Engaging Your Stakeholders: How To Make Allies of Investors and Activists

by Peter Firestein

This chapter covers

- The cultures of corporate managers and investors are vastly different, requiring managers to learn the language of investors to derive fair value in financial markets.
- Systematic research by companies into the perceptions of investors is essential in converting market skeptics into supporters.
- Insularity is the enemy of good decision-making. The airing of diverse perspectives provides the best protection against a management's own excesses.
- The sustainability of an enterprise requires its alignment with the society in which it functions.
- A company's reputation depends on the narrative that it creates through its actions and its communications.
- A company's reputation depends ultimately on its values.

Introduction

No company exists without the consent of widely diverse groups of individuals and organizations. These range from customers to investors to social and civic groups—in fact, to the entire society that surrounds the corporation. It is a mistake—sometimes a fatal one—when any company takes the position that it is free to ignore those who have an interest in its financial health or the impact of its operations. But if the company chooses to take these relationships seriously and implements objective strategies to accommodate the interests of those who consider themselves part of its orbit, it maximizes the chance that it will survive crises and achieve long-term sustainability as a healthy and productive enterprise.

Living in Peace with the Arbiters of Value: Your Shareholders

The Yin–Yang of Companies and Capital Markets

There isn't a company anywhere that is free of dissonance with its shareholders and analysts. That's the nature of life in the equities markets. The market always wants more information, and the company wants the market to be satisfied with the information that it is comfortable giving. Although corporate managers and investors can hardly expect to agree on everything, the distance between them is unnecessary and costly to both.

No management of a public company, regardless of the strength of its financial performance, can consider itself successful without growth in the equity price. Many factors can conspire to prevent price and performance from matching up, including investors' macroeconomic expectations and their view of industry prospects.

But the real disconnect between company managements and equity investors lies in the two groups' wildly divergent cultures. You could say that managers are from Mars and investors from Venus. While both may be reasonable and rational, they often approach a single company with profoundly different ideas on how to create value from its assets.

CEOs often feel victimized by what they see as the refusal of investors and the financial media to accept their views of their own companies. After all, who knows the company better than those who run it? They often remark that the investors who feel so free to offer their criticism couldn't run a public company for one single day. And the investors would agree, but that's not the point. The differences between them are more profound.

Managers go to the office every day with highly evolved ideas about how to create value in the companies they lead. Their professional lives involve the development of strategy, the execution of business plans, allocation of capital, forecasting of product cycles, divining what the competition is up to, and engaging in dozens of other disciplines for which their boards, investors, and employees hold them responsible. Investors, on the other hand, operate in great part from objective valuation models. They can take a more or less mechanical view of the company's past financial performance and, having listened to management's plans and guidance, extrapolate the past into the future. They assess the company's announced strategy and try to read current management's ability to execute it. In many ways, the two groups speak a different language.

Complicating the issue is the absence of serious consideration of investor relations in business education. Despite the fact that investors' understanding of a company is one of the most important factors in determining its market value—and therefore the personal wealth of its managers—the investor relations enterprise has often been regarded as a side issue in the development of capital. "Value paradox" is the term I have coined to describe the weird dynamic by which a company's well-being is determined by investors who seldom come near the company, never sit in on its strategy sessions, and carry on only intermittent communication with those who do.

Giving Investors the Tools to Make Judgments

Investors care about few things more than a company's level of financial disclosure. Whether management breaks out its results by product, by specific geographic areas, by business unit, or by other categories is of crucial importance for at least two major reasons.

- First is the information itself. Investors must justify to their own managements and clients their decisions to buy or sell a stock. The level of confidence they have in their future ability to explain their actions—whether the stock price rises or falls—vastly affects their willingness to invest.
- The second reason a company's level of disclosure receives so much attention has to do with what that disclosure says about the seriousness with which management regards investors. Other factors being equal, investors will commit to a company whose management they believe will

> not only tell them the truth, but will also give them the best sense of the business. After all, the investor's ability to succeed in his or her profession depends on the ability to read the company, and you can't read a company whose management you can't trust. So, it is management's obligation not only to run the company well, but also to be believable. One of the most profound difficulties in this relationship lies in the fact that management can only demonstrate past performance, whereas investors only care about the future.

So, how do you turn your skeptics in the market into supporters?

