MiFID II
A PLATE-JUGGLING EXERCISE FOR INVESTOR RELATIONS

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Ever since the European Securities & Markets Authority announced plans to create a single regulatory framework for financial market activities and services back in December 2014, there has been discussion about how tightened regulation would affect trading, reporting and transparency throughout the financial community.

The Markets in Financial Instruments Directive (MiFID II) is finally due to come into force on 3 January 2018. And as the deadline creeps closer, there is still a lot of debate about how regulation will affect different parts of the financial markets.

One group that will see sweeping changes as part of the shake-up is the Investor Relations community. Under the directive's plans to separate the remuneration for investment research and trading, the entire framework of the existing investor-analyst-company relationship will change.

The current situation is fairly stable. Asset managers tend to pay a "bundled" fee for the research and advisory services that they receive from brokers, banks and other advisers. In practice, this means that the cost of investment research on countries, sectors and individual companies is priced into the service provider's overall offering, and can be offset against the commission fees for placing trades with this service provider.

From any listed company's perspective, this system ensures sell-side output that motivates constant debate in the market about its equity story, attracting new investors in the process and providing existing investors with all the facts and commentary they need, and more. In other words: banks act as advocates for the company, bring investors to it, and make connections that would otherwise prove hard to forge.

But the regulator disapproves. It feels that this convenient set-up is short-changing the pension funds and retail savers that make up a significant part of the market, and is preventing the market from functioning efficiently.

So from January 2018, asset managers will be required to pay for substantive sell-side research.

What's more, the cost of all investment research that is acquired will have to be presented and explained to investors in a transparent manner.

More specifically, the Sell Side will have to lay bare to the regulators its income streams from the provision of research services in great detail. At the same time, the Buy Side will have to make transparent, again in minute detail, which research services they receive.

And this is the crux of the new system: rather than regulating the Sell Side even more, it is now the Buy Side which will be penalised if it receives so-called 'inducements' i.e., substantive services that it does not pay for.

SHAKING UP THE MARKET

There has been a lot of speculation about how this will play out on a practical level, with the key finding so far being that nobody really knows.

Conventional wisdom has it that asset managers will narrow the range of sell-side research they will pay for, and that sell-side research will take a hammering. The number of brokerage houses is expected to decrease significantly, and the attention of remaining brokers will most likely focus on the largest, most highly traded stocks.

Smaller research houses are under threat. Unbundling is proving to be neither cheap nor easy, and many smaller firms will struggle to cover their costs, let alone support a fully functioning team of analysts.

There is a risk that those brokers that cover mid-market and small-cap companies will either focus on one niche area, or simply disappear, leaving large-cap companies covered but opening up a significant gap in the market for small- and mid-caps. Likewise, newer firms will struggle to carve out a presence in the market unless they specialise.

A potential consequence is a whole host of companies struggling to attract meaningful external coverage, with costly repercussions: if a company's share trading liquidity were to suffer, its share price could stagnate or even slide into being undervalued. Remedying an inelastic share price could prove to be even more expensive than going into the MiFID II era prepared.

What's more, undervaluation has its own inherent risks: listed companies that are perceived to be cheap relative to peers could easily become targets for predators. In a market where attractive investment opportunities are rare and listed companies are increasingly coming into the crosshairs of Private Equity, the pressure to keep up with the pack is higher than ever.

GOING BEYOND RESULTS TO TELL THE STORY

To avoid these scenarios, it will fall to corporates to tell their own story and shape their perception and valuation in the market themselves, rather than leaving the task to the Sell Side.

A natural consequence of this new world will be the coming together of financial marketing and more conventional corporate marketing: corporates will need to identify the most suitable investors themselves, as well as the main remaining sell-side influencers, work out what type of equity story tickles their fancy, and find the right channels and platforms to convey that story. They will then need to put together a marketing plan that prioritises talking to investors using their preferred channels and service them according to their needs.

In this MiFID II world, Investor Relations Officers (IROs) will be made responsible for leading the charge.

Currently, sell-side analyst consensus shapes much of the value of a company in the eyes of existing and potential shareholders. One of the most important jobs of the IRO, therefore, is to keep an eye on the Sell Side and provide them with relevant company information in a timely manner. Today, this process does not discriminate; by and large, service and corporate access opportunities are sprayed across all coverage analysts, influential or not. It then falls to these analysts to work their magic: they multiply the company's story and shape it in line with what they perceive are key financial and strategic milestones.

