a valuation as possible but rather a fair value of the stock price. Finding the right investors, build-
ing trust and relationships with them, and developing long-term ownership patterns to combat
volatility are the new goals of the profession.

Investors themselves are changing. They are not satisfied with the information in the obligatory
disclosure filings despite the increased amount of such information. They want to understand
the company, its strategy, its vision, and its role in society. Favaro (2001) explains that today
communications targeted at investors “have to be able to explain not only the numbers, but also
the nature of the business, its long-term strategy, and non-financial information, as investors have
learned to incorporate these higher-level questions into their buy and sell decisions” (p. 7).

The history of investor relations shows that this is an integrated function. It is most successful
when it is not limited to just one area of expertise. A successful IRO is more than a financial-
analyst-in-residence or a promotional-publicist-in-residence—in either of these possibilities, a
great deal of value is being left at the table. Investor relations is a profession in its own right
that requires its own set of skills and expertise. At the very least, it combines both communica-
tion and financial skill sets:

Prevailing wisdom is that inasmuch as it [investor relations] deals largely with financial data it is best
left in the Financial Department and, perhaps, staffed by ex-security analysts, lawyers or other com-
fortable with numbers…. This may be yesterday’s rationale. The [Return on Equity] analysts are
really interested in Return on Expectations. We submit that too often missing from the “quants”
communications is any sense of corporate vision; or long range strategic rationale; or corporate com-
petence; or leadership—all subjective values better left to broad-gauged PR [public relations] people
to communicate. (Budd, 1993, pp. 44–45)

Although it is doubtful that public relations professionals will be much better at investor relations
than ex-financial analysts, the importance of communicating both “quants” and “quals” cannot be
doubted. Thus, perhaps, instead of arguing that investor relations is better left to communication
specialists (as was the case in the earliest era of investor relations history) or that investor relations
is better left to financial specialists (as was the case in the second era), the profession can start
working on integrating both areas of expertise. And as such enter the third era of investor relations
development: synergy.

Today’s investor relations cannot settle for only financial disclosure—investors are not inter-
ested in seeing the 10-K. Rather, investors are interested in understanding the company, its busi-
ness model, and its value-generation capabilities. If it involves reading a 10-K, investors will read
it. But typically it requires more than that and this is where investor relations can earn its keep by
of the [investor relations] specialists will be more important than ever” (p. 211). It has become
important for IROs not only to know the words of the investor relations language (financial terms)
but also to know the grammar of this language and the proper ways to use these words (strate-
gic communication). In other words, both areas of expertise—business and communication—are
essential to the modern practice of investor relations.

The changes in the media landscape and communication technologies have also brought
changes to investor relations. Following the information age, when information was the most
valuable asset, we are now in the postinformation age, when information is widely available to
everybody and in fact commoditized. IROs must take into account the impact of investor relations
messages not just on investors but also on employees, consumers, and others. Favaro (2001)
points out that today investor relations practitioners must “possess extraordinary public rela-
tions skills and understand the implications of upcoming announcements for all of the company’s
major stakeholders—including employees and the community—and not just the shareholders”
Investor relations is a strategic function that involves managing the expectations of both the investment community and management. It is a subfunction of strategic communication and public relations and, as such, it has certain similarities with the historical development of the overall field. However, it also has certain differences along its timeline, both between specific periods and in the characteristics of these periods. In general, the historical professional period can be categorized into three large eras.

The earliest era, the communication era, was characterized by a lack of financial expertise among investor relations practitioners. Investor relations tasks were assigned to publicists, who were largely press agents and technicians and focused on putting the company’s name into the mass media. Investor relations in this period lacked strategic and managerial activities. Organizations did not conduct research to understand their shareholding patterns. Feedback was not collected from shareholders. The stream of information was one-way: from the organization to the publics, mostly through the mass media channels.

The second era, the financial era, saw a shift of investor relations responsibilities from communications specialists to accountants and financial professionals. Under the supervision of CFOs, investor relations activities became focused on persuasive communications to investors aiming to push the stock price up. The focus on the mass media changed to a focus on one-on-one meetings with institutional shareholders and financial analysts. This changing nature of communications enabled two-way information streams. Feedback was gathered. It was, however, rarely used to modify the activities of corporations. Rather, it was used to craft more persuasive messages to “sell” the organization: The higher the stock price, the better.
Currently, investor relations is entering a third era, the synergy era. Communication and finance skill sets are valued equally highly for their contribution to investor relations. The goal of the function is an improved understanding of the company among investors and analysts. IROs are looking for a fair value rather than a high value—overvaluation is perhaps as bad as undervaluation. The communication is two-way, with information traveling from the organization to investors and back from the investors to the organization. Feedback from investors is actively sought and shareholder research is conducted. The NRI recommends that “the company’s investor relations officer … should be required … to report feedback from investors and analysts” (Thompson, 2002, p. 1). The feedback is analyzed at the highest level of the organizational hierarchy and is used in decision-making and strategic planning. CEOs expect their IROs to be actively engaged in corporate decision-making and to supply information from shareholders and about shareholders to the management team. Indeed, it is vital for the management of the company to know who the organization’s investors are, as such knowledge enables the company to serve investors better. Kevin Rollins, a former president of Dell Inc., explains: “We’ve also charged our investor relations team with sharing and interpreting feedback from the investment community for us … ultimately, my job and Michael’s [CEO Michael Dell] job is to lead Dell in a way that drives sustainable, dependable shareholder value over time” (as cited in Conger, 2004, p. 3). IROs manage the expectations of their current and prospective investors as well as the expectations of the executives of their organizations.

References