You begin by making yourself predictable. The strongest rhetorical structure through which CEOs can speak to investors is one in which they show that a plan set forth a year ago (or two years or six months ago) was successfully executed and that the results were as forecast—or better.

The best way to get investors on your side is to educate them about the company. Make them experts. With all the technology available, and the sophistication of current valuation models, it is remarkable how well investors still respond to a manager's personal generosity in communicating about the company.

There is almost always a tug-of-war in management's mind about how much information to release. First of all, managers must consider that any information offered to investors may become available to the competition. You can't swear an investor to secrecy, so there is a powerful impulse to withhold information—sometimes to ridiculous degrees.

On the other hand, the availability of information about the company can be a powerful force in raising share value. Managements must consider how much the unnecessary restriction of information is costing them. They can go a long way toward resolving this dilemma by convening regularly to identify the information that must be ring-fenced for competitive reasons. Companies that are realistic about this understand that the criticality of specific information is always changing. Making these regular reassessments allows them to free up information that could contribute to investors' understanding of the business and therefore, potentially, to pay more for the shares.

Diversity of Perspectives as a Safety Net

Avoid the echo chamber. There is a structural trap into which many management teams fall in which they discuss the value proposition and strategies of the company only among themselves without the moderating benefit of external points of view. I believe that many of the decisions by pharmaceutical companies to withhold information on the side effects of drugs resulted from a damaging level of insularity. Managers should understand the importance of allowing the terms by which informed outsiders judge the company to inform their internal discussions.

When applied to capital markets, this principle means that managers must learn to speak the investors' language—to know which parts of the investment story hold value for them, and which do not. The company may be very proud of a technology it has developed, for example. It may believe that its superior design and engineering prove that it will succeed against competitors in the future. But investors may resist paying the company simply for being smart. They are likely to demand information about how the company will monetize its technology. No matter how brilliant it is, they may consider a technology to be a misguided R&D investment and an example of poor management if there isn't a clear payoff.

The Perception Study

Perhaps the best way to go about developing the market intelligence that would avoid such pitfalls lies in what is known in the investor relations world as a "perception study." This is an intelligence-development resource whereby a company authorizes a consultant to act as an intermediary with investors in carrying on discussions about the means by which they judge its share value. These conversations are confidential and candid in a way that would not be possible for the company itself.

The findings of a perception study can be both surprising and highly nuanced. Depending, of course, on the talents of the consultant, company management may learn that specific changes in its disclosure practices will give investors an improved perspective, and therefore the comfort to increase their commitment to the company's shares.

A perception study can impact more than a company's communications practices. Management may be able to identify in investor comments possible changes in strategy that are both reasonable to carry out and capable of bringing investors to a higher estimate of the company's future earnings potential.

A deliberate program of gathering investor intelligence over an extended period of time—say, two years—not only delivers critical market intelligence, but it can also educate management instincts to the extent that executives find themselves capable of anticipating market reaction to strategies and initiatives they have not yet announced—or even decided on. Such instincts can be developed to the point of enabling management to forecast market reaction to M&A transactions which it may only be considering.

While the perception study's purpose is to collect intelligence on investor attitudes toward the corporation, it also provides a meaningful tool of outward communication in demonstrating the company's sensitivity to market attitudes. After all, no investor will be interested in holding a stock unless he or she believes that someone else will come along in the future to pay a higher price. Clear evidence that management is working to achieve this often provides current investors with an additional source of confidence in the company.

The Strange Brew of Numbers and Psychology

The management of a publicly traded company must understand that, although conversations with investors and analysts focus primarily on financial performance figures and descriptions of strategy, investors' private considerations involve much more nuanced and subjective matters. Their observations go to such a personal level as interpreting managers' body language when they speak, assessing their apparent degree of confidence, and, most of all, noting the consistency of what they say over time.

Investors also care a great deal about "bench strength," that is, the talent just below top management that runs business divisions and makes day-to-day decisions. They need to get to know such people through investor conferences which the company may attend or sponsor, or through the participation of these second-tier managers in meetings that corporate leaders undertake from time to time in making "roadshow" trips to visit investors.

Considerations of the talent pool come into play particularly when, as is often the case in these days of rapid turnover, investors concern themselves with a company's leadership succession plan. Is there talent within the organization to replace the current chief? And would that new leader be able to continue to replenish the ranks of management?