But if the Sell Side is diminished as a mediator between company and investor, if disintermediation takes place, IROs will have to pick up the pieces and work the magic themselves. This will require a real shift in the role of the IRO, and will push job descriptions more into the territory of conventional public relations.

Of course, reporting cycles aren't going anywhere. But beyond that, IROs will be tasked with shaping their company story in a way that goes beyond just results presentations and statements. Whether that is through traditional financial communications or embracing digital marketing and social media will depend on the demands of the shareholder base, which are also currently in flux due to the ascendancy of digital platforms and channels.

In any case, tackling this environment will require a new approach to the two pillars of messaging and stakeholder analysis.

A clear and concise messaging platform and equity story give a company the means by which to describe itself, explain its strengths and outline its vision. With fewer analysts in the picture, IROs will have to change the way the company talks about itself: there will be even more pressure on the IR team to shape an in-house view as to where the market debate about the stock currently is, how management is viewed, which investors should be targeted, and with which arguments.

In short, internal IR work will have to become far more strategic than we would argue it currently is. In this respect, our paper from 2015 (our "Plea for Strategic IR") still very much rings true.

Messaging is at the heart of any PR campaign, and provides a basis for all forms of communication to internal and external stakeholders. But it needs to hit the right note. And being sandwiched between communications and finance, IROs are in the prime position to compile all the available information on the company into a digestible and compelling format.

IROs will have to get out there and be more visible in the financial community. This means doing a significant amount of research on their company's stakeholders, followed by a clear programme of investor targeting. No longer will they be able to lean on the banks to make the connections and put people together. IROs will need more eyes and ears in the market than ever before. Again it comes down to Strategic IR.

And behind this, in the background, they will need to use a few more of the oldest tricks in the PR book. Speak directly to financial journalists and key influencers in the market. Give management the chance to become key influencers through media outreach and increased market

commentary. All that in close collaboration with their PR colleagues of course. And get regular roadshows and investor days in the calendar, perhaps even arranged in-house rather than through a dwindling number of sell-side brokers.

One increasingly relevant area here is the use of big data and social media. Corporate and consumer communications teams have rapidly adopted digital targeting techniques in recent years to personalise relationships with their online audiences. By contrast Investor Relations, which has always been part art, part science, have been reluctant to embrace these digital techniques.

However, the opportunity that big data provides to find investors and their influencers online and build a direct relationship through personalised and compelling investor-relevant content is becoming harder to ignore. To find and communicate effectively with new and existing investors online, IR professionals will need to adopt many of the digital communications skills currently found in their company's consumer or customer marketing department.

CONTACT, ACCESS AND TRANSPARENCY

A ramped-up IR function takes both time and money, something which could prove troublesome for already lean IR teams. IROs are facing up to the prospect of juggling their existing, already considerable workload with a growing need to do their own investor marketing.

This may prove particularly problematic for small and mid-sized companies, who are already struggling to gain enough analyst attention to drive liquidity. For a large-cap company with an analyst base of up to 30, losing even several analysts arguably would not have a detrimental effect. However, for a smaller company, with an analyst following of only a few, this could seriously affect not only overall perception of its long-term value, but also hamper vital trading liquidity – a toxic combination.

From a practical perspective, this requires money. Historically, companies have put considerably larger sums into their PR budgets when compared with their IR budget. Under MiFID II, it will be time to redress the balance. IROs will need all the financial support they can get in making sure their companies don't lose out as their analyst base diminishes.

If all else fails, there is always the option of contracting paid research. But we feel that it's worth exercising caution here. Lurking in the background of such arrangements has always been the question of potential conflicts of interest. Credibility can never be as high as through conventional coverage. And more generally the market will always prefer to hear the story from the horse's mouth.

PREPARING FOR A NEW WORLD

So with less than two months until MiFID II comes into force, IR teams and the companies they represent are facing a number of challenges.

As MiFID II bites, the existing investor-analyst-company relationship will disintermediate and the Sell Side will retreat. Listed SMEs in particular are likely to lose sell-side coverage and will increasingly have to fend for themselves. Paid research has limited credibility; the Buy Side will always prefer to see and hear the management directly.

In a nutshell, what does this mean for IR?

IR has to become more punchy, more focused, more marketing-oriented, more strategic. It needs to make better use of Board resources. IROs would do well to pick up a few more conventional techniques from their colleagues over in PR, and should align themselves more closely. And importantly, IR also needs more funding; the imbalance between IR and PR budgets needs to be redressed.

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