In the end, making allies of investors means building their confidence in the company by helping them to understand it in their own terms rather than exclusively in the light in which management wishes it to be seen.

The Value Paradox

> The relationship between public companies and investors can be described as a "value paradox." Corporate managers must be administrators, creative strategists, shrewd allocators of capital, and savvy about both customer psychology and industry competition. Investors, on the other hand, are analysts of financial data and, to a considerable extent, psychologists in their assessments management's abilities and candor. Investors can dissolve the relationship with the company at any moment by selling their stock. Company managements have no such freedom. It is therefore critical that they *learn the language* of investors as a way of keeping them and attracting new ones to maximize market value.

Transparency as a Matter of Survival

> The defining reality of the information age is that transparency is no longer a choice. If you don't offer it to the world, the world will impose it on you anyway. Every corporate action, therefore, requires thought along two independent tracks. The first, of course, centers on the value of the action itself. How does it support the company's overall value proposition? The second—equally important and often missed—involves a careful assessment of how the action will play out with the company's various constituencies. Will investors attribute the same value to the action as management? Will resistance among social constituencies divert the company in ways that compromise its original intended value? No conceived action has value until it is accompanied by a strategy to explain and defend it.

Making Allies of Social Stakeholders

In the age of the Internet and 24-hour cable news, it has become virtually impossible for a company to hide anything at all. The age of the fortress corporation—when companies had the ability to act almost exclusively in their own interests and control the information that circulated about them among the public—ended when it became possible for dissident employees and bloggers everywhere to communicate at the push of a computer button. And they not only began to communicate, they quickly became able to organize opposition to a company with surprising ease.

Because of the reputation risk the information age has brought upon us, the influence of investors has been matched by that of nonfinancial stakeholders. These may include governments, regulators, communities in which a company operates, the media that speak to those communities, and activist groups with interests in the environment, human rights, and labor. To an increasing extent, the "buzz" about a company can determine its destiny. So it is nothing more than sensible management these days to assume that any company will run into trouble some day—whether it deserves to or not.

The Time to Prepare for Crisis Is Now

The time to prepare for a crisis is five years before it occurs. Crises seldom approach slowly over the horizon. Most often, they explode in front of corporate headquarters without advance notice. It is the CEO's job to prepare for crisis every day that he or she holds the position. The least of this obligation is to organize the preparation, and continual updating, of a crisis action plan. So, when a significant adverse event occurs, everyone who is involved in the corporation's defense will immediately know his or her specific duties and lines of communication.

Far more challenging is the design and execution of strategies that will attract the support of critical stakeholder groups, which, in a crisis, can make the difference between life and death for a company. Their support often means that the company is more likely than otherwise to receive the benefit of the doubt when things go wrong—when a product is shown to be dangerous to the public, when an environmental mishap occurs, or if it turns out that workers have been mistreated.

When a pipeline bursts, or a product turns out suddenly to be harmful to customers, or improper marketing practices are publicly disclosed, there is a short period of time—often called the "golden hour"—before the press stakes its claim to the event and when the company is able to tell its story, establish the initiative, declare empathy for any victims, and demonstrate that it is the solution, not the problem.

If the company has already established a reputation of trust with influential individuals and organizations, it will find allies in its time of need to resist the impulse on the part of the press, politicians, and the public to assign blame. It is those politicians, in particular, whose carefully developed support may turn critical at a moment when the company's future may hang in the balance.

How does the company establish this support?

A company that wishes to protect itself from a future crisis must undertake two initiatives that are distinct but deeply connected with each other.

- It must vigorously pursue the development of relationships with crucial stakeholders in government and among regulators, the media, and activist groups who may place themselves in opposition to the company.

- And it must base these relationships on a clear and candid narrative about itself founded on legitimate and clearly defined values. The company should demonstrate day after day, and year after year, that its values are aligned with those of the society around it. This is not easy to do; and it is impossible to fake.

The Communication of Convergence

One of the most creative initiatives a management can take to defend itself against unknown future crises is to engage those groups with whom there is friction and little or no communication. A simple invitation to talk extended to an opposition group can result in a dialog that grows over time. The content of the dialog matters less than the simple fact that it happens. Eventually, both sides become committed to the communication process and develop an interest in seeing it succeed.

One of the results of this "communication of convergence" is that the two sides will begin to develop a shared vocabulary around contentious issues. Over time, the company may begin to hear its own phrases and manner of describing the problem echoed not only by its interlocutors on the other side, but also by that part of the public that adheres to opposing opinions.

The requirement for entering into such a dialog is the willingness to commit to a mutual vulnerability. You can't ask for an engagement by the other side that you yourself do not offer. So, your dialog will also evolve as a result of this interchange.

While the benefits of this process are great, their achievement requires commitment on the part of a senior executive not only to the idea, but also to the task of convincing dissenting voices within the organization that the idea is a good one. The rewards, however, are worth the trouble.

By Your Narrative You Will Be Known

Ultimately, the entire subject of making allies of your investors and social stakeholders comes down to the task of evolving a single narrative by which they identify you.

Coca-Cola's narrative is not "We quench your thirst." Water does that. Coca-Cola's narrative is "We bring the world together."

Like any company, Coca-Cola has to support its narrative in its public actions. So, when social activists and some elements in the international media took note that Coca-Cola was diverting water from parched villages in India to make its soft drinks, it made little difference that the company had a legal contract that allowed it to do so. The company had to take whatever steps necessary to dispel the notion that it was exercising its power for commercial purposes at the expense of powerless people. That's how Coca-Cola—reluctantly at first, but later with great creative energy—became a leader in developing technology to support sustainable water supplies.

It's All About Your Values

If the requirement for a good reputation is to align with the social norms of the community around you, that community will be asking one question: What are your values? And developing a solid set of values—values that mean something—may be the hardest part of building a strong reputation.

The moral tone of an organization—whether it is a small office or a global enterprise that involves hundreds of thousands of employees—comes from the top, from the single leader. But the great paradox in the matter of corporate values is that, although the leader must lead, he does not create the company's values on his own. The walls of corporate cafeterias everywhere are adorned with lists of corporate values, and they're worth about as much as the attention they are paid by those rushing through their meals. You can mandate strategy, investment, and standards of all kinds. But you can't mandate values. They must come from everywhere within an organization. That's the only way to obtain commitment.

A solid and legitimate set of values not only increases the likelihood that conduct throughout the organization will limit risk, but it also provides a foundation for all important relationships. Values are the language of association—and therefore of survival.

The Values-Based Enterprise

> Corporate survival in a world where there are few secrets requires alignment of the enterprise with the norms of the society that surrounds it. Companies will always be defined by the narratives which their actions project. So, achieving the most secure levels of sustainability requires that a company create for itself a deliberate narrative based on an observant understanding of its constituencies. The core of this narrative will always be the fundamental values the company is seen to hold. To maximize the chance of companywide commitment to a set of values, they must be derived from a conversation that includes the whole organization. Values cannot be mandated from above.

Case study

Chiquita Brands

Management must establish a process of collecting views from throughout the company. Then it must relinquish control. Chiquita Brands, famous for its bananas, sought a number of years ago to transcend a reputation developed over many decades for exerting excessive power over workers in its Central American plantations.

Among many initiatives, the company drafted a set of corporate values at its headquarters in the American Midwest, then sent the list out for review and suggestions to its employees who work the plantations.

The document returned to headquarters with a surprising addition. The Latin American workers had found a big gap: headquarters' list of values failed to mention the importance of family. Seeing the revised list, the management team at headquarters—whose families were also central to their lives—realized for the first time that for a company's values to be legitimate they had to encompass all important features of the lives both of senior executives in glass towers and of those who cultivated the bananas in the field. And that's how commitment to a discrete and unique set of values came to be achieved in a widely diverse corporation.

Summary and Further Steps

- The cultures of corporate managers and professional investors are far different from each other. It is management's obligation to understand how investors assign value to the company and to address them in terms that give the company the best chance to achieve the highest reasonable valuation.
- In the information age, managers must assume that virtually everything they do will eventually come to public light. Transparency is no longer an option, it is imposed. So managers must understand the "optics" of their actions and know that any business planning process must include a strategy for communicating it to financial markets and the public. If you can't explain it openly, you probably shouldn't do it.
- Long-term sustainability requires alignment of a company's values with its social context. A corporate leader must implement a systematic review of his or her company's standing among its social constituency and invest in senior personnel to assess how the company's practices and policies match up with public norms and expectations.

